

VAT Groups: recent cases and proposals for reform

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I. Introduction

1. VAT depends on the concept of a 'taxable person', that is an economic operator who engages in transactions that give rise to taxable or exempt turnover.
2. Normally, the concept of a 'taxable person' is congruent with domestic law on personality. But not always. So, for example, a partnership counts as a 'taxable person' even though in England and Wales it has no legal personality. And European law confers on Member States power to recognize as a 'single taxable person' a number of entities 'closely bound to one another by financial, economic and organisational links': Principal VAT Directive, Article 11.
3. The purpose of Article 11 is to simplify administration (so that a single undertaking divided into different legal entities can submit a single VAT return), and to prevent abuse (so that a single undertaking cannot escape VAT by artificially dividing itself into a number of smaller undertakings). They are particularly important to prevent the so-called 'cascade of wages' between group members, and in exempt industries such as financial services.

4. However, Member States can decide whether or not to exercise the power to recognize VAT groups: many have not done so. And because recognition of VAT groups is conditional, not only on the exercise of the power by Member States but also for example on the criteria by which it is determined whether different entities are sufficiently closely connected to be treated as a single taxable person, Article 11 does not have direct effect. On the other hand, if implemented, it must be implemented in a manner consistent with EU law.
5. The UK has recognises VAT groups, and has done since the first days of VAT. But UK law does not have any means of amalgamating a number of separate persons into a single person. So instead of creating some single taxable person, UK legislation seeks to achieve the same result by means of a number of different deeming provisions. So, for example, supplies within a VAT group are ignored for VAT purposes; and all supplies by a member of a VAT group to a third party are treated as made by the 'representative member'. While this is satisfactory for the vast majority of transactions, it inevitably creates difficulty here and there.
6. In this paper I will consider some of the recent EU case-law on VAT groups; some current proposals for reform; and some recent UK cases.

II. EU case-law

7. The three main ECJ cases on VAT groups are Case C-162/07 *Ampliscientifica and Amplifin v. Ministero dell'Economia e delle Finanze* [2008] ECR I-4019, Case C-7/13 *Skandia America Corp (USA) v. Skatteverket*, Judgment dated 14 September 2014, and Cases C-108 and 109/14 *Larentia + Minerva / Marenave*, Judgment dated 16 July 2015.

8. In *Ampliscientifica*, trouble arose because Italian law recognized VAT groups but only where the purported members had been connected by a parent / subsidiary relationship for at least one whole calendar year. On that basis, certain repayments were refused to a company that claimed to be, in effect, the representative member of the group. The Court held:

‘It is to be observed, secondly, that the effect of implementing the scheme established in the second subparagraph of Article 4(4) of the Sixth Directive is that national legislation adopted on the basis of that provision allows persons, in particular companies, which are bound to one another by financial, economic and organisational links ***no longer to be treated as separate taxable persons for the purposes of VAT but to be treated as a single taxable person***. Thus, where that provision is implemented by a Member State, the closely linked person or persons within the meaning of that provision cannot be treated as a taxable person or persons within the meaning of Article 4(1) of the Sixth Directive (see, to that effect, Case C-355/06 *van der Steen* [2007] ECR I-0000, paragraph 20). It follows that treatment as a single taxable person ***precludes persons who are thus closely linked from continuing to submit VAT declarations separately and from continuing to be identified, within and outside their group, as individual taxable persons, since the single taxable person alone is authorised to submit such declarations.***’

9. This is not terribly clear. The concept of being ‘identified ... as individual taxable persons’ in the Sixth VAT Directive (which had a more or less identical provision to Article 11) concerned what UK law calls registration. It said nothing about supplies, in particular supplies between member of the group. In any event, Italy had not properly implemented the EU provision, because it had not first consulted the VAT Committee (which a Member State has to do before recognising VAT groups).
10. Having held that the Italian legislation could not be regarded as exercising the power conferred by the predecessor of Article 11, the Court went on to hold that the validity of the legislation depended on principles of EU law, in particular fiscal neutrality and proportionality, in particular having

regard to EU law's aim of preventing tax avoidance and abuse. It seems reasonably clear that any national law recognising VAT groups has to comply with these principles too (as well as other general principles of EU law, such as effectiveness and equivalence).

11. But this left the situation rather unclear as regards provisions which sought to recognise groups.
12. Some further detail was given in the next case, Case C-7/13 *Skandia America Corp (USA) v. Skatteverket*, Judgment dated 14 September 2014.
13. *Skandia* involved the Old Mutual insurance group. One of the group companies, Skandia America Corp., was incorporated in Delaware. It had a branch in Sweden. The Swedish branch was part of a VAT group, the other members of which were other companies in the Old Mutual group which were established in Sweden. The US head office of Skandia America Corp. purchased IT services from a third party (presumably software). It transferred these to the Swedish branch, at a mark-up of 5%, and internal invoices were issued. The Swedish branch then processed them and supplied them onwards to other companies in the group. The Swedish tax authority sought to charge VAT on the supplies by the US head office to the Swedish branch. The Swedish branch objected.
14. The Court of Justice held first, on the basis of Case C-210/04 *Ministeria dell'Economia v. FCE Bank* [2006] ECR I-2803, that the normal position where a head office and a branch is concerned is that there is no supply between the two, as they are not independent. However, it then went on to consider whether the fact that the branch was a member of a VAT

group, and the head office was not a member of it, made a difference. The

Court held:

- ‘29. In this connection, treatment as a single taxable person precludes the members of the VAT group from continuing to submit VAT declarations separately and from continuing to be identified, within and outside their group, as individual taxable persons, since the single taxable person alone is authorised to submit such declarations (judgment in *Ampliscientifica and Amplifin*, C-162/07, EU:C:2008:301, paragraph 19). It follows that, in such a situation, the supplies of services made by a third party to a member of a VAT group must be considered, for VAT purposes, to have been made not to that member but to the actual VAT group to which that member belongs.
 30. Therefore, for VAT purposes, the services supplied by a company such as SAC to its branch which, such as Skandia Sverige, belongs to a VAT group, are considered not to be supplied to that branch but must be regarded as being supplied to the VAT group.
 31. Inasmuch as the services provided for consideration by a company such as SAC to its branch must be deemed, solely from the point of view of VAT, to have been provided to the VAT group, and inasmuch as that company and that branch cannot be considered to be a single taxable person, it must be concluded that the supply of such services constitutes a taxable transaction, under Article 2(1)(c) of the VAT Directive.’
15. Thus, the Court went further than in *Ampliscientifica* and, in case that clearly involved national legislation intended to recognise VAT groups, discussed how the existence of a VAT group affected the question whether supplies had been made. Given that the effect of the Swedish legislation was that the Swedish branch, but not the head office, of Skandia America Corp. was part of the Swedish VAT group, supplies for consideration by head office to branch were taxable supplies.
 16. This raises a number of questions, and indeed both the Commission and the EU VAT Committee are currently grappling with them.

17. First, Article 11 permits Member States to recognise as a single taxable person 'persons established in the territory of the country'. But whereas Sweden restricts its implementation, as regards a cross-border company, to the Swedish branch, the UK, for example, includes the whole of the company, wherever established. Thus, a company formed in the UK but with a branch in Sweden could be a member of two VAT groups. Obvious planning opportunities arise.
18. A further planning opportunity arises because of the requirement for 'consideration'. In the context of a single company, what has to be done for there to be 'consideration'? At one end of the spectrum, a bank transfer from (for example) a UK bank account operated by a UK head office to a Swedish bank account operated by the Swedish branch would probably count, in particular if an invoice was issued. But what about a book entry? And it would be easy to ensure there was no consideration, by simply not making any book entry. So a more or less free choice is given to the company whether there should be a taxable supply or not.
19. Other issues arise too, in terms of how far Skandia may be applied: for example, it seems clear it would apply to other types of intra-company transactions, for example between branches, or a supply by a branch to a head office; on the other hand, the Commission says that the judgment applies also to supplies of goods, whereas a sub-committee appointed by the VAT Committee says it does not (or at least it should not).
20. Indeed, given the scope for contradictory outcomes and tax avoidance, the sub-committee has suggested that some degree of harmonisation should be considered, at least as regards the issue of territoriality.

21. In the UK, HMRC has said that its approach depends on whether the Member State which has recognised the VAT group takes a broad (UK-style) territorial approach, or a narrow one (Swedish style). If narrow, then Skandia will be applied, so that a supply for consideration between a part of a company established in the UK and a part established and part of a VAT group in another Member State will count as a taxable supply (provided the other conditions for its being so are met). If broad, it will not. HMRC has published a list of which countries it regards as taking the narrow approach, and which as taking the broad. See Revenue and Customs Brief 23 (2015).
22. So, planning opportunities have arisen. But they may have a limited lifespan, depending on what approach the EU takes to harmonisation.
23. The third case in the series was in fact the joined cases of *Larentia + Minerva* and *Marenave*, referred by the Bundesfinanzhof. *Larentia + Minerva* concerned a German Kommanditgesellschaft, which was itself a limited partner in another KG. It argued that it and the other KG ought to be recognised as a VAT group. *Marenave* concerned a company which had acquired shares in four KGs. Again, it sought to be recognised, with the 4 KGs, as a VAT group. Under German law, recognition was not granted, as a KG does not have separate legal personality, and German law only permitted entities having legal personality to combine into a VAT group. In addition, German law required there to be a relationship of subordination between the entities involved (it may be assumed that sister companies could combine, but only if the parent was also involved).

24. From the facts it is not entirely clear how the second issue arose in the cases, but both requirements were discussed by the Court.
25. It held first that because the nature of the financial, economic and organisational ties that had to exist for persons to be sufficiently 'closely connected' to be recognised as a group had to be determined by Member States, Article 11 did not have direct effect.
26. However, it was lawful for Member States to impose additional conditions, beyond those set out in Article 11, such as legal personality or a relationship of subordination, only if they were, 'both necessary and appropriate for attaining the objectives [of EU law] seeking to prevent abusive practices or behaviour or to combat tax evasion or tax avoidance'. Whether the national provisions were justified on that basis was a matter for the national court to determine.
27. This gives rise to issues under UK law.
28. For example, the VAT group provisions are restricted to 'bodies corporate': VATA94, section 43. So even other bodies having legal personality (such as Scottish partnerships) cannot be part of a VAT group; and certainly not other subjects such as English partnerships, unincorporated associations, or even sole traders.
29. In addition, UK law has a control test. For there to be a VAT group, one member must control the other(s), or one person, whether a body corporate or an individual, must control them both, or a partnership must control them: VATA94, section 43A. This is slightly broader (it seems) than the German provision, as, in effect, sister companies may be a group even though their parent is not a member.

30. However, it none the less precludes persons and associations other than bodies corporate from being members, notwithstanding that they can be taxable persons; and requires some relationship of control somewhere.
31. Accordingly, HMRC is consulting on whether the grouping provisions should be loosened, by abandoning the requirement to be a body corporate, and replacing the control test with something else. The consultation is likely to open this spring: no consultation document is available as of yet. But certainly, the likely outcome is a much broader possibility to form VAT groups. Planning opportunities will almost certainly arise.

III. UK case-law

32. Finally, briefly on UK case-law.
33. As mentioned at the start, the trouble with UK law is that its concept of legal personality does not sit easily with the idea of a single taxable person; and the implementation provisions therefore have to find a way of achieving the existence of a 'single taxable person' by roundabout means.
34. Thus, where companies form a VAT group, there is a 'representative member'; intra-group supplies are ignored; supplies between a group member and a third party are treated as having taken place between the representative member and the third party; and the representative member is deemed to be carrying on the type of business of the group member who actually made the supply.
35. It is obvious that this approach leads to difficulties when one gets away from 'normal' transactions.

36. The particular context in which difficulties have arisen is Fleming claims. When a member leaves a group, does the claim go with it, in so far as it arises out of its activity, or does it stay with the group? If the latter, and if an ex-member makes a claim, does HMRC have to pay the group, or can it refuse the claim on the basis that it was made by the wrong person?
37. These issues have arisen in the cases *Taylor Clark Leisure Limited v. HMRC* [2013] SFTD 381 (FTT); [2015] STC 223 (UT); Court of Session awaited; *Standard Chartered / Lloyds v. HMRC* [2014] UKFTT 316 (TC); *MG Rover / BMW v. HMRC* [2014] UKFTT 327 (TC); and *Gala Leisure Limited v. The Commissioners For Her Majesty's Revenue and Customs* [2015] UKFTT 516 (TC).
38. In *Standard Chartered* and *MG Rover*, opposite decisions were reached on the question of entitlement: in other words, does the claim go with the member who leaves. In *Standard Chartered*, it was held that it did not; in *MG Rover*, it was held that it did. HMRC accept the *Standard Chartered* decision, though it seems that these cases may be going to be referred to the ECJ.
39. In *Gala Leisure*, the FTT followed *Standard Chartered*.
40. In *Taylor Clark*, the Upper Tribunal reversed the First-tier on entitlement, but that followed agreement between the appellant and HMRC that *Standard Chartered* was correct. However, in *Taylor Clark* the claim was lodged by a company that had left the group. There therefore remained the question as to whether HMRC was required to pay the representative member. The Upper Tribunal said no; but the case has now been heard by the Court of Session (Court of Appeal equivalent) and a judgment is

awaited. The issue boils down to whether the claim can be regarded as having been made by the single taxable person, on the basis that notwithstanding it had left the group at the time it made the claim the ex-member remained part of the single taxable person in respect of the transactions that had given rise to the claim.

IV. Conclusion

41. In conclusion, VAT groups are difficult characters to deal with at the moment, given the uncertainties arising out of recent ECJ case-law. It can be expected that the law will change significantly, at both EU and national level, over the next few years. But in the meantime there are planning opportunities to be taken – or at least, pitfalls to be avoided...