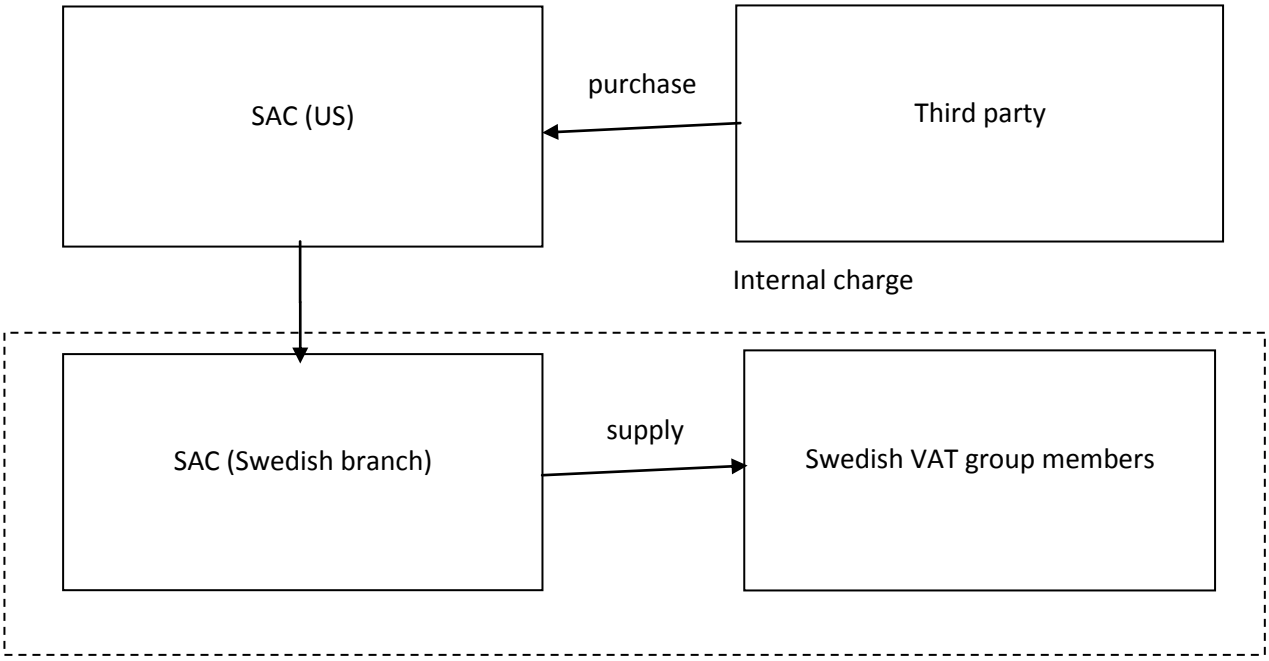
VAT Focus

Skandia America Corporation (SAC) CJEU decision

This recent CJEU judgement has significant implications for businesses that are registered within a VAT group containing a member company that has an overseas branch. It is important that those businesses fully understand the potential impact.

The case considered the following situation:



Key: VAT Group Registration

SAC argued that the internal charge from the US to its Swedish branch was outside the scope of VAT (a transaction within the same legal entity not being a supply).

The implication of this being that, because the Swedish VAT group member would not be charged VAT on a transaction between members of the same VAT group, a service could be imported via a branch network and resold without VAT (whereas a direct purchase by any member of the VAT group from the third party supplier would attract VAT).

The court was asked to decide:

i. Are supplies by a non-EU head office to its branch taxable supplies if the branch is within an EU VAT group?

ii. If the answer to (i) is "yes", is the non-EU head office to be considered established outside the EU?

The Advocate General had already offered the opinion that the local branch should not have been allowed to join the VAT group and offered four options:

a) withdraw decision to allow the branch to be VAT group registered;

b) take the view that SAC as a whole was within the VAT group;

c) take the view that neither head office or branch are within the VAT group;

d) allow VAT to be levied on the charge from the non-EU head office as an anti-avoidance measure (allowed within Article 11 of the Principle VAT Directive (PVD)).

The CJEU in its ruling took a different view from the AG and concluded that:

- Where there is a supply of services from a non-EU branch to an EU branch within a VAT group this is a taxable transaction. This is because the VAT group as a whole is "the taxable person" and this must be viewed as a different legal entity to the non-EU branch of one of its member companies.

- The VAT group becomes liable for the VAT payable in the supply.

The current position in the UK

UK law allows an overseas company with a UK fixed establishment (branch) to become a member of a VAT group. Where this occurs it is accepted that the overseas company itself is a group member, not just the branch. Services bought in by the overseas group member and supplied to members of the UK VAT group are disregarded for VAT purposes.

Sitting alongside this law are anti-avoidance rules to try and prevent abuse and stringent review processes that allow HMRC to refuse VAT group applications that present a revenue risk.

The implications of the judgement

The first thing to note is that there is no higher court to which an appeal can be made - the decision sticks and is binding on all EU member states. However, this is not to say that member states cannot choose to interpret the judgement differently. It would then be for the European Commission to decide whether or not the member state should be subject to infraction proceedings if they fail to implement the judgement correctly.

On one reading, this judgement relates only to the narrow facts considered (i.e. imports by a branch member of a VAT group from its non-EU head office). However, a wider possible implication is that "*It is always necessary to treat a VAT group as distinct from any overseas branch of a member in relation to any supplies between that VAT group (or a member of the VAT group) and that overseas branch*.

However, such a simplistic analysis raises paradoxical points that will not be easy to resolve. For example, a member of a UK VAT group makes supplies to the French branch of one of the VAT group members. Must this be treated as a supply?

One could argue on the basis of the Skandia decision that the answer is "yes". However,

one could equally argue that:

a) the UK VAT group is recognised by the UK authorities not the authorities of the territory in which a overseas branch is located,

b) VAT groups exist as an optional measure within the EU (each member state has discretion as to whether to recognise them and local rules apply - and France does not allow VAT groups), and

c) from the perspective of the branch in France, this is simply an internal purchase because as far as the French authorities are concerned there is no VAT group recognised under French law.

If it is implied by the Skandia judgment that France must recognise the UK VAT group, then what are the other implications arising? Must France also accept that transactions between VAT group members that arise in France must be disregarded? [If so then effectively, the UK has been able to impose recognition of a VAT group on the French authorities, a facility that France does not afford to local businesses if not then a VAT group is being recognised as the "taxable person" for some purposes but not others.]

If France maintains that the intra-branch transaction is outside the scope of VAT (refuses to recognise the UK VAT group) then a situation might arise whereby:

- In the UK, the UK VAT group must recognise a supply (the VAT group is a different taxable person to on overseas branch of one of its members),
- In the UK, if the supply by the VAT group is taxable in its nature this would give the UK VAT group a right to reclaim all related input tax (i.e. a higher recovery than currently arises), but
- In France, the French branch can avoid accounting for VAT because the VAT group exists only in the UK (not France). Therefore from a French perspective it remains a VAT free "outside the scope" internal transaction.

If this paradox is addressed by trying to identify circumstances in which the VAT group status of the UK company is relevant (e.g. supplies to the French branch) and circumstances when it is not (e.g. supplies between VAT group members that arise in France) it is entirely unclear that there is a legal basis to do so or what factors would impact upon the decision.

In short:

- the judgement is very clear in stating how a transaction of the kind considered by the CJEU should be taxed,

- the logic supporting the decision requires VAT groups to treat themselves as a separate "taxable person" from any overseas branch, with all of the consequences that flow from this in relation to both purchase and sales transactions,
- when the deeper significance of applying the obvious implications of the judgement are considered, it very difficult to see how this could occur.

This is perhaps reflected in HMRC's current stance which is*: "HMRC is considering whether the judgment has any application to UK grouping provisions, which are different to those in Sweden."*

It is difficult to know how to respond to this decision. Many commentators are suggesting that the impact will be enormous with additional VAT costs running to £100's millions - particularly within the financial services industry. However, until HMRC, and other tax authorities, make their views known, it is difficult to judge whether the decision will present as many tax saving opportunities as it does potential VAT costs.

This judgement seems to us to underline that VAT groups are an issue in EU law that is crying out for greater harmonisation and if EU member states and the European Commission do not take steps to deal with this then it is very difficult to feel sympathy with any tax leakage that occurs.

Perhaps the most straightforward approach would be for all member states offering the facility of VAT groups to deny VAT group status to any business that has an overseas branch. However, even this would present difficulties - for example in Germany a VAT group is not something conferred on an applicant but arises on a mandatory basis as a result of close financial and organisational relationships, whether the taxpayer wants this or not.

Immediate steps

In our view most businesses are unlikely to benefit from immediate changes to their VAT arrangements. However, there may be situations in which a change would be beneficial and to identify such cases it would be prudent to review the situation and the potential impact at an early stage.

Given that it is difficult to pre-empt changes that cannot get be predicted with confidence, the focus of that review should be:

- Measuring the value of supplies made between branches (where a company has a branch within a VAT group). It is necessary to do this to gather headline "potential impact" figures.

- Assessing whether there is an alternative basis to bring supplies outside the scope of VAT or exempt transactions. [Recognising a supply does not mean that in all cases VAT should be applied to that transaction.]
- Evaluating whether it will be possible to influence HMRC policy on any areas that are to be changed. For example, if Branch A employs staff and supplies services to Branch B there would be a clear distortion if it must apply VAT to a transaction between those branches.
- Assessing organisational changes that may mitigate impact. Tax authorities are, understandably concerned about the potential for businesses to utilise overseas branches and VAT groups to avoiding VAT costs that would otherwise have arisen. However, tax authorities should be less concerned when the internal supplies involve consumption of non-VATable inputs (such as salary and payroll costs). There may be measures that can avoid creating a potential VAT cost that may arise only because of VAT group membership.

If you wish to discuss how this judgement may impact upon you please contact Dean Carey on 01206 321 029 or by email to dean.carey@ukvatadvice.com.