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Skandia: Intra-Company Supplies Treated as Taxable Transactions for VAT Purposes by the Court of Justice of the European Union

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On 17 September 2104, the Court of Justice of the European Union (the "**CJEU**") gave its preliminary ruling in the case of *Skandia America Corporation USA, Sweden Branch v Skatterverket* (C-7/13) ("***Skandia***"). The decision of the CJEU has been awaited with interest throughout this summer, and the CJEU has now ruled that the supply of externally purchased services from a company's main establishment in the United States to its Swedish branch is a taxable transaction for value added tax ("**VAT**") purposes. The decision of the CJEU has not followed the opinion delivered by Advocate General Wathelet on 8 May 2014, in which he had opined that such services should not be subject to VAT.

Initial press coverage of the CJEU's preliminary ruling has emphasised the potential for significantly higher VAT bills which may be faced by corporate taxpayers with limited VAT recoverability (such as banks, insurers and other financial institutions). While this is a possibility within a number of EU Member States, this Clients & Friends Alert considers whether the current UK VAT rules and practice could ensure that the consequences for UK financial institutions may not be as severe as initial reactions may have suggested.

Background

The relevant facts in *Skandia* can be summarised as follows:

- Skandia America Corp. (USA) ("**Skandia USA**"), a US incorporated company, purchased IT services from external third-party suppliers which were then made available, with a 5% mark-up, to other members of the Skandia USA group and Skandia Sverige, the Swedish branch of Skandia USA ("**Skandia Sweden**"). The relevant costs of the provision of services were allocated between Skandia USA and Skandia Sweden by the issue of internal invoices;
- Skandia Sweden was registered for Swedish VAT and was a member of a Swedish VAT group;

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- no VAT was declared as being chargeable on the intra-company supply of IT services from Skandia USA to Skandia Sweden on the basis that such supplies were being made within a single taxable entity for Swedish VAT purposes; and
- the Swedish revenue authority took the view, however, that the IT services supplied by Skandia USA to Skandia Sweden constituted "taxable transactions" and should be liable to Swedish VAT.

The Questions before the CJEU

Two questions were referred by the Stockholm Administrative Court to the CJEU:

1. Do externally purchased services supplied from a company's main establishment in a third country (here, the United States) to that company's branch in an EU Member State, together with an allocation of costs for the purchase by the branch, constitute taxable transactions if the branch belongs to a VAT group in the Member State?
2. If the answer to the first question is "yes", is the main establishment in the third country to be viewed for VAT purposes as a taxable person which is not established in the EU Member State of the branch, with the result that the branch purchaser of the services is to be taxed for the transactions?

The Advocate General's Opinion

The issues in *Skandia* had been considered in Advocate General Wathelet's opinion on 8 May 2014. The conclusion drawn by the Advocate General had been that the branch of an overseas entity could not be included in a VAT group independently from the main establishment of the entity in a third country, and that supplies between the main establishment of the entity (here, Skandia USA) to its branch (here, Skandia Sweden) were not taxable supplies for VAT purposes.

CJEU's Preliminary Ruling

In considering the first question, and having regard to the activities and operations of Skandia Sweden, the CJEU concluded that Skandia Sweden was dependent, as a factual matter, upon Skandia USA. Accordingly, Skandia Sweden could not be treated as a taxable person for VAT purposes. The result was that and Skandia Sweden was not a party to a "taxable transaction".[1]

However, the CJEU went on determine that where supplies are made by a third party to a member of a VAT group, the supply should be considered, for VAT purposes, as a supply to the VAT group to which that member belongs (rather than the individual VAT group member, which in the *Skandia* case was Skandia Sweden). The treatment of a VAT group of companies and establishments as being a single taxable person in its own right for VAT purposes was critical to the CJEU's reasoning on this point. Following this approach, Skandia USA's supply of IT

[1] Skandia (C-7/13), paragraph 26.

services constituted a "taxable transaction" which was made to the Swedish VAT group of which Skandia Sweden was a member. As the Skandia Sweden branch was a member of a VAT group, no supplies were treated as being made to the branch itself for VAT purposes.[2]

The decision of the CJEU on the second question dealt with the application of the VAT "reverse charge" procedure whereby an taxpayer in an EU Member State is required to account for the VAT on supplies it receives from outside the EU Member State in which it is established as if it had made the supply itself. Having already determined that the relevant recipient of the supply for VAT purposes was the Swedish VAT group (of which Skandia Sweden was a member), it was unsurprising that the CJEU held that the Swedish VAT group was the relevant party which would be liable for the VAT on the supply of services under the VAT "reverse charge" procedure.[3]

Consequences of the CJEU's Preliminary Ruling

A number of press reports immediately following the delivery of the CJEU's preliminary ruling have suggested that corporate taxpayers with limited VAT recoverability (such as banks and financial institutions) may now be facing additional VAT liability on both intra-group and intra-company supplies. Any requirement to account for VAT liabilities on intra-company supplies of services between a main establishment in a third country and a branch establishment in a Member State would greatly increase the VAT administration and accounting burden on groups and lead to potentially irrecoverable VAT input tax costs for partially exempt groups. Jurisdictions, such as the UK and Ireland, where a significant number of banks and financial institutions operate through branch networks for capital efficiency and regulatory reasons would potentially be adversely affected by the CJEU preliminary ruling in *Skandia* if the relevant provisions of the Swedish VAT rules were replicated in domestic legislation.

However, a number of important differences exist between the UK and Swedish VAT rules. These differences may mean that the impact in the UK of the CJEU's decision might not be as marked as perhaps initially thought.

Whilst UK VAT rules allow supplies between members of a group to be ignored for VAT purposes, a branch of a body corporate cannot alone be a member of a VAT group; the whole body corporate must be a member of the VAT group. As such, had the facts in *Skandia* arose in the UK, Skandia Sweden would not have been able to be a member of a UK VAT group separate from Skandia USA in the first place. On this basis, the practical consequences for partially exempt and VAT-sensitive UK VAT groups might be limited.

HMRC, representing the UK Government before the CJEU, made a robust defence of the current UK VAT grouping rules, the targeted UK's anti-abuse rules relating to VAT grouping and the UK's VAT treatment of branch establishments. The Advocate General's opinion of May 2014 appeared to suggest that he was broadly supportive of the UK's approach. It is

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[2] Skandia (C-7/13), paragraph 32.

[3] Skandia (C-7/13), paragraph 37.

understood that HM Revenue and Customs are now considering the implications of the CJEU's preliminary ruling in *Skandia*. In line with other VAT judgments delivered by the CJEU, we would anticipate a published response by HMRC to the CJEU's preliminary ruling in due course. It is possible that HMRC might favour revising the UK VAT grouping and branch establishment rules following the CJEU's decision in *Skandia* to align the UK's VAT regime more closely to other Member States such as Sweden. Any such revision would have significant consequences and would, it is submitted, need to be introduced with a transitional period to allow business which are affected to consider reorganizing their activities. However, the distinctions between the UK VAT rules for grouping and branch establishment and those of Sweden do offer the scope for the HMRC to continue to defend the UK's current VAT position in this area, an approach which would need the support of the UK Government.

If anything, the preliminary ruling in *Skandia* serves as a reminder of the need to carefully consider which corporate group entities should be grouped for VAT purposes and the advantages conferred by the establishment of VAT groups.

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