

SKANDIA AMERICA CORPORATION

EU Tax Cases Tracker

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Produced by Tolley®**C-7/13 Skandia America Corporation USA, filial Sverige v Skatteverket**

Supplies of services by the principal establishment of a US company to its Swedish branch which is a member of a Swedish VAT group may be regarded as taxable supplies made to the VAT group where it is possible to regard it as a single taxable person.

Case Stage: Judgment**Background of the case**

The present case concerns whether services supplied by a foreign company to one of its EU branches, which is a member of a VAT group in its member state of establishment, is a supply of services for the purposes of VAT.

Skandia America Corporation is a company incorporated in the US and a member of a worldwide insurance group (the group). Its role within the group is to centralise the purchases of IT services for the group. Those services are first acquired from third parties and then allocated to the various subsidiaries and branches of the group. Skandia America Corporation has a branch established in Sweden, which is in charge of transforming the IT services provided by Skandia America Corporation to produce a final product. Those final products are intended to be supplied to various entities of the group in Sweden. The branch is a member of a VAT group in Sweden. At each stage of the supply chain a mark-up of 5% is added to the price of the services. The Swedish tax authorities took the view that the supplies of services between Skandia America Corporation and its branch in Sweden were taxable transactions for VAT purposes and Skandia America Corporation was liable to pay the VAT thereon. The tax authorities determined that the branch was the fixed establishment of Skandia America Corporation in Sweden and a taxable person for VAT purposes. Skandia brought an action against the tax authorities' decision on the ground that that decision was in breach of the principle in the *FCE bank* case. There, the Court ruled that "a fixed establishment, which is not a legal entity distinct from the company of which it forms part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of the costs imputed to it in respect of those supplies".

The referring court decided to refer two questions to the EU's Court of Justice. In essence, the national court sought to ascertain whether the principle in the *FCE bank* case applies to the situation where a branch of a foreign company is a member of a VAT group in its state of establishment and if so whether the person liable to pay VAT is the supplier or the recipient of the services. Germany and the UK intervened in the procedure before the EU's Court of Justice.

Comments from Maric Glaser

There have been comments that this case is a rerun of the *FCE Bank* case (C-210/04). However, there are differences.

In *FCE Bank*, the service supplied was an internal service between an establishment of the company, which was established in one country and another of its establishments in another country (Italy). The Italian authorities sought to treat the transaction, as one subject to VAT. However, the Court of Justice concluded that there was no supply.

The Court's reasoning was largely based on the definition of a taxable person in Article 4(1) of the Sixth VAT Directive (now Article 9(1) of the Principal VAT Directive 'PVD') and in particular the fact that a branch is not a person independent of the company of which it is part. In view of these findings, the Court did not need to and declined to consider whether any of the fundamental freedoms such as the freedom of establishment was engaged.

Notwithstanding the judgment in *FCE Bank*, the European Commission issued a Communication in 2009 (*Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of*

value added tax [COM/2009/0325 final](#)) contending that a VAT group only comprises the establishments of companies within the country where the VAT group is established. Accordingly, *FCE Bank* does not apply to an intra-company supply where the one party to the transaction is part of a VAT group in the country where that branch is (see para 3.3.2.1). The Commission argues that this view –

- Is in accordance with the current wording of the territoriality criterion in Article 11;
- The territorial scope coincides with the VAT jurisdiction of the Member State implementing the VAT grouping scheme
- The notion 'established' within the meaning of Article 11 corresponds to 'established' as it can be found in other provisions of the VAT Directive.

The Commission considers *FCE Bank* and contends –

“... this ruling makes no reference whatsoever to the situation of a VAT group.”

While this statement is true, it should be noted that *FCE Bank* was a member of a VAT group (see para 6 of *Ford Motor Company Limited v HMRC* [2007] EWCA Civ 1370 (originally VAT case 19750)). It seems inconceivable that the authorities did not know that *FCE Bank* was part of the Ford VAT group but since the point was not raised, it is of course open to the Court to consider it in this case in light of the Commission's arguments.

The services in *FCE Bank* comprised consultancy, management, staff training, data processing and the supply and management of application software. Those services are described in the judgment as “internal transactions”. It is not clear of the extent to which the services were acquired from third parties but it is quite possible for all of this to have been provided using the company's own staff.

The referring Court in this case makes the point that the services were acquired from third parties and then resupplied to the branch. The recent draft guidelines on VAT published by the OECD (*OECD International VAT/GST Guidelines Draft Consolidated Version* published February 2013) suggest that where there is a supply of services from one establishment to another it should be treated as a two-stage transaction – first the third party acquisition and then a supply subject to VAT by one establishment to another. However, the guidelines also state –

This draft deals only with the place of taxation with respect to services and intangibles that a multiple location entity acquires from an external supplier. It does not deal with internally generated or developed services or intangibles, or with value that is added internally to externally acquired services or intangibles; these cases remain outside the scope of these draft Guidelines.

The guidelines therefore do not deal with a recharge of the cost of an internal resource such as salaries.

There are four arguments against treatment of the transaction as a separate supply -

- As in the case of *FCE Bank*, it is clear that the branch to branch supply is not made by an independent taxable person and so is not a supply within the PVD – indeed, depending on the accounting adopted, there may in fact be no recharge at all so difficulties will arise as to just what is the consideration for the supply;
- It breaches the principle of the neutrality of the tax since a company that is part of a VAT group will be treated differently to one that is not part of a VAT group;
- It potentially acts as a barrier to free movement of persons since a company seeking to second someone from another branch would no doubt prefer one from within its own territory or from an branch where a VAT group does not exist to avoid a VAT cost on an otherwise VAT free charge;
- It potentially acts as a barrier to the freedom of establishment – as discussed above, this issue was raised in *FCE Bank* but not considered by the Court but it is clear that a company seeking to establish a branch in another member state might incur and additional VAT cost on salaries compared with a local operation. It cannot be justified by arguing that a supply of staff from another oversea entity would be subject to VAT since

there is no overseas entity.

The Commission's argument that the formation of a group creates a new taxable person needs to be viewed in light of the fact that it only creates such a relationship in the territory where it is formed and nowhere else. It is of course true that the VAT group provisions might be abused to avoid VAT on a supply from overseas but there are two solutions to this potential problem -

- First, the second indent of Article 11 of the PVD allows a Member State to introduce legislation to combat avoidance of abuse as the UK has in VATA 1994, s43(2A);
- Second, if the service is indeed received by more than one establishment notwithstanding that it has been paid for by one branch, it is arguable that to that extent the supply is received in the country to which the costs are recharged.

Questions referred

Do supplies of externally purchased services from a company's main establishment in a third country to its branch in a Member State, with an allocation of costs for the purchase to the branch, constitute taxable transactions if the branch belongs to a VAT group in the Member State?

If the answer to the first question is in the affirmative, is the main establishment in the third country to be viewed as a taxable person not established in the Member State within the meaning of Article 196 of the Directive, with the result that the purchaser is to be taxed for the transactions?

Judgment of the Court

Recalling its ruling in *FCE bank*, the Court observed that the supply of services between a foreign company established in a third country and its EU branch is taxable if the branch carried out an independent economic activity. A branch is independent if it bears the economic risk arising from its business. The court observed that, in the present case, the Skandia Swedish branch did not operate independently. Moreover, by virtue of national law, it has no capital on its own and its assets belong to the Skandia US. The existence of an agreement on the sharing of costs is irrelevant since the agreement has not been negotiated between independent parties.

The Court went on to note that the Skandia Swedish branch is a member of a VAT group in Sweden and as such can no longer be identified as an individual entity. Only the VAT group exists for VAT purposes. Therefore, supplies between a branch which is a member of a VAT group and its main establishment must be considered to have been made to the group and not to the member of that group. The Court specified that the company and its branch can no longer be considered to be a single taxable person. Accordingly, the supplies of services in the present case as deemed to be made to the VAT group and constitutes taxable services within the meaning of Article 2(1)(c) of the PVD.

The Court then addressed the question of who is liable to pay VAT. The Court observed that, in application of Article 196 of the PVD, VAT is payable by the recipient of services where the supplier is not established in the same member state as the recipient. In the present case, Skandia US is established in a third country and it constitutes a separate taxable person from the VAT group. Therefore, the group as recipient of the services is liable for VAT.

Comments from Maric Glaser

The Court of Justice has disregarded the Advocate General's opinion in this case. His opinion broadly supported the UK view that branches form part of the VAT group because it is the person (company) that is a part of the VAT group not the branch.

Instead, the Court in its judgment has taken the view that where a local branch of a company established in a third country is included in a VAT group in a Member State, it effectively ceases to exist for VAT purposes; its activities are those of the VAT group and that in turn means that supplies from the principal establishment of that company in a third country to the branch in the VAT group are to be regarded as supplies for consideration.

It should be recalled that Article 11 creates a fiction that is intended to achieve two objectives –

- Simplify the administration of tax;
- Prevent avoidance as for example is done by the UK's disaggregation provisions.

Article 11 creates the fiction of a single taxable entity but what should that entity look like? Arguably, it should look like a single company (or individual) whose business is organised in divisions and/or branches. Such a company could have branches both within and outwith the country/ies where it is VAT registered including the possibility of a division with branches in more than one country whose inter-branch transactions would be ignored as in the case of *FCE Bank*.

Instead the Court's view carries the fiction further by not only creating a single entity in Sweden but also treating only part of the overseas company as being a separate entity in order to reach the conclusion that there are two independent persons for VAT purposes.

Among the issues that need to be resolved are –

- External v internal costs: Although Sweden appears to have only attacked the third party costs channeled through the branch, it would be possible to argue that the supply of internal resources is also covered by the judgment eg a supply of staff. Is that correct?
- Staff: Is a member of staff that has a contract requiring him to work in more than one branch to be regarded as an employee of both the VAT group and the other entity so that an allocation of staff costs is not consideration for a supply but a disbursement of costs falling within Article 79(c) of the PVD?
- Consideration: For there to be a supply, there must be consideration. If the company does not account separately for the branch, what is the deemed consideration? Article 80 provides for consideration to be deemed to be market value but does that apply to a cost sharing arrangement rather than a commercial transaction between real third parties?
- If two companies are grouped for VAT purposes both in Member State A and Member State B, does the fact of identical VAT groups affect the conclusion. Here it should be borne in mind that it was quite likely that both branches of FCE Bank were registered for VAT so the existence of VAT registrations in more than one country does not mean that there are separate taxable persons.
- Does the judgment apply in reverse? A VAT group is a territorial concept; it does not operate across borders so the question arises whether or not a country that does not implement Article 11 must treat the VAT group as a separate person?

The Court was not asked to consider non-VAT EU law. Among the further objections to the reasoning of the Court are –

- The judgment, if it applies to branches situated in two or more EU member states might deter a person from creating an establishment in another EU member state because that would result in a VAT cost;
- It could deter companies from allowing secondments of staff across borders if those were regarded as taxable supplies of staff rather than disbursements and were subject to VAT;
- It appears to be contrary to the principle of neutrality since a company that is not included in a VAT group can rely on FCE Bank but the fact that a company is in a VAT group means that VAT would need to be added.

HMRC have not yet issued any guidance on how they will approach the judgment but have indicated that UK law on the issue differs from that of Swedish law. Until any changes in legislation are effected it would appear to be possible to continue to use UK law to avoid the effect of the *Skandia* decision.

Opinion of Advocate General Wathelet

At the time of writing, the opinion was not made public in English. The below summary is an unofficial translation based on the French version of the opinion.

Advocate General Wathelet delivered his opinion on the 8 May 2014. He concluded that Article 11 of Directive 2006/112 ('PVD') must be interpreted as meaning that the branch of a company

incorporated under the law of a third country cannot, independently from the company which it forms part, be a member of a VAT group in its state of establishment. He considered that that article allows only independent legal persons to form a VAT group. A branch does not have a legal personality. Therefore, the decision granting the inclusion of the Swedish branch in a VAT group was unlawful. It is for the national court to determine the consequences of the unlawfulness of the decision.

Branches cannot form a VAT group independently from the company with which it forms part

Advocate General Wathelet first answered the question of whether a branch as such can be a member of a VAT group in its state of establishment even though the parent company is not a member of the VAT group ie whether the Swedish branch on its own can be regarded as being a person established on the Swedish territory within the meaning of Article 11 of the PVD. The Advocate General answered the question in the negative. He is of the opinion that the term “person” in that Article refers only to an independent legal person. A branch does not have a legal personality. Therefore, it cannot be part of a VAT group independently from the company with which it forms part.

The Advocate General considered that this solution is in line with the FCE bank case. In that case, the Court ruled that a branch and its head office or other establishment are part of a single entity and therefore cannot be regarded as a taxable person distinct from that company as a whole (see C-210/04 FCE Bank, para. 34 to 37).

The Advocate General rejected the argument of the Swedish government and the European Commission that when a branch is included in VAT group it becomes part of that group and ceases to form part of that company for VAT purposes. Therefore, according to the Swedish Government and the Commission, the FCE bank case does not apply in a situation where a branch is a member of a VAT group. (It is worth noting that although not mentioned in the Court of Justice judgment in FCE Bank, the High Court in the case of Ford Motor Company Limited v HMRC notes that FCE Bank Ltd is part of the Ford VAT Group.)

The Advocate General disagreed with that interpretation considering that it cannot be implied from the fact that the FCE bank case does not refer to the situation of VAT group that a branch is to be regarded as ceasing to be part of the company of which it is part and becoming a part of the VAT group. Moreover, that argument does not answer the question of whether a branch on its own can be part of a VAT group. It is also irrelevant in the opinion of the Advocate General that the supply of services between the principal establishment and its branch is made for consideration (which it should be noted is internal).

The Advocate General also rejected an argument that the *Credit Lyonnais* case (C-388/11) permits branches to form part of a VAT group. In that case, the Court ruled that a company which has established his seat in a member state and a fixed establishment in another member state must be considered as being established in that latter state for the activities which are carried out in that state. Mr Wathelet considered that that ruling does not go against his solution. On the contrary, it confirmed that only the entire company can be included in a VAT group because the company concerned is thus regarded as being a “person established in the territory of that Member State” within the meaning of Article 11 of the PVD.

Finally, the Advocate General noted that the combined application of the FCE bank principle and the possibility that a branch on its own could be treated as part of a VAT group would lead to situation where neither the transactions between the foreign parent company and its branch nor the transactions between that branch and the other members of the VAT group would be subject to VAT. Such principles are therefore incompatible because a branch cannot be regarded as being the same legal person with its parent company and at the same time as being a separate entity for the purpose of the VAT group.

Advocate General Wathelet concluded that the decision of the Swedish authority to allow the Skandia branch as such to be a member of a VAT group is unlawful.

Supplies between a main establishment and its branch are not taxable

As noted above, AG Wathelet identified four possible consequences of the unlawfulness of the decision to include branches in a VAT group.

- The decision can be disapplied with the consequence that the branch is regarded as not forming part of the VAT group. The transactions between the US company and its Swedish branch are therefore not subject to VAT. On the contrary, the transactions between the branch and the VAT group become taxable.
- The decision may be interpreted in conformity with the EU law by considering that the entire company is a member of the VAT group. That implies that a foreign company with a fixed establishment in a member state can be qualified as being a “person established on the territory [of the state where the group is formed]” within the meaning of Article 11 of the PVD. As supported by the UK government, the Advocate General is of the opinion that that article allows such foreign company to be admitted in its entirety as a member of a VAT group in the state of establishment of its branch. That conclusion is also confirmed by Article 2(1)(c) and Article 43 of the PVD. If Skandia America Corporation is considered to be a member of the Swedish VAT group, the transactions between the US company and its Swedish branch are not subject VAT. However, the transactions between the Swedish VAT group (including Skandia America Corporation) as a recipient of the services and any third party suppliers (which can be established in another member state than Sweden or in a third country) are subject to VAT because they constitute supplies of services carried out for consideration in the territory of a member state by a taxpayer acting as such within the meaning of Article 2(1)(c) of the PVD. In another word, as Skandia America Corporation is a member of the Swedish VAT group, the purchases of IT services made by that company from external suppliers and then supplied to the Skandia branch are regarded as taking place between the suppliers and the VAT group. The Advocate General considered that such supplies are transactions made for consideration carried out on the territory of a member state. In application of Article 56 of the PVD, such electronic supplies of services are regarded as taking place in the place of establishment of the recipient of the services, in the present case, in Sweden where the VAT group is established. The Swedish VAT group is therefore liable to pay VAT on the transactions between the external suppliers and Skandia America Corporation.
- The inclusion of a company in a Swedish VAT group required that the company expressed its willingness to take part of the group. If Skandia America Corporation did not do so, it could be concluded that neither the US company nor its branch is a member of the VAT group. The consequences of such situation are similar to those of disapplying the decision (a).
- Finally, the Advocate General contemplated the assumption that the taxation of the transactions between the Skandia America Corporation and Skandia could be justified by the objective to fight tax evasion. Article 11 of the PVD provides that member states may adopt any measures needed to prevent tax evasion or avoidance.

The Advocate General observed in all assumptions the transactions between the principal establishment and its branch are not taxable. On the contrary, the transactions between the branch and its clients are subject to VAT.

He thus answered to the first question referred in the negative concluding that a branch cannot be a member of a VAT group independently from the company with which it forms part. The consequence to that exclusion is that the supplies between a main establishment and its branch are not taxable, however any supplies between that branch and its clients which are or not member of the VAT Group, are subject to VAT.

Alternatively, the VAT group is liable for the VAT due on the supplies between the principal establishment and its branch

In answer to the second question referred, the Advocate General concluded that if the Court decides that the services bought from third parties of the companies group and supplied by Skandia America Corporation to its Swedish branch, and where the purchase cost was allocated to that branch, are taxable. That implies that the Swedish branch is not regarded as being a fixed establishment of the US company but as forming part of the recipient of the services i.e the VAT group. Therefore the Advocate General is of the opinion that the VAT group is liable to pay VAT in application of Article 196 of the PVD.

Comments from Maric Glaser

At the time of writing, the opinion was not made public in English.

The Advocate General's opinion largely accords with the interpretation of Article 11 of the PVD taken by the UK in regard to VAT groups. In essence, this is that it is the whole entity that forms part of the VAT group and not just that part (or those parts of the entity) that is established in the country where the VAT group is formed. This is the case even though the UK has no jurisdiction to tax transactions undertaken in the VAT group outside the UK.

The Commission argues that this is contrary to the territorial principle of VAT. Under this principle, a member state only has jurisdiction over transactions in its own territory. However, contrary to the Commission's view, this also means that the fact that a person is recognised as part of VAT group in one country (say the UK) does not mean that the entities within that group are also to be regarded a single person in another territory. The VAT Group exists only within the country where it has been created. Each member state has a full discretion to apply Article 11 or not in the way in which it chooses. Similarly, the fact that a member state chooses not to implement Article 11 does not compel or according to the Advocate General allow it to recognise the VAT group formed in another member state.

This can be illustrated as follows –

- Companies A, B and C are members of a VAT group in member state, X. From the perspective of country X only, there is a single taxable entity in its territory.
- B also has a branch in a third country, Z that does not have a VAT system.
- Each of companies A, B and C also have branches in member state Y, which does not permit VAT grouping and so each company is registered separately in country Y. From the perspective of country Y, there are three separate taxable entities.
- Since in X, it is the whole of A that is included in the VAT group, if A's branch in X, receives services from its branch in Y, those services do not comprise a supply because from X's perspective, there is an intra VAT group supply.
- However, in country Y, the VAT group does not exist so it looks at the transaction in accordance with the FCE Bank principle and the transaction does not constitute a supply from A (in Y) to A (in X) – it is an intra-branch transaction.

Recognising that groups can be used to perpetrate tax avoidance, the Advocate General points out at para 74 that Article 11 second paragraph permits member states to take measures to prevent such avoidance. The UK has done this in VATA 1994, s43(2A) of VAT 1994.

S43(2A) is aimed at a situation such as the following –

- Assume that C in the above example is partly exempt. It wants to acquire services that would be reverse chargeable. It therefore arranges for B, which has a branch in Z to purchase the services. B then uses the services to provide services to its branch in X (which is part of a VAT group with C) so that is not regarded as a supply because it is an intra VAT group supply. A (in X) can then in theory provide services to C without those supplies being treated as supplies.
- If C (in X) then supplies services to its branch in Y, then VAT is potentially avoided because if the original supply by the third party supplier was received by C directly, it would be subject to the reverse charge.
- While Article 11 permits the member state implementing it to take measures to prevent avoidance, the same would not appear to be true of a member state that does not implement Article 11.

As there is no official English translation of the Opinion, it is not clear whether the Advocate General intended to imply that the second paragraph of Article 11 does not require legislation for it to be applied. However, it seems more likely that all he was doing was pointing out that in its legislation permitting the formation of VAT groups, Sweden could legislate to prevent an intra-group supply from being disregarded for VAT in cases of avoidance of VAT that was properly due (as the UK has).

It is notable that the referring court did not seek to examine other EU law issues in relation to the transactions in question. In *FCE Bank*, the referring court raised the issue of whether or not the freedom of establishment was breached. To illustrate why this might be the case, consider the example below –

- A company has three branches, A, B and C in countries X, Y and Z respectively. Each branch makes supplies to both of the other branches. Under the *FCE Bank* judgment, none of those supplies would be taxed because they would all be part of a single entity that could not be artificially split.
- However, suppose that the company acquires a subsidiary, D, in country Y, which has implemented Article 11 on a compulsory basis so that according to its national legislation B and D are part of a VAT group.

The consequences of such an event if the Swedish Government contention were upheld, would mean that by virtue of an action of a member state a transaction that was previously non-taxable (say a supply of staff) from the branch of A or C in member states X and Z to branch B would become subject to VAT. This could potentially impact on the freedom of establishment by imposing a cost on a transaction that would not otherwise be subject to VAT.

It would also appear potentially to breach the principle of the neutrality since it would mean that a branch-to-branch supply taking place in a single country would not be subject to VAT whereas a branch-to-branch supply taking place across borders would be.

Finally, it might have an impact on the movement of staff; a member of staff in either branch A or C would be less likely to be seconded to B simply because there could be a significant VAT cost and presumably a supply by B to either A or C would also not be treated as outside the scope of VAT since the Swedish view results in branches A and C being regarded as separate persons to the VAT group of which B is a part.

European Law

- Articles 9(1), 11 and 196 of Directive 2006/112,

National Law

- Mervärdesskattelagen (VAT Act), art. 6a, §§ 1-4, art. 5, § 7(1), art. 1, § 2(1) and (2) and art. 1, § 15

Related cases

- [C-210/04 FCE Bank](#) (Fixed establishment - Non-resident company - Legal relationship - Cost-sharing agreement - OECD Convention on double taxation - Meaning of 'taxable person' - Supply of services effected for consideration - Administrative practice)
- [C-162/07 Ampliscientifica](#) (Parent companies and subsidiaries - Implementation by the Member State of the single taxable person scheme - Conditions - Consequences)

Referring court

Sweden: Förvaltningsrätten i Stockholm (Administration Court, Stockholm), Skandia America Corporation USA, filial Sverige v Skatteverket, decision of 28 December 2012

Reference lodged at the Court on 7 January 2013 under case number C-7/13

Language of the Case: Swedish