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OPINION STATEMENT

Opinion Statement FC 3/2023 on VAT Groups

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1. Background

The Court of Justice's decision in C-812/19 *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket* considered the question of how the provisions relating to VAT Groups in Article 11 of the Principal Directive interrelate with the decision of the Court of Justice in C-210/04 *Ministero dell'Economia e delle Finanze v FCE Bank plc*.

In the *FCE Bank* case, the Court considered that no VAT was chargeable on supplies of services between the head-office of the Bank in the UK and its fixed establishment in Italy. The Court considered that the Italian branch was not performing an independent economic activity because it was the Bank as a whole, rather than the branch, that was incurring the risk and any charges agreed between the branch and head office could not be considered to be negotiated between independent parties. FCE Bank was a member of the UK VAT group of Ford, the car manufacturer. However, that fact was not highlighted to the Court.

2. The Judgement

As in the earlier decision of C-17/13 *Skandia America Corp (USA), filial Sverige v Skatteverket,* the reference in Danske Bank related to a Member State, Denmark, that considered that only fixed establishments within its jurisdiction could form part of a VAT group. This is made evident from both paragraphs 12 and 24 of the Judgement. For example, paragraph 12 states:

> "Under Danish legislation, only establishments located in Denmark may become members of a Danish VAT group. Accordingly, the Swedish branch of Danske Bank is not part of that group, so that it cannot be regarded as forming a single taxable person together with the principal establishment of that company".

The Court considered that the existence of the Danish VAT group meant that the Danish head office should be considered a distinct entity from its Swedish branch which was not part of the VAT group. It accordingly considered that the Danish head office should be considered to be rendering supplies to its Swedish branch, with the consequence that VAT was due in Sweden on the receipt. In reaching this conclusion, the Court was following the reasoning of the Court in the earlier *Skandia America case*. However, one significant difference between the *Skandia America case* and the *Danske Bank* case is that the *Danske Bank* case also raised the issue of whether the Swedish authorities were obliged or entitled to recognise the existence of a VAT Group in another Member State. On this additional issue the Court, at paragraph 33, observed that:

> "the fact remains that the existence of a VAT group in that Member State must, where appropriate, be taken into account for the purposes of taxation in other Member States, in particular when the latter assess the tax obligations of a branch established in their territory".

So the Court was clearly recognising that there may be a need for tax authorities to recognise the existence of VAT groups in other Member States. However, the use of the words "where appropriate" leaves open the possibility that there may be limitations on this obligation.

3. The approach of Member States to VAT Grouping

Many Member States have adopted a similar approach to Sweden and Denmark and consider that only fixed establishments that are within that state can form part of a VAT group. However, there have also been Member States that have favoured the whole entity approach, so that on joining a VAT group in those states the entire entity, including any foreign establishments, form part of the grouping for the purposes of imposing VAT in that Member State. These states included Malta, the Republic of Ireland and the Netherlands, although the Netherlands has indicated that it is proposing to alter its approach. Although no longer a Member State, the United Kingdom was also an advocate of this broader approach.

This approach accords with the literal reading of Article 11 which talks about "persons" and not "fixed establishments" in a Member State forming part of the grouping. It also accords with the legal and economic realities, because as the Court recognised in the *FCE case,* fixed establishments cannot generally be considered distinct taxable persons. The states that have previously adopted the whole entity approach have in many cases done so without any material problems or have addressed any problems by taking appropriate anti-avoidance measures, as is expressly envisaged by Article 11.

4. Issues Concerning the Whole Entity Approach

One issue that arises from the *Danske Bank* case is whether it remains open to a Member State to adopt the whole entity approach. There are comments in the *Danske Bank* case which could be read as rejecting a whole entity approach. In particular:

(i) the Court at paragraph 29 observed that:

> "having regard to the territorial limits resulting from the first paragraph of art 11 of the VAT Directive, the Swedish branch of Danske Bank cannot be regarded as forming part of the Danish VAT group in question".

However, those comments were made in the context of a Member State that adopted the national establishments only approach. There is in fact nothing in the explicit wording of Article 11 which prevents the adoption of a whole entity approach. Indeed, if anything the contrary is the position, since Article 11 refers to "persons" rather than "establishments" joining the grouping. Indeed, in *Skandia America,* Advocate General Wathelet at paragraphs 40-61 and 66 of his Opinion considered that the whole entity approach was the approach that should be adopted. While the Court in *Skandia America* clearly accepted that a national establishment only approach could be adopted, it certainly did not question the legitimacy of the whole entity approach. For these reasons

it is also possibly significant that the rules as implemented in Denmark clearly did not permit the Swedish establishment to form part of the Danish Group and it may be that the statement should be read as no more than an acknowledgement that the Danish VAT grouping rules were consistent with the Directive. Such a reading would also be consistent with the Court's decision in C-141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH*, at paragraph 49-60, and in Case C-269/20 *Finanzamt T v S* at paragraphs 43-53, since these clearly recognise that Member States have some discretion and optionality in how they implement VAT grouping rules.

(ii) Similarly, the Court at paragraph 33 in *Danske Bank* also observed that:

> "the wording of art 11 of the VAT Directive precludes a Member State from extending the scope of a VAT group to entities established outside its territory".

However, that comment begs the question of what is the relevant entity. If a Member State adopts the whole entity approach, it is clearly a reasonable reading of the Directive and therefore the judgment that it is a reference to the entire taxable person, which accords with the Court's reasoning in FCE Bank.

(iii) It could also be suggested that the fact that the Court in *Danske Bank*, at paragraph 33, considered that Member States were required to recognise VAT groups in other Member States also supports the conclusion that the Court was rejecting the whole entity approach to VAT grouping. The *Danske Bank* decision illustrates how the process of recognition can have VAT consequences in other Member States that are required to recognise the grouping, in that case a VAT charge in Sweden on services rendered by the Danish head-office which only arose because Sweden recognised the Danish VAT group. It could also impact on the ability to recover input tax[1]. If the whole entity approach is acceptable, these consequences potentially become more complex because the consequences of recognising the group will then not be so uniform, although we do not consider that is necessarily a reason for rejecting the whole entity approach especially since we can see a possible working model that is consistent with the wording of the Directive for the reasons outlined in paragraph (iv).

(iv) Assuming the whole entity approach continues to be justified, then it could be suggested that the fact that Member States are only required to recognise grouping in other Member States *"where appropriate"* means that they are not required to recognise fixed establishments outside the Member State in question as forming part of the grouping. On this basis, the Member State adopting the whole entity approach could rely on the decision in the *FCE Bank* case not to charge tax on services from overseas fixed establishments that form part of the VAT group under its rules. However, if other Member States are not required to recognise overseas establishments as forming part

[1] The ability to recover input tax when no VAT grouping is involved was considered in Case C-165/17 Morgan Stanley & Co International plc v Ministre de l'Économie et des Finances. If a fixed establishment only approach is adopted and the supply is by a member of a VAT group the right to recover input tax will instead be by reference to a taxed transaction.

of the grouping, they could rely on the Danske Bank case to impose a charge when supplies are rendered from establishments that form part of a VAT grouping in a Member State applying the whole entity approach to establishments in their state.

5. View of the VAT Committee

Following the decision in Danske Bank the VAT Committee has reviewed this issue. The guidelines produced by the Committee now state that:

> "The VAT Committee almost unanimously agrees that in case of a legal person comprising a main establishment (hereinafter "head office") and a fixed establishment (hereinafter "branch") within different territories, only the entity (head office or branch) physically present in the territory of a Member State that has introduced the VAT grouping scheme may be considered to be "established in the territory of that Member State" for the purposes of Article 11 of the VAT Directive, and thus able to join a VAT group there".

The dissenting voices are clearly correct to observe that neither the *Skandia America or Danske Bank* cases were directed at Member States that have adopted the whole entity approach, which brings into question whether that can be a correct reading of the decisions, especially when the whole entity approach also clearly accords with the literal wording of Article 11. The fact that the Court clearly considered that States may be required to recognise VAT groupings in other Member States clearly raises issues as to how the process of recognition applies if some Member States adopt the whole entity approach. However, we can see a possible working model for the reasons explained in paragraph 6(iv) above.

The comments about recognising VAT groupings in *Danske Bank* are clearly directed at groupings in other Member States. The Commission's view, although it does not appear to be currently shared by all the Member States for all purposes[2], is that there is no similar obligation to recognise VAT groups of third countries. Assuming the Commission's view is correct, and it is difficult to see how there can be any legal basis for requiring a Member State to take account of the VAT grouping rules in a third country, then this means that services provided by a head office or fixed establishment in a third country can continue to benefit from the *FCE Bank* decision even if the head office or fixed establishment is a member of a VAT grouping in the third country. The Commission is currently conducting a review of the treatment of financial services. This is possibly a reason why as part of that review there may be merit in recommending that the provisions governing VAT groupings in the Directive should be clarified so as to make it even clearer that the existence of a grouping does not preclude reliance on the *FCE Bank* decision at least if the Member State elects to adopt a whole entity approach. Such a change would ensure that members of VAT groupings in third countries are no longer placed at a potential advantage, since they can secure the national benefits of VAT grouping and also avoid charges on services from a fixed

2 This is evident from VAT Committee Working Paper 1027 (25 October 2021) see in particular para 3.4 and the Minutes to the 119th Meeting in Working Paper No 1042. The Minutes indicate that at least one Member State did not generally agree to the Commission's analysis, although it also indicated that it was willing to adopt a different approach when it came to the practical implications of the One Stop Shop.

establishment which is a member of the third country VAT group to an establishment in the European Union by relying on the *FCE Bank* decision. Because the grouping rules are optional, such reforms may have the possible benefit that Member States who want to make changes can then adopt them while those that do not are then not required to do so.

6. Obligation to Recognise Groupings in Other Member States

Another related issue of uncertainty which arises from the *Danske Bank* case relates to the extent that Member States have an obligation to recognise groupings in other Member States. The minutes to the 119th Meeting in Working Paper No 1042 of the VAT Committee indicate that some Member States had reservations about whether this should extend to registering VAT Groups for VAT in other Member States when a fixed establishment which is part of a grouping makes a supply in a different Member State. It also indicates that there was wider uncertainty about how the One Stop Shop should apply to members of VAT groups and establishments of members of the group in other Member States. One further illustration of the uncertainty generated relates to the triangulation provisions in Article 141 of the Directive. If the group is to be recognised as a notional single person for VAT purposes, does this mean that supplies between members of the group can be ignored for the purposes of the triangulation provisions, so that what is in fact a four party supply chain can be considered a triangular chain to which the article applies, with one of the transactions being ignored because it is between two parties who are established in the same state and are members of a single VAT grouping? The minutes to the 119th Meeting in Working Paper No 1042 indicate that the Commission and VAT Committee are giving consideration to providing guidance on these issues for the purposes of the One Stop Shop. However, this example highlights that it would be helpful if wider guidance could be produced on these issues or alternatively to have a regulation governing these issues.

7. The Position in the United Kingdom

The United Kingdom has traditionally supported the whole entity approach. S 43(2A) VATA 1994 is clearly premised on the assumption that the whole entity approach should generally be applied. Following the decision of the Court in the *Skandia America,* HMRC set out its views in HMRC Brief 18 (2015). This indicated that the UK would continue to generally apply the whole entity approach; however, it considered that fixed establishments that form part of a VAT group in another Member State would be considered part of a different taxable person if the Member State only permitted establishments within that Member State to form part of its VAT groupings and has implemented the *Skandia* judgement so that intra-entity transactions with a UK establishment are treated as supplies for VAT purposes. Since the UK is no longer a member of the European Union, it is difficult to see any reason why the rules adopted in Member States should any longer be of any relevance when determining whether VAT should be charged on supplies from fixed establishments in Member States. It is in any event difficult to see any principled basis upon which account can be taken of one class of the grouping rules adopted in other Member States and not others. Either the whole entity approach should be adopted in all cases or not at all. HMRC's guidance on this issue is therefore clearly also in need of further review.

Surprisingly given its previous acceptance of the whole entity approach, HMRC has in fact attempted to rely on the *Danske Bank* judgment to challenge the whole entity approach in the Upper Tribunal in *HSBC Electronic Data Processing (Guangdong) Ltd* [2022] UKUT 41 (TCC) para 6. However, the Tribunal refused HMRC permission to raise such arguments. Even if the Court had granted permission, it does not follow that the *Danske Bank* case should be followed in the United Kingdom. Firstly, there are issues as to whether a conforming interpretation is possible given the fact that s 43(2A) VATA 1994 is clearly premised on the assumption that the whole entity approach should be adopted. Secondly, decisions of the Court of Justice looking at the position post-Brexit are just of persuasive authority: see s 6(1)-(2) European Union (Withdrawal) Act 2018. For the reasons that we have explained above, we do not consider that it is clear that the *Danske Bank* decision is inconsistent with the adoption of a whole entity approach. However, if this is incorrect, the Court's reasons for rejecting the whole entity approach would appear to be partly premised on requirements to recognise VAT groups in other Member States. It must therefore be strongly arguable that the reasoning of the Court in *Danske Bank* does not apply in the United Kingdom post Brexit, because there is no longer any such a requirement. Brexit has altered the context in which the provisions need to be construed and there is therefore no reason why the whole entity approach should not continue to be adopted.

8. Other issues related to VAT Grouping

At paragraph 25, the Court in C-812/19 *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket* observed that:

> "25. As regards the effects of belonging to a VAT group constituted under art 11 of the VAT Directive, the Court has held that such a group forms a single taxable person. 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 of 17 September 2014, *Skandia America (USA), filial Sverige* (Case C-7/13) EU:C:2014:2225, paras 28 and 29 and the case-law cited)".

The Court made similar comments in its judgment in Case C-141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH,* at paragraph 46. While the Court is undoubtedly correct in considering that that the grouping rules have an impact on how VAT is charged, we consider that there are limits on how far the fiction should be applied and it would be unfortunate if this is applied overly rigorously. We observe that:

(i) in the Netherlands it remains open to each member of a VAT group to prepare separate returns, although these returns must be prepared on the basis that the member forms part of a single taxable person. Despite the cited statements from the Court that suggest that only one return should be submitted, we can see nothing in the wording of Article 11 that precludes such a practice, which is appreciated by businesses in the Netherlands for audit control reasons and because it means that returns can be

submitted by the person directly responsible for preparing the information. The statements by the Court were also not focusing on the methodology being applied in the Netherlands. Advocate General Medina in Case C-141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH*, at paragraph 46 of his opinion, correctly observe that "many details are left to the discretion of the Member States". The Court's judgment, at paragraphs 49-60 also accepts that there is an element of discretion left to States when deciding how to implement grouping arrangements. We therefore consider that such a practice should be considered acceptable for that reason.

(ii) in determining whether exemptions are available, we consider that account should be taken of the identity of the real-world supplier in so far as the identity of the supplier is relevant when determining whether the conditions for exemption are satisfied. We consider that this is consistent with the objectives of VAT grouping as summarised by the Court at paragraph 49 of its Judgement in Case C-141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH* where it observed that the purposes of VAT grouping are "either in the interests of simplifying administration or with a view to combating abuses such as the splitting-up of one undertaking among several taxable persons so that each might benefit from a special scheme, to ensure that Member States would not be obliged to treat as taxable persons those whose 'independence' is purely a legal technicality". The Court, at paragraph 80, also considered that the members should be considered to be continuing to be engaged in independent economic activity. Similar views were expressed in Case C-269/20 *Finanzamt T v S* at paragraphs 54-63. However, we can see that Case C-77/19 *Kaplan International Colleges UK Ltd v HMRC,* considered at paragraph (iii) below, possibly provides some support for a more restrictive view;

(iii) we also consider that a similar approach should generally be adopted when analysing the nature of supplies to a member of the grouping, for example for the purposes of determining whether there is a transfer of the totality of assets for the purposes of Article 19 of the Directive. However, in Case C-77/19 *Kaplan International Colleges UK Ltd v HMRC* the Court, at paragraph 44, considered that the fiction that the VAT group was a single taxable person meant that the cost sharing exemption in Article 132(1)(f) should only apply to members of the VAT group when all the members of the VAT group were members of the Article 132(1)(f) cost sharing group. While we can see that it is likely to require a review of the relevant provisions of the Directive to reverse that specific decision, we consider that this is unduly restrictive and it would be unfortunate if this reasoning were applied in other contexts. We consider that it should generally be sufficient that the particular member of the VAT group receiving the supply meets the relevant requirements;

(iv) despite (ii) above, there may be circumstances where the VAT grouping does impact on the analysis of transactions undertaken by the grouping. This is made evident from the *Danske Bank* case where the fact that the group is treated as being a separate taxable person results in a liability when there otherwise would not be one. Another probable

example relates to the recovery of input tax relating to the activities of a passive holding company that is a member of a VAT group, when we consider that the input tax relating to the passive holding company can probably be regarded as residual input tax of the group even though the company would have no right of recovery input tax if it was not a member of the group. On one reading we can see that Advocate General Medina's Opinion in Case -C141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH* and his Opinion in Case C-269/20 *Finanzamt T v S* would question whether this should be the position. While the Opinions reach the correct conclusions on the specific issues being considered, it would not be automatically correct to apply all the reasoning to different scenarios. It is also considered that some support for this conclusion is provided by the Court's judgment in C-85/11 *Commission v Ireland*, where the Court accepted that non-taxable persons can be part of a VAT grouping. It also receives support from the approach taken by the Court in Case C-77/19 *Kaplan International Colleges UK Ltd v HMRC*. It would be surprising if the holding company, having become part of the VAT group and therefore a taxable person, had no impact on the ability to recover what could be regarded as residual VAT if the group were a single taxable person as a matter of fact. The Irish government's submission suggest that they accepted that this would be a consequence.

(v) concerns have been expressed that Case -C141/20 *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH* and Case C-269/20 *Finanzamt T v S* support the imposition of a VAT charge on transactions between members of a VAT group. We do not consider that this is a correct reading of the decisions.

9. Conclusions

These are issues upon which it may also be helpful to have further guidance from the VAT Committee. Indeed, while it will clearly require legislative action, we consider that there would be considerable merit in developing the idea of EU wide VAT groupings. The effect of a national establishment only approach is effectively to discourage the provision of cross-border services within a commercial grouping within the EU, which we consider to be unfortunate and inconsistent with the idea of an EU wide single market.