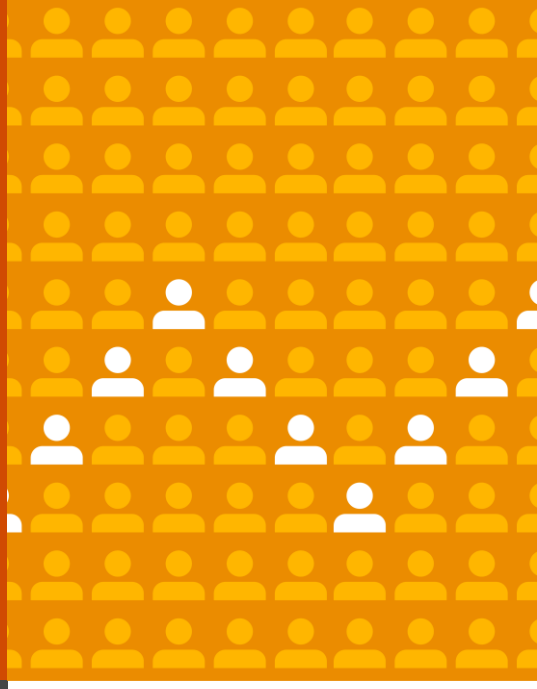
TEAC pronounces on the VAT taxation for transactions between the head office and its branch



Analysis of the recent pronouncement issued by the Central Economic Administrative Court (TEAC) on the VAT Taxation of the transactions between the head office and its branch

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TEAC has recently ruled about a topic which had been already addressed by the Spanish General Directorate of Taxes (SGDT) in its most recent resolutions: the VAT taxation of transactions between the headquarters and its branches.

In the specific case at hand, a branch performing insurance activity, that is the dominant entity of a VAT Spanish Group, receives services from its parent company in Ireland, which in turn receives those services from the Group's headquarters, located in Switzerland. The particularity is that the branch had previously been a subsidiary, and the services had been received directly from the headquarters in Switzerland, without going through Ireland.

The TEAC, confirming the conclusions reached by the Spanish Tax Audit Body, considers that the services received by the branch are subject to Spanish VAT, based on these main arguments:

- The branch is independent from its parent company, because it has indirectly an endowment capital. This determines that it also bears the economic risks associated with its activity (ECJ FCE Bank Judgement).
- In so far the branch belongs to a VAT Group in Spain, transactions with its parent company must be understood as being carried out between that parent company and the VAT Group as a single taxable person different from its members (ECJ Skandia Judgement).
- In any case, most of the services must been understood as being supplied from the head group in Switzerland, with the branch office being the actual recipient of those services rather than the parent company in Ireland.

With reference to the first of these arguments, attention is called to the fact capital is assumed as indirectly allocated to a branch, that as such, does not have endowment capital as admitted by specific regulation.. Furthermore, in the particular case of insurance activity, the branch in Spain of an insurance company established in another Member State, is subject to the supervisory Authority of the origin State (the one of the parent company). Therefore, it is not easy to appreciate the referred independence, at least for this purpose.

In this independence test, the intervention of the branches in the performance of transactions subject to VAT with third parties should come into play -at least, tangentially- as a delimiting element of the "own activity" of that branch; something that is not dealt with in the Court's Judgement. Basically, if a branch does not intervene in the supply of taxable transactions but limits to operate with its parent company, is there any own activity in respect of which the branch would be assuming an economic risk?

In conclusion, if a branch does not intervene in the supply of taxable transactions but limits to operate with its parent company, is there any own activity in respect of which the branch would be assuming an economic risk?

Time to review the transaction of branches and, in particular, the context in which they are carried out.

Likewise, it is important to note that, when the ECJ has ruled on this potential autonomy of a Permanent Establishment from its head office, for the purposes of VAT taxation of transactions between them, it has never concluded in the affirmative. The ECJ has recognized the independence in cases unlikely to be similar to the one at hand.

As regards the VAT Group argument, it was already used by the ECJ to conclude the taxation between parent and branch in the Skandia Case, and is the one used by the TEAC now to reach the same conclusion. And this, despite the fact that, as is well known, the Special Scheme for Groups is configured in the VAT Directive, under its Title III, as a taxable person scenario, and not as a special rule for determining the taxable base, as the Spanish case. The question is clear; if services are going to be taxed in Spain, who is going to declare them?, under what VAT number? Note that the SGDT has not recognized in any Resolution, the direct application of the ECJ criteria in this topic.

As regards the third argument, it would be needed to keep about what can be inferred from the reality of the operations in each case.