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DISSERTATION

**VAT GROUPING: IS THE IMPLEMENTATION IN A CROSS-BORDER SCENARIO COMPATIBLE
WITH THE TERRITORIAL LIMITATION LAID DOWN IN ARTICLE 11 OF THE VAT DIRECTIVE ?**

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ABBREVIATIONS

General abbreviations

ECJ	European Court of Justice
FE	Fixed Establishment for VAT purposes
HO	Head Office
MS	Member State (of the EU)
The Communication	Commission Communication COM(2009)325 final
The VAT Directive	Council Directive 2006/112/EC of 28 November 2006

Journals

BFIT	Bulletin for International Taxation
BTR	British Tax Review
ECTR	EC Tax Review
ET	European Taxation
IVM	International VAT Monitor

1 INTRODUCTION

1.1 Critical aspects of VAT grouping under EU legislation

The concept of VAT grouping is enshrined in Article 11 of the Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ ('the VAT Directive'). According to this provision, any Member State ('MS') '*may regard as a single taxable person any persons established in the territory of that [MS] who, while legally independent, are closely bound to one another by financial, economic and organisational links*'.²

1.1.1 An optional scheme

The use of the conditional 'may' in Article 11 makes it clear that VAT grouping is optional and MSs can choose whether or not to implement it in their domestic VAT systems.³ By contrast, a mandatory VAT grouping would favour a more consistent and non-distortionary application of this scheme for the benefit of all MSs.⁴

In any event, harmonisation does not yet exist among MSs that are still implementing VAT grouping. The broad wording of Article 11 leaves considerable leeway for its implementation⁵ and this has led MSs to adopt measures that vary significantly across the EU. This lack of homogeneity is considered one

¹ [2006] OJ L347/1

² Emphasis added.

³ To date, about half MSs have adopted a VAT grouping legislation.

⁴ PricewaterhouseCoopers 'Report on Economic effects of the VAT exemption for financial and insurance services' (2006), para 7.2.5
<http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/financial_services_study_mainreport_en.pdf> accessed 21 July 2014

⁵ At any rate, even when the VAT Directive does not contain the necessary guidance on how to implement a specific provision, MSs are supposed to implement it in coherence with 'the aims and role of the provision at issue within the scheme of [the VAT Directive]'. See case C-72/05 *Hausgemeinschaft Jörg und Stefanie Wollny v Finanzamt Landshut* [2006] ECR I-08297, para 28

of the crucial factors in the uneven playing field that currently exists among MSs,⁶ especially when it comes to the territorial limitation provided in Article 11.

1.1.2 The territorial limitation

The territorial limitation that stems from the literal interpretation of Article 11 is one of the most critical aspects of VAT grouping and is at the core of this research. This is principally because it has not been given the same meaning by all MSs.⁷ The absence of guidance in the EU legislation has enabled a minority of MSs⁸ to override such a territorial principle, allowing cross-border forms of VAT grouping. Cross-border VAT grouping encourages businesses to engage in VAT-shopping practices, i.e., to establish their businesses where VAT cross-border groups are permitted.⁹ Therefore, VAT, which was conceived as a neutral form of taxation,¹⁰ has actually lost this essential characteristic and has become a crucial aspect of economic choices for businesses. Needless to say, this situation is not compatible with a proper implementation of a VAT system.¹¹

1.1.3 Entitled subjects

Another element of uncertainty over VAT grouping resides in the meaning of the expression ‘any persons’ that is used in Article 11 to designate who is eligible for the scheme at issue. To some extent, the matter has recently been resolved by the European Court of Justice (‘ECJ’)¹² which clarified once and for all that ‘any person’ is not synonymous with ‘taxable person’. Therefore, in spite of the opposite opinion that

⁶ Andrea Parolini, ‘European VAT and Groups of Companies’, in Guglielmo Maisto (ed), *International and EC Tax Aspects of Groups and Companies* vol 4 (IBFD 2008) para 5.2.1

⁷ Nevertheless, VAT grouping is usually confined to persons established within the MS where the group has been set up. Cf Ben JM Terra and Peter J Wattel, *European Tax Law* (6th edn, Kluwer Law International 2012) para 6.5

⁸ Cross-border VAT grouping is in practice permitted in Finland, the Netherlands and the United Kingdom. Cf Kenneth Vyncke, ‘EU VAT grouping from a Comparative Tax Law Perspective’ (2009) 18 ECTR 299, para 3.2

⁹ PricewaterhouseCoopers (n 4) para 2.6(2.34)

¹⁰ The need to ‘ensure neutrality in competition between [MSs]’ was clearly stated in the third recital of the Council Directive (EEC) 67/228 of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (Second Directive) [1967] OJ 71/1303

¹¹ cf OECD ‘International VAT/GST Guidelines’ (2014) para 2.7 <www.oecd.org/ctp/consumption/international-vat-gst-guidelines.pdf> accessed 21 July 2014. According to the OECD, VAT ‘should not be the primary driver for business decisions’.

¹² See, *ex multis*, case C-85/11 *Commission v Ireland* [2013] OJ C156/3 and case C-86/11 *Commission v United Kingdom* [2013] OJ C171/4

the Commission set out in the Communication of July 2009,¹³ non-taxable persons¹⁴ can indeed be part of a VAT group.¹⁵

Nevertheless, the correct interpretation of the term ‘persons’ used in Article 11 is still in doubt. The question hinges on whether the term is to be interpreted as having the meaning of ‘anyone’, in line with the common interpretation of Article 9(1) of the VAT Directive,¹⁶ or whether it expresses the narrower concept of legal entity.¹⁷ This is an important dilemma since in the former case subjects that are also not legal entities¹⁸ would be eligible for VAT grouping. By contrast, in the latter case only legal entities would be eligible, with the corollary that a fixed establishment for VAT purposes (‘FE’) which is not a legal person, would not be part of a VAT group in its own right.¹⁹ This is another topic that is thoroughly dealt with in this research.²⁰

1.1.4 The evolution of VAT grouping

The problems that have just been pointed out and those dealt with below stem mainly from the fact that the scope of VAT grouping has radically changed over time. It was initially devised as an anti-abuse instrument and as a means of simplifying VAT administration,²¹ but MSs have chiefly used VAT grouping to

¹³ Commission, ‘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)325 final, para 3.3.1

¹⁴ i.e. persons that do not carry out an economic activity in the meaning of Article 9 of the VAT Directive.

¹⁵ One of the most interesting consequences of this finding is that pure holding companies, whose activity is confined to the mere holding of share in other companies, can register for VAT grouping. A pure holding, in fact, cannot be considered as a taxable person. See case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* [1991] ECR I-3111

¹⁶ As it has been explained below, the expression ‘any person’ used to define a taxable person in Article 9 has to be read with the meaning of ‘anyone’. See Terra and Wattel (n 7)

¹⁷ This issue is at the centre of the Opinion of AG Wathelet in the pending ECJ case C-7/13 *Skandia America Corporation USA, filial Sverige v Skatteverket* [2013] OJ C55/8, that has been analysed below.

¹⁸ i.e. subjects that are neither individuals nor legal persons.

¹⁹ Actually, the same problem involves partnerships, which are not legal entities. Therefore, a partnership could not be a member of a VAT group.

²⁰ See ch 6 below

²¹ See Commission, ‘Proposal for a sixth Council Directive on the harmonization of Member States concerning turnover taxes Common system of value added tax: Uniform basis of assessment’ COM(73)950 [1973] Bulletin of the European Communities Supp 11. In the explanatory memorandum of this proposal VAT grouping was described as an instrument provided ‘in the interests of simplifying administration or of combating abuses (e.g. the splitting up of one undertaking

grant benefits to taxpayers,²² especially those that cannot fully deduct input VAT. This change in the purposes of the provision at issue has not been associated with any changes in the original structure of Article 11. Hence, this shows its inadequacy in coping with issues that are out of its original scope. Such inadequacy has been widely exploited by international groups which are increasingly engaged in the implementation of VAT-saving schemes based on VAT grouping combined with parent/branch structures.

Close attention has been paid at EU level to abusive forms of VAT grouping since their misuse can lead to situations of double non-taxation. Nevertheless, the approach that has been followed hitherto by the Commission and by tax authorities of some MSs seems to be neither in compliance with the freedom of establishment²³ nor with the ECJ case law, namely, with the principle elaborated in the case of *FCE Bank*.²⁴ The present analysis is exclusively focused on the latter aspect. Accordingly, the issue of the freedom of establishment is not considered.

1.2 Main features of this research

1.2.1 Purpose

Within the outlined context, this research provides an in-depth analysis of the approach of the Commission to the principle of territorial limitation enshrined in Article 11(1) of the VAT Directive, with a view to (i) pointing out the main shortcomings underlying this approach; and (ii) arguing in favour of the compatibility of cross-border VAT grouping with Article 11.

From this perspective, the study focuses on the effects of VAT grouping on the relationship between a head office ('HO') and an FE in a cross-border scenario, i.e., when either the former or the latter becomes part of a VAT group established in a different country. The aim of this approach is (i) to demonstrate that VAT grouping does not jeopardise the single-legal-entity principle according to which HO

among several taxable persons so that each may benefit from a special scheme)', by which MSs 'will not be obliged to treat as taxable persons those whose "independence" is purely a legal technicality'.

²² Oskar Henkow, *Financial Activities in European VAT: A Theoretical and Legal Research of the European VAT System and the Actual and Preferred Treatment of Financial Activities* (Kluwer Law International 2008) para 6.3

²³ On this topic see Ad van Doesum, Herman van Kesteren and Gert-Jan van Norden, 'The Internal Market and VAT: intra-group transactions of branches subsidiaries and VAT groups' (2007) 16 ECTR 34

²⁴ Case C-210/04 *Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v FCE Bank plc* [2006] ECR I-02803

and FE are one single legal person; and (ii) to rebut the Commission's opposite view according to which VAT grouping could split up HO and FE that, as a result, would no longer be the same taxable person but two separate taxable persons.

1.2.2 Methodology

With a view to fulfilling the aforesaid purpose, the position of the Commission will be placed under analysis in terms of coherence with the case law of the ECJ and domestic courts. Furthermore, the Commission approach will be questioned in the light of a principle elaborated in the present research (the 'all-in all-out' principle).²⁵

2 HOW VAT GROUPING WORKS

2.1 The single entity approach

In order to understand these problems and contextualise the following analysis, the starting point will be to highlight the main features of VAT grouping. In doing so, as pointed out earlier, it must be borne in mind that due to a lack of guidance in the EU legislation, MSs have implemented VAT grouping in very different ways.

The VAT grouping envisaged in Article 11 is essentially based on a 'fiction' through which the legal form of group members is deliberately overlooked and, accordingly, they are treated as a single taxable entity.²⁶ To put it in the Commission's words, by becoming part of a VAT group 'a number of closely bound taxable persons are merged into a new single taxable person for VAT purposes', with a view to giving economic substance precedence over legal form.²⁷ One of the most important consequences of this fiction is that intra-group transactions are outside the scope of VAT. Such transactions, either the supplies of

²⁵ See ch 6

²⁶ Andrea Parolini, Carlos Bechara, Mariken van Hilten, Des Kruger, Rebecca Millar and Greg Sinfield, 'VAT and Group Companies' (2011) 65 BFIT 349, para 3. This method of consolidation is referred to as 'legal fiction' in the article.

²⁷ COM(2009)325 (n 13) para 3.2

services or the provisions of goods, are treated as carried out between members of the same legal entity, i.e., as if all the members of a VAT group were branches of the same parent company.

2.2 Who benefits from VAT grouping

VAT grouping principally benefits members that are not fully entitled to deduct input VAT. This category of taxpayers can enjoy savings on direct costs, i.e., those attained through an actual and permanent reduction in the VAT fiscal burden. Exploiting the fact that intra-group transactions are outside the scope of VAT, subjects with no or only a partial right to deduct input VAT can reduce the amount of irrecoverable tax.²⁸ Specifically, the legal fiction on the basis of VAT grouping allows all VAT costs attached to transactions between group members to be neutralised, since limitation on the right to deduct VAT and exemptions without the right of deduction do not apply to intra-group supply of services or provision of goods.²⁹

For these reasons, VAT grouping can considerably benefit undertakings that provide banking and insurance services, whose right to deduct VAT is limited because of the exemption of such services. For these subjects, VAT is an item of cost whose incidence can be very burdensome. Therefore, VAT is a factor weighed up attentively when bank and insurance groups come to plan their business structures. In general, exemption discourages the process of outsourcing in favour of an in-house production of services³⁰ since VAT charged by external suppliers would not be deductible.

In this context, VAT grouping represents a potential solution to the problem. If the supplier of services meets the conditions set out in Article 11(1) and becomes part of a VAT group along with the recipient bank or insurance, this provision of services will be outside the scope of VAT since transactions within the VAT group are completely disregarded.

²⁸ Christian Amand, 'VAT grouping, FCE Bank and force of attraction - the internal market is leaking' (2007) 18 IVM 237, para 2

²⁹ Kenneth Vyncke, 'VAT grouping in the European Union: purposes, possibilities and limitations' (2007) 18 IVM 250, para 2.1.1

³⁰ Parolini et al (n 26) para 2

From a VAT perspective, VAT grouping equates parent/subsidiary structures to parent/branch structures. By joining a VAT group, a subsidiary ‘dissolves itself’ and merges into the group, i.e., ‘into a new single taxable person for VAT purposes’.³¹ Therefore, the subsidiary becomes one single taxable person with its parent company, in the same way as a branch forms one single taxable person with its HO.³² As far as the VAT treatment is concerned, at least in a domestic setting,³³ the position of a subsidiary and its parent when they are both members of a group and the position of a branch and its HO are absolutely the same, i.e., their reciprocal transactions are outside the scope of VAT.

2.3 Who does not benefit from VAT grouping

VAT grouping is generally restricted to subjects that are established within the territory of the MS where a VAT group has been set up.³⁴ This is a corollary of the literal interpretation of Article 11(1) of the VAT Directive which seems to exclude any form of cross-border VAT grouping. Such a limitation is justified by the Commission on grounds that VAT grouping is an option for MSs and its extension beyond the boundaries of the territory where a VAT group is registered may infringe the sovereignty of other MSs and distort competition at EU level.³⁵

The result of such territorial restriction is that the above mentioned benefits that derive from being part of a VAT group, namely, the fact that intra-group transactions are outside the scope of VAT, cannot be enjoyed in a cross-border scenario. In practice, this problem may be overcome by having recourse to VAT grouping rules in combination with the principle elaborated by the ECJ in *FCE Bank*.³⁶ This states that transactions between HO and FE are outside the scope of VAT as carried out within the same taxable person. The outcome of this combination amounts to cross-border VAT grouping.

³¹ COM(2009)325 (n 13) para 3.2

³² That an FE forms a single taxable person with its HO for VAT purposes was the main finding of the ECJ judgment in the case of *FCE Bank* (n 24)

³³ i.e. in the MS where the group has been set up.

³⁴ cf Amand, ‘VAT grouping, FCE Bank and force of attraction’ (n 28) para 2

³⁵ COM(2009)325 (n 13) para 3.3.2.1

³⁶ Case C-210/04 (n 24). FCE was an Italian branch of FCE Bank, a company established in the United Kingdom.

3 CROSS-BORDER VAT GROUPING

3.1 The case of *FCE Bank*

The ECJ in *FCE Bank* ruled that an FE ‘which is not a legal entity distinct from the company of which it forms part, established in another [MS] 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’.³⁷ Therefore, according to the ECJ, an HO and its FE are one single taxable person. As a corollary, their mutual provision of services is outside the scope of VAT even in a cross-border scenario since it is carried out within the same subject.

The ECJ decided the case giving preference to legal form over economic substance. It adhered to a ‘single-entity approach’³⁸ that tallies with the general principle of civil law (‘single-legal-entity principle’), according to which an FE is not a legal entity apart from its HO, i.e., an FE is not a legal entity in its own right. Given that HO and FE are the same legal entity and considering that a legal entity ‘can constitute only one taxable person’,³⁹ the ECJ came to the conclusion that a provision of services could not be envisaged in the case at issue.

This is a finding derived from the application of the aforesaid single-legal-entity principle in the field of VAT. As far as this research is concerned, such a finding is of paramount importance since the following analysis hinges upon it.

3.2 *FCE Bank* and VAT grouping

The principle enshrined in *FCE Bank* gives rise to de facto cross-border VAT grouping, at least as far as the provision of services is concerned.⁴⁰ The result that is achievable by exploiting this principle is the

³⁷ *ibid* para 41 (emphasis added)

³⁸ Pierre-Marie Glauser, ‘Head Office/Branch Relationships from the Perspective of Swiss VAT’ (2010) 21 IVM 31, para 3.2

³⁹ Case C-210/04 *FCE Bank* (n 24) Opinion of AG Léger, para 55

⁴⁰ cf Parolini et al (n 26) para 7.1

same as the one which derives from VAT grouping. In both cases, transactions between subjects that are part of these arrangements, i.e., a parent/branch structure or a VAT group, are outside the scope of VAT as they are performed within the same taxable person, i.e., the HO in the former case and the group in the latter one. The essential difference resides in the fact that while VAT grouping benefits that result from non-taxation of intra-group supplies of services are only enjoyable on a territorial basis, i.e., within the territory of the MS implementing VAT grouping, the benefits of a parent/branch structure are also enjoyable in a cross-border scenario, i.e., in the country of residence of the HO and in the one of its FE.

Therefore, replacing parent/subsidiary structures with HO/FE ones has turned out to be very beneficial to businesses that cannot fully deduct input VAT. These businesses have exploited the momentum derived from *FCE Bank* to widen the use of the latter kind of structures in order to implement VAT-saving schemes. For those subjects, such as financial institutions, that are not entitled to deduct input VAT, the possibility of availing themselves of an FE established in a country where no VAT is charged (or is charged at a low rate) or of an FE abroad that has higher pro rata of deduction than the HO, may generate considerable savings in terms of VAT. For example, if a bank established in a MS were to purchase directly or from one of its subsidiaries abroad some services that are taxable under the default place-of-supply rule set out in Article 44 of the VAT Directive,⁴¹ the bank would have to account for VAT under the reverse charge mechanism and could not deduct input VAT. By contrast, if the same services were channelled through the bank's FE abroad, such services would be outside the scope of VAT by virtue of the principle elaborated by the ECJ in *FCE Bank*. In actual fact, the bank may benefit from savings in terms of VAT as this would be achievable by joining a VAT group. Obviously, the same result may be attained in the opposite scenario, i.e., where in-bought services are channelled through the HO and recharged to its FE abroad.⁴²

⁴¹ According to Article 44, as a rule, '[t]he place of supply of services to a taxable person acting as such shall be the place where that person has established his business'.

⁴² In any event, it has to be borne in mind that such a scheme works only if it is possible to give evidence that the real beneficiary of the services is the subject (either the FE of the HO) to which such services has been charged. In the case of *Zurich* the UK High Court considered as taxable in the UK some services the cost of which had been recharged from Zurich HO to its FE in UK because the latter was found to be the real beneficiary of these services. *Zurich Insurance Co v RCC* [2006] EWHC 593 (Ch), [2006] STC 1694

3.3 Abusive VAT-saving schemes

Some well-known problems arise when the described situation is combined with a VAT group.⁴³ The *FCE Bank* principle coupled with VAT grouping leads to VAT leakage⁴⁴ due to VAT-saving practices based on abusive channelling of services via an FE established abroad to its HO or vice versa.

This phenomenon can be outlined by using the former example and adding that the bank did not have an FE abroad. If the bank were part of a VAT group along with a branch (FE_{CO}) of a company (CO_{HO}) established abroad in a country where there was no VAT (or where it was charged at a lower rate) or where there was no restriction in deduction, the fiscal burden of non-deductible input VAT could be avoided by the bank acting along the following lines. The service provider, instead of invoicing the services directly to the bank, could invoice them to CO_{HO}. Then, CO_{HO} could recharge the same services to its branch FE_{CO} which, in turn, could recharge the full cost to the bank, the actual beneficiary of the services at issue. The final result would be double non-taxation. VAT would not be due anywhere. This is possible by means of the combination of the *FCE Bank* principle, which justifies non-taxation of the first stage of the transaction (CO_{HO} - FE_{CO}), with VAT grouping rules, which allow non-taxation of the second stage of the provision at issue (FE_{CO} - bank). As a matter of fact, this combination removes the territorial limitation of VAT grouping provided in Article 11(1) of the VAT Directive, opening the way for cross-border VAT grouping.

⁴³ cf Christian Amand, 'Cross-Border Entities and EU VAT: A Contradictory Concept?' (2010) 21 IVM 20

⁴⁴ Parolini (n 6) para 5.2.5

4 THE EU COMMISSION APPROACH TO CROSS-BORDER VAT GROUPING

4.1 Critical aspects

The only attempt to regulate VAT grouping through common principles at EU level is embodied in the 2009 Communication from the Commission⁴⁵ ('the Communication'). Nevertheless, the Communication does not seem fit to cope with the problem of abusive use of VAT grouping since it is based on principles that are not fully compliant with either ECJ case law or civil law principles.

The Commission's approach to avoiding those abusive practices that are based on a combination of VAT grouping and the *FCE Bank* principle, hinges upon a strict interpretation of the territorial scope of Article 11 of the VAT Directive coupled with a refusal to apply the *FCE Bank* principle in a VAT group context. Accordingly, the Communication sticks to the definition of 'person established' under the meaning of Article 11. Nevertheless, the Communication focuses on the notion of establishment, disregarding the meaning to be given to the concept of person that has been taken into consideration only with reference to the position of non-taxable persons.⁴⁶ This oversight, as demonstrated below, is far from being insignificant since it takes for granted that an FE can be part of a VAT group in its own right.

Following this questionable approach, the Communication reads that the 'established' status for VAT grouping purposes applies (i) to businesses established in the territory of the MS implementing VAT grouping; and (ii) to FEs of foreign businesses established in the MS implementing VAT grouping. In contrast, it is not considered established for (i) businesses non-established in the territory of the MS implementing VAT grouping with an FE situated therein; and (ii) FEs abroad of businesses established in the territory of the MS implementing VAT grouping.

It follows from this that the parameter adopted by the Commission to draw a line between an established and a non-established subject under Article 11 is the physical presence of a subject in the

⁴⁵ COM(2009)325 (n 13)

⁴⁶ cf *ibid* para 3.3.1

territory of the MS where a VAT group has been set up, regardless of the fact that this subject is a legal entity or an FE. This is a very pragmatic approach that gives precedence to economic substance over legal form, in step with the rationale underlying VAT grouping as a whole.⁴⁷ Nevertheless, it falls foul of the single-legal-entity principle which the ECJ applied in *FCE Bank* where, by contrast, legal form was given precedence over economic substance.⁴⁸

4.2 Subjects excluded from VAT grouping

What stands out as a fundamental flaw in the application of this approach are the two exclusions: (i) FEs established abroad of businesses resident in the MS where a VAT group is registered; and (ii) businesses non-established in this territory but with an FE situated therein.⁴⁹ As just noted, such exclusions are clearly at odds with the finding of the ECJ in *FCE Bank*, and this was even admitted in the Communication.⁵⁰ The justification set forth therein is based on the fact that ‘by joining a VAT group, the taxable person becomes part of a new taxable person, the VAT group and, consequently, dissolves itself for VAT purposes from its [FE] located abroad’.⁵¹ It follows as a natural corollary that ‘any services [that the HO] subsequently supplies to its [FE] abroad would be considered as supplies made between two separate taxable persons’.⁵² Therefore, in the Commission’s view, VAT grouping could split up an HO and an FE that, as a result, would no longer be the same taxable person but two separate taxable persons.

Admittedly, the approach chosen by the Commission is coherent with the aim of safeguarding the territorial limitation of VAT grouping when an FE is involved. The only way to confine VAT grouping within the boundaries of the MS where a VAT group is registered and avoid the abusive use of this scheme is by

⁴⁷ As it has been pointed out above, in the Communication (see para 3.2) VAT grouping is described as a ‘fiction’ created for VAT purposes with a view to giving to economic substance precedence over legal form.

⁴⁸ cf above para 3.1

⁴⁹ Such a consequence is justified in the Communication with the need of preserving the sovereignty of MSs which could be undermined in reason of the optional nature of VAT grouping. Since VAT grouping is an optional regime ‘it should not have the effect of extending beyond the physical territory of the [MS] which has introduced the VAT grouping’.

⁵⁰ The Commission recognised that the exclusion at issue ‘may at first glance seem inconsistent with the *FCE Bank* ruling’.

⁵¹ COM(2009)325 (n 13) para 3.3.2.2

⁵² *ibid*

denying the application of the *FCE Bank* principle. Nevertheless, this result cannot be justified under VAT rules currently in force as interpreted in the light of the ECJ case law. It should be borne in mind that territorial limitation set out in Article 11 is just a consequence of the fact that VAT grouping is an optional scheme.⁵³ In this context, such limitation only has the function of confining the effect of VAT grouping within the borders of the MS implementing the scheme, i.e., the function of avoiding that the ‘sovereignty of another [MS] may be infringed’ by this implementation.⁵⁴ Therefore, territorial limitation cannot go beyond its scope and end up changing the legal nature of a relationship between an FE and an HO. This is even more so if one considers that Article 11 is, as a whole, only a rule of administrative and anti-abuse nature⁵⁵ that is not meant to alter the legal liability of transactions within parts of a single legal entity.⁵⁶

4.3 Incoherence with *FCE Bank*

The fact that the Commission’s theory is based on an incorrect premise can be inferred, first of all, from the intrinsic contradictions underlying the Communication itself. It states that, by joining a VAT group, ‘the taxable person becomes part of a new taxable person, the VAT group’.⁵⁷ As a consequence, an HO and its FE would become two separate subjects for VAT purposes.

The major fault in this reasoning lies in the erroneous interpretation that has been given to the concept of taxable person. As noted above, the ECJ stated clearly in *FCE Bank* that an HO and its FE ‘constitutes a *single taxable person*’.⁵⁸ This is the logical consequence of the fact that (i) according to the single-legal-entity principle to which the ECJ adhered, HO and FE are the same legal entity, since a branch does not have a legal personality per se; and (ii) a legal entity, as a rule, ‘can constitute one and only one

⁵³ cf *ibid* para 3.3.2.1

⁵⁴ *ibid*

⁵⁵ About this specific nature of Article 11 see COM(73)950 (n 21)

⁵⁶ Maric Glaser, ‘Cross border transactions within vat groups’ [2008] 9 Tax Adviser 26, 27
<www.tax.org.uk/Resources/CIOT/Migrated%20Resources/0-9/026-027ta0908vat-groupsindd.pdf> accessed 25 July 2014

⁵⁷ COM(2009)325 (n 13) para 3.3.2.2

⁵⁸ Case C-210/04 (n 24) para 37 (emphasis added)

taxable person'.⁵⁹ In other words, this means that the concept of taxable person encompasses both HO and its FEs. Therefore, by reading the aforesaid excerpt from the Communication in the light of the cited jurisprudence, it can be concluded that, if by joining a VAT group it is 'the taxable person' that becomes part of the VAT group, both the HO and its FEs become part of the VAT group as they are one single taxable person.

Instead of splitting up HO and FE, as contended by the Commission, VAT grouping produces the opposite result and gathers the two of them into a new taxable person, i.e., the VAT group. Accordingly, the aforesaid approach by the Commission, which is based on the division of HO and FE into separate subjects when one of them joins a VAT group, amounts to a blatant violation of the single-legal-entity principle set out in *FCE Bank* due to a misinterpretation of the concept of taxable person.

5 THE SINGLE ENTITY PRINCIPLE AND THE FORCE OF ATTRACTION BETWEEN HO AND FE

5.1 The origin of the force of attraction

It has been proven above that VAT grouping, rather than splitting HO and FE, gathers them up as a single taxable person in a new taxable person, i.e., the VAT group. One could argue that a force of attraction exists between HO and FE. When one of them becomes part of a VAT group, by virtue of the single-legal-entity principle it attracts the other into the group, regardless of any consideration about the place of establishment. The fact that the Communication admits that it is the '*taxable person* that becomes part of the VAT group' bears out the existence of such an attraction. As pointed out above, this admission, read in the light of the single-legal-entity approach, means that an FE cannot be part of a VAT group without its HO and vice versa, and this implies that they attract one another.

⁵⁹ *ibid* Opinion of AG Léger, para 56

Therefore, not only is cross-border VAT grouping compatible with VAT principles but it is also a natural consequence of the application of the single-legal-entity principle to which the ECJ abided by in the case of *FCE Bank*.

To date, the ECJ has never dealt with cases of cross-border VAT grouping, even if this void is going to be filled soon with the judgement in the pending case of *Skandia*.⁶⁰ Instead, domestic courts have already settled cases on this matter, making use of the single-legal-entity principle and the related force of attraction. Interestingly, these cases were decided before the case of *FCE Bank*. This demonstrates that the aforesaid principle is immanent and well settled in civil law systems.

5.2 Case law based on the single-legal-entity principle

5.2.1 The Dutch case

A discussion will follow on a judgment from 2002 by the Dutch Supreme Court which dealt with the single-entity approach. This case is still topical because it presents many points of similarity to the pending case of *Skandia*. In terms of juridical features, the Dutch case is particularly interesting because it is a unique example of the application of the force of attraction that arises from the single-legal-entity principle in a cross-border VAT grouping scenario.

In brief, the Dutch court was faced with a situation involving two FEs in the Netherlands (FE_{NL1} and FE_{NL2}) belonging to two HOs established in the UK (HO_{UK1} and HO_{UK2} respectively). Both the FEs and their HOs were part of a VAT group in their MS of establishment (NL and UK). The Dutch tax authorities sought to recover VAT from supplies of services between HO_{UK1} and FE_{NL1}. From the tax authorities' point of view, HO_{UK1} and FE_{NL1} could not have been treated as a single entity because their relationship had been invalidated by FE_{NL1} being part of a VAT group in the Netherlands.

The court did not share this view and held that the principle of territoriality under VAT grouping legislation had to be interpreted as meaning that an HO established outside the Dutch territory but having an FE therein had to be treated as a single taxable person since it was part of the Dutch group. The court

⁶⁰ Case C-7/13 (n 17)

specified that a non-established HO (HO_{UK1}) had to be considered as part of a Dutch VAT group if its FE (FE_{NL1}) was part of this group. Accordingly, the supplies of services between HO_{UK1} and FE_{NL1} were deemed to be outside the scope of VAT since the transactions had been carried out within the same taxable person, i.e., the VAT group. In substance, the court recognised the force of attraction exerted by the FE part of a VAT group upon its HO established abroad by virtue of which both of them were considered to be members of the same Dutch VAT group.

The result was a clear case of cross-border VAT grouping whose effects even went beyond the transactions carried out between HO_{UK1} and its FE_{NL1} . The Court also pointed out that transactions between the non-resident HO (HO_{UK1}) and an FE (FE_{NL2}) of another non-resident HO (HO_{UK2}) had to be considered as outside the scope of VAT since they were carried out within the same taxable person, i.e., the Dutch VAT group. In other words, each HO (HO_{UK1} and HO_{UK2} in the example) with an FE in the Dutch VAT group (FE_{NL1} and FE_{NL2} respectively) was considered to be established in the Netherlands for VAT grouping purposes by virtue of the force of attraction exerted by its FE.

5.2.1.1 Main features

The decision of the Dutch court allows the following rule to be developed. Transactions between a non-established HO and its FE part of a VAT group are outside the scope of VAT because they are performed within the VAT group. Furthermore, transactions between a non-established HO with an FE part of a VAT group and the FE part of this group of another non-established HO (in the example, transactions between HO_{UK1} and FE_{NL2}) are also outside the scope of VAT since they are carried out within the same VAT group, i.e., the same taxable person. Notably, the Dutch court decided that transactions between HO_{UK1} and FE_{NL1} were outside the scope of VAT not because they were put in place within the same taxable person as represented by the parent company, as it would have been following an *FCE Bank*-like approach, but because they were carried out within the same taxable person as represented by the VAT group. This is

an interesting difference with the case of *Skandia* where it was on grounds of the *FCE Bank* principle, and not of Article 11, that the AG sought to justify the non-taxability of transactions between HO and FE.⁶¹

Needless to say, such an example of cross-border VAT grouping could not have been achieved under the conditions stated in the Communication. Namely, according to the principle of physical presence that denies de facto the principle of attraction on which the Dutch court based its decision, a subject can only be part of a VAT group if it is physically present in the territory of the MS implementing VAT grouping. Hence, since in the Dutch case the HOs (HO_{UK1} and HO_{UK2}) were not physically present in the Netherlands, they could not have benefited from the effects of the Dutch VAT group.

The case is also interesting because it indicated how the principle of territoriality set out in Article 11 could be interpreted. Even though the final result from the ruling of the Dutch court clearly amounted to cross-border VAT grouping, the effect of it remained totally confined in the Netherlands and did not affect the position of the UK or that of any other country in the least. From the UK perspective, the implementation of a cross-border VAT group in the Netherlands was an absolutely neutral outcome, since the effects of this situation could not have gone beyond the Dutch borders. A hypothetical cross-border supply of services in the opposite direction, i.e., between FE_{NL2} (acting as a supplier) and HO_{UK1} (acting as a recipient) would have been subject to VAT under the reverse charge mechanism in the UK. In fact, subjects gathered within a VAT group return to their former individual status of taxable person in all those situations where another MS does not recognise group registration between them.⁶² In other terms, the cross-border VAT group at the centre of the Dutch case was just a *Dutch* cross-border VAT group without any repercussions outside the Netherlands. Accordingly, no problems of breach of sovereignty could arise from the implementation of VAT grouping.

In the light of this, the position of the Commission in the Communication, where it justified the territorial limitation of VAT grouping on grounds of the protection of fiscal sovereignty of MSs, is

⁶¹ See *ibid* para 69

⁶² Vyncke, 'EU VAT grouping from a Comparative Tax Law Perspective' (n 8) para 3.3

unfounded. All that territoriality in Article 11 would mean was that a VAT group would only be recognised in the MS that allowed its implementation,⁶³ i.e., the MS under the law where it was registered. Accordingly, other MSs, in abiding by the same principle of territoriality but applied to their circumstances, have no obligations whatsoever to recognise a VAT group set up abroad and are absolutely free to disregard its effects.

5.2.2 *The Finnish case*

Another case worth noting which was decided on grounds of the single-legal-entity principle is one heard by the Finnish Supreme Administrative Court in 2004.⁶⁴

It concerned a company group which consisted of a Swedish company (HO_{SE}) that was a member of a VAT group in Sweden. It owned two branches: (i) an FE in Finland (FE_{FI}) which was part of a VAT group registered therein together with a local company (CO_{FI}); and (ii) an FE in Denmark (FE_{DK}) which was part of a Danish VAT group. The Finnish tax authorities contended that either services provided by HO_{SE} or FE_{DK} to FE_{FI} had to be accountable for VAT under the reverse charge mechanism in Finland. The court took an *FCE Bank*-like approach. It ruled that since services and charges within a single legal entity cannot be considered as transactions under civil law and no specific VAT rules existed which allowed a deviation from this principle, such services had to be considered outside the scope of VAT. No relevance at all was given to the fact that all the subjects involved in the matter were part of a VAT group in their MSs of establishment.

5.2.2.1 Main features

The Finnish court recognised that the civil law single-legal-entity principle (later on featured in *FCE Bank*) that underlies the relationship between an HO and its FE, is not sensitive to VAT grouping. In other words, it was the court's opinion that the legal unity between HO and FE could not be broken by VAT grouping but remains intact regardless of VAT grouping. That is to say, the court admitted that the single-legal-entity principle is still effective within a VAT group, as was recently held by the AG in the case of

⁶³ Glaser (n 56) 27

⁶⁴ The case was reported in (2005) 16 IVM 77

Skandia. This conclusion can be inferred from the fact that the Finnish court settled the case based only on the principle at issue. Namely, the court considered transactions between HO and FEs outside the scope of VAT on grounds that these transactions were carried out within the same legal entity, i.e., the HO, and completely overlooked the fact that each part involved in the transactions belonged to a distinct VAT group.

On the one hand, this position is coherent with the idea that VAT grouping is a composite concept, i.e., a VAT group is made up of many single entities that are *just treated* as one single entity but that still preserve their legal identity.⁶⁵ On the other hand, the court position is clearly antithetical to the Commission's view set out in the Communication as it upheld the disappearance of a subject as a single legal entity due to its merging in a new taxable person, i.e., the VAT group.⁶⁶

5.2.3 The Dutch case v the Finnish case

From a comparative perspective, the Finnish court's position was very different to the Dutch judgment in terms of rationale. In the latter case, the court used the single-legal-entity principle, not to exclude transactions between HO and FE from VAT, but as a means of attracting the non-resident HO within the Dutch VAT group of which its FE was a part. In substance, the Dutch court adopted a two-pronged approach in its judgement. First, it relied on the force of attraction that stemmed from the single-legal-entity principle in order to attract the non-established HO into the VAT group of its FE. Then, the court considered the transactions between the two as non-taxable pursuant to Article 11 of the VAT Directive, since they were carried out within the VAT group. Therefore, in the Dutch case the non-taxability of transactions between HO and FE derived from VAT grouping rules and not from the direct application of the single-entity principle. Therefore, the Dutch and the Finnish courts came to the same conclusion, i.e., the non-taxation of provisions between HO and FE, but used different grounds.

⁶⁵ cf Amand, 'Cross-Border Entities and EU VAT: A Contradictory Concept?' (n 43) para 2 citing Chartered Institute of Taxation, 'VAT Grouping: proactive submission of the CIOT' (2008)

⁶⁶ As it has noted before, it is the Commission's opinion that 'by joining a VAT group, a taxable person becomes part of a new taxable person, the VAT group and, consequently, dissolves itself for VAT purposes'. COM(2009)325 (n 13) para 3.3.2.2

Moreover, the judgment of the Finnish court allowed the scope of the Dutch court findings to be widened. The Finnish case concerned a multilateral situation involving transactions between three subjects, i.e., one HO (HO_{SE}) and two FEs belonging to it (FE_{DK} and FE_{FI}), that were established in three different countries. The court took the view that not only were transactions between the HO and its FEs to be considered outside the scope of VAT but also those between the two FEs, in spite of the fact that each of them was part of a distinct VAT group in its MS of establishment. This implies that in the Finnish court's point of view, VAT grouping could break neither the link between HO and FE nor the link between FEs.

The aforesaid demonstrates that the Commission's interpretation of the concept of territorial limitation of VAT grouping set out in the Communication falls foul of either civil law principles or ECJ and national case law.

6 THE CONCEPT OF 'PERSON' UNDER THE VAT GROUPING LEGISLATION

6.1 Who is a person for VAT grouping purposes

The mistaken point of view set out in the Communication stands out even more clearly from another perspective; namely, when taking into account the meaning to be given to the concept of person under Article 11 of the VAT Directive. In this context, the term 'person' is used as synonymous with 'legal entity'. This implies that denying businesses that are non-established in the territory of the MS implementing the VAT grouping with an FE situated therein⁶⁷ the ability to be part of a VAT group runs counter to the single-legal-entity principle.

6.1.1 Reconciling the English version of the VAT Directive with other versions

The first step in order to demonstrate the Commission's mistake is to reconcile the English version of the VAT Directive with other language versions. As explained in the Opinion of AG Wathelet in the case

⁶⁷ See *ibid* para 3.3.2.1. On this topic see above, para 4.2

of *Skandia*,⁶⁸ the proper meaning of the term person used in Article 11, i.e., a ‘legal entity’, can be deduced by reading this provision in conjunction with Article 9, which sets out the definition of taxable person. However, in order to see the difference pointed out by the AG, who rendered his Opinion in French, one has to refer to language versions of the VAT Directive different from English. In the English version of the VAT Directive, such a difference cannot be noticed since both Article 9 and Article 11 refer to ‘any person’. However, in non-English versions Article 9 and Article 11 are clearly worded in a different way. Article 9, in giving the definition of taxable person, makes reference to ‘anyone’ or simply ‘one’,⁶⁹ so that a taxable person is ‘*anyone* who ... carries out ... an economic activity’. In contrast, Article 11 uses the different term, ‘persons’, as in the English version. Accordingly, Article 11 applies to ‘*persons* established in the territory of [the MS implementing VAT grouping]’.

In any event, it is settled opinion that the notion of ‘any person’ in Article 9 of the English version is not confined to natural or legal persons,⁷⁰ i.e., to legal entities. On the contrary, it has to be read in coherence with other languages, that is, with the meaning of ‘anyone’.⁷¹ Thus, the opinion of the AG in *Skandia*, based on the French version of the VAT Directive, also makes sense with reference to the English version.

6.1.2 Person as legal entity

It can be inferred from the different wording of Articles 9 and 11 that the scope of Article 11 is narrower than that of Article 9. The reason is that the term ‘person’ ought to be interpreted according to its ordinary meaning of ‘legal entity’, i.e., an individual or body corporate. This implies that the word ‘person’ in Article 11 has a meaning that is not as wide as the term ‘anyone’ used in Article 9. This conclusion is upheld by the ruling of the ECJ in the case of *Heerma*,⁷² where the ECJ advocated that the notion of taxable

⁶⁸ Case C-7/13 (n 17), Opinion of AG Wathelet, para 44

⁶⁹ cf Henkow (n 22) para 6.2

⁷⁰ *ibid*

⁷¹ cf Ben Terra and Julie Kajus, *A guide to the European VAT Directive - Introduction to European VAT* (vol 1, IBFD 2009) para 9.6.4 and Terra and Wattel (n 7) para 6.5

⁷² Case C-23/98 *Staatssecretaris van Financiën v J. Heerma* [2000] ECR I-00419

person not only applied to legal entities but also to a body of persons (a Dutch partnership in *Heerma*). According to the Opinion of AG Wathelet in *Skandia*,⁷³ this finding would not have been reached if Article 9, as Article 11, had referred to a ‘person’.

Moreover, this is perfectly in line with the academic literature according to which the meaning of ‘anyone’ in Article 9 of the VAT Directive (‘any person’ in the English version) is not limited to individuals and legal persons but, unlike Article 11, it also applies to subjects that lack legal personality, such as joint ventures and partnerships.⁷⁴ In conclusion, there are sound arguments to contend that the term ‘person’ in Article 11 is to be interpreted as a ‘legal entity’,⁷⁵ and that an FE, as explained earlier,⁷⁶ is not a legal entity per se.

6.2 The ‘all-in all-out’ principle

As it has been noted previously,⁷⁷ the Commission did not give enough weight to the notion of a person that is eligible for VAT grouping since it considered only the position of non-taxable persons when drawing up the Communication. In doing so, the Commission mistakenly took for granted that an FE was a person under Article 11 and as such was entitled to be part of a VAT group in its own right, i.e., without its HO. On the contrary, according to the single-legal-entity principle, an FE is a person *along with* its HO. They form a single legal entity that cannot be split up. This implies that each time an FE is part of a group, it is invariably part of the group along with its HO. In fact, under Article 11 only distinct legal entities are eligible for VAT grouping and an FE is not a legal entity, or at least it is not a legal entity that is distinct from its HO. Therefore, either both the HO and its FE are part of a VAT group or they are both outside the group; following a principle that could be referred to as the ‘all-in all-out’ principle.

⁷³ Case C-7/13 (n 17) Opinion of AG Wathelet, para 45

⁷⁴ *Terra and Kajus* (n 71) para 9.1.1. The same opinion is shared by *Henkow* (n 22) para 6.2

⁷⁵ From this interpretation of the term ‘person’ in Article 11 as a ‘legal entity’ stems, moreover, that a partnership, that is not a person, could not be a part of a group in its own right.

⁷⁶ See above, para 3.1

⁷⁷ See para 4.1

Evidence of the existence of this principle can also be provided from another perspective; by having regard to the principles underlying the notion of taxable person for VAT purposes. The starting point of this analysis is the Opinion of AG Wathelet in the case of *Skandia*. In his view, an FE could not both be the same taxable person along with its HO in force of the principle laid down in *FCE Bank*⁷⁸ and be apart from it owing to its membership of a VAT group.⁷⁹ This double status runs counter to the principle according to which ‘the same legal entity can constitute only one taxable person’.⁸⁰ This latter principle can be deduced from a *contrario* reading of Article 11 itself, as the ECJ did in the case of *Polysar*.⁸¹⁻⁸² The ECJ pointed out that, according to Article 4(4) of the Sixth Directive,⁸³ ‘persons who, while legally independent, are closely bound to one another by financial, economic and organizational links *may only be treated* as a single taxable person *where* they [comply with the conditions laid down in Article 4(4) of the Sixth Directive]’.⁸⁴ Therefore, if in order to be treated as a single taxable person for VAT grouping purposes, independent legal persons have to comply with the conditions set out in Article 11 (formerly Article 4(4) of the Sixth Directive), this means *a contrariis* that, as a rule, one legal person is just one and only one taxable person. The same conclusion can be inferred from the ECJ ruling in *Ampliscientifica*.⁸⁵ The ECJ held that, in force of VAT grouping, closely linked persons that are part of a VAT group could no longer be treated ‘as a taxable person ... within the meaning of Article 4(1) of the Sixth Directive’,⁸⁶⁻⁸⁷ i.e., as a single taxable person. Namely, the ECJ held that the treatment as a single taxable person for VAT grouping purposes ‘*precludes* persons who are thus closely linked ... *from continuing to be identified*, within and outside their [VAT]

⁷⁸ cf *FCE Bank* (n 24) para 37

⁷⁹ Case C-7/13 (n 17) Opinion of AG Wathelet, para 58

⁸⁰ Case C-210/04 (n 24) Opinion of AG Léger, para 55

⁸¹ Case C-60/90 (n 15)

⁸² cf *Henkow* (n 22) para 6.2

⁸³ Now Article 11(1) of the VAT Directive.

⁸⁴ Case C-60/90 (n 15) para 15 (emphasis added)

⁸⁵ Case C-162/07 *Ampliscientifica Srl and Amplifin SpA v Ministero dell’Economia e delle Finanze and Agenzia delle Entrate* [2008] ECR I-04019

⁸⁶ Now Article 9 of the VAT Directive

⁸⁷ Case C-162/07 (n 85) para 19

group, as *individual taxable persons*'.⁸⁸ This implies again that, as a rule, one legal person is just 'one and only one taxable person'⁸⁹ and in order to force this principle it is necessary to rely on Article 11 provided that the conditions laid down therein are met.

From the aforesaid it follows that since an HO and its FE constitute a single legal entity and the same legal entity can constitute, as a rule, one and only one taxable person, an FE cannot be considered to be a taxable person with its HO and a member of a VAT group at the same time. Therefore, either both HO and FE are part of the same VAT group or both are outside of it, in coherence with the 'all-in all-out' principle.

To sum up, an FE is (i) neither a distinct taxable person under Article 9 of the VAT Directive, since it is a single legal entity along with its HO, (ii) nor a person under the meaning of Article 11, since it is not a legal entity. From both these circumstances it follows that an FE cannot be part of a VAT group in its own right. Namely, from the first circumstance it follows that an FE cannot be part of a VAT group without its HO because the settled principle 'one legal entity one taxable person' would be breached. From the latter circumstance it follows that an FE can only be part of a group along with the HO with which it forms a single legal entity.

All this supports the existence of the envisaged 'all-in all-out' principle, in force of which either both HO and FE are part of a VAT group or both are outside of it. Hence, the opinion of the Commission set out in the Communication about the splitting up of HO and FE into two different subjects due to VAT grouping and the concomitant merging of the latter in a group is not reconcilable either with the principles underlying the notion of taxable person under Article 9 or with the concept of person under Article 11 (to be intended as having the meaning of legal person).

⁸⁸ *ibid* (emphasis added)

⁸⁹ Case C-210/04 (n 24) Opinion of AG Léger, para 56

6.2.1 Reconciling the single-legal-entity principle with VAT grouping

The 'all-in all-out' principle allows the single-legal-entity approach followed by the ECJ in *FCE Bank* to be reconciled with VAT grouping rules. The Commission's opinion about the splitting up of FE and HO clearly runs counter to the civil law concept of single-legal entity. There are no grounds for the contention that this concept can be overridden by rules of an administrative and anti-abusive nature,⁹⁰ as those on VAT grouping are.⁹¹

Postulating the existence of the 'all-in all-out' principle in the VAT system allows the single-legal-entity principle to be respected in a VAT grouping scenario and the coherence of the VAT system to be restored accordingly. This is because, as it has been said before, the 'all-in all-out' principle means that either both the HO and its FE are part of a VAT group or they are both outside the group. Thus, an FE could not at the same time be a single taxable person with its HO by virtue of the *FCE Bank* ruling and be apart from it due to its membership of a VAT group without its HO.⁹² Namely, the 'all-in all-out' principle assumes that an FE is always part of a group along with its HO so that they always preserve intact their status of single legal entity, and this includes within a VAT group. As a consequence, contrary to the Commission's opinion, the single-legal-entity status of HO and FE is not dissolved by VAT grouping, as the Finnish court held in the case discussed earlier.⁹³

6.2.2 Reconciling *FCE Bank* with VAT grouping

It follows from these arguments that the effects of *FCE Bank*, that is, the non-taxation of transactions between HO and FE, can also be relied on when HO or FE become part of a VAT group. Namely, the fact that by virtue of the 'all-in all-out' principle an FE cannot be part of a group in its own right resolves the problem of the application of the *FCE Bank* principle to transactions between HO and FE when a VAT group is involved. The Commission has always denied the effects of the principle at issue in a VAT

⁹⁰ cf Glaser (n 56) 27

⁹¹ see COM(73)950 (n 13)

⁹² Case C-7/13 (n 17) Opinion of AG Wathelet, para 58

⁹³ See para 5.2.2

grouping scenario. In the Communication, when referring to the case of an HO that was a member of a VAT group, it stated that in ‘joining a VAT group the taxable person becomes part of a *new taxable person*, the VAT group and, consequently, *dissolves itself* for VAT purposes from its [FE] located abroad’.⁹⁴ In the observations submitted in the case of *Skandia*, the Commission confirmed the same point of view in the opposite situation, i.e., with an FE that joined a group. The Commission, in line with the Communication, contended that due to the principle of single taxable person under Article 11,⁹⁵ in becoming a member of a VAT group the FE was no longer part of the same taxable person with its HO established abroad but it had become part of a new taxable person, i.e., the VAT group.⁹⁶ Therefore, it was the Commission’s opinion that the *FCE Bank* principle could not be relied on in a VAT grouping scenario because in joining a VAT group HO and FE would lose their status of single taxable person.

Through the analysis carried out above it has been demonstrated that, in compliance with the single-legal-entity principle, an FE cannot be part of a VAT group in its own right but only along with its HO. This implies that when the former is part of a VAT group, the latter is also part of it (‘all in’). Accordingly, they are still the same taxable person although rejoined within a new taxable person, i.e., the VAT group. This conclusion is coherent with the idea that a VAT group consists of many single entities that are *just treated* as one single entity under Article 11 of the VAT Directive.⁹⁷ It follows that the reason put forward by the Commission to deny the effects of *FCE Bank* in a VAT group, i.e., the splitting up of FE and HO due to VAT grouping, is unfounded.

6.2.3 Rebutting unfounded criticism

The ‘all in all out principle’ allows the criticism related to the joint application of the *FCE Bank* principle and Article 11 to be rebutted.

⁹⁴ COM(2009)325 (n 13) para 3.3.2.2 (emphasis added)

⁹⁵ See above para 2.1.1

⁹⁶ Case C-7/13 (n 17) Opinion of AG Wathelet, para 33

⁹⁷ Amand citing CIOT (n 65)

6.2.3.1 Double VAT status

It has been pointed out in the legal literature⁹⁸ that if one admitted the validity of the *FCE Bank* principle in a VAT grouping scenario the final result would be a case of double VAT status. That is to say, an FE would end up being part of two taxable persons simultaneously, i.e., the VAT group of which it was a part in the MS of establishment and the HO to which it belonged. This would be in breach of the rule of ‘one legal person one taxable person’. To avoid this situation, it has been suggested⁹⁹ that the *FCE Bank* principle should not be applied when either an HO or its FE are part of a group and, consequently, that VAT should be charged on their transactions as they were carried out between two different taxable persons.

As it has been demonstrated above, under the ‘all-in all-out’ principle problems of double tax personality, i.e., the same subject that is part of two taxable persons for VAT purposes, cannot arise by definition because FE and HO are always joined as a single legal entity, either within a VAT group or outside it (‘all in’ or ‘all out’). Therefore, it needs not get rid of the *FCE Bank* principle, with the consequence that it also applies within a VAT group.

6.2.3.2 Channelling of in-bought services

Furthermore, it has been contended¹⁰⁰ that the *FCE Bank* principle should not apply when a VAT group is involved because it facilitates the abusive channelling of in-bought services.¹⁰¹ The ‘all-in all-out’ principle allows this problem to be resolved with no need to deny the effects of *FCE Bank*. In fact, if HO and FE are both deemed to be part of a group, in-bought services are to be considered as rendered directly to the VAT group and, therefore, are subjected to VAT in the MS where the VAT group is registered.¹⁰² Thus, the ‘all-in all-out’ principle, which removes the interposition of HO or FE between the supplier of services and their real beneficiary, i.e., the VAT group, makes it impossible to put in place abusive schemes based on the channelling of in-bought services regardless of the application of the *FCE Bank* principle.

⁹⁸ Vyncke ‘VAT grouping in the European Union’ (n 29) para 3.5.2

⁹⁹ *ibid*

¹⁰⁰ *ibid*; Parolini (n 6) para 5.2.5

¹⁰¹ About these abusive schemes see above, para 3.3

¹⁰² cf Case C-7/13 (n 17) Opinion of AG Wathelet, para 69

Admittedly, the 'all-in all-out' principle can only avoid abusive schemes based on the channelling of in-bought services, that is, when a third party supplier is involved. On the contrary, it does not offer any relief against abusive schemes based on channelling of self-produced services; in other words, those produced by HO or FE on their own. These schemes can only be addressed by ad hoc anti-avoidance rules implemented at a national level pursuant to Article 11(2) of the VAT Directive.¹⁰³ No remedies can be drawn from the EU VAT legislation. However, abusive schemes are generally implemented with reference to in-bought services.

6.3 Who is a person established for VAT grouping purposes ?

Once it has been made clear that an FE is not a legal person, it stems from this that the expression 'person established' in Article 11, that is synonymous with legal entity, can only refer to the parent company (HO) which the FE belongs to.

This conclusion is corroborated by the Opinion of AG Léger in the case of *FCE Bank* according to which '*an enterprise having [an FE] in the host [MS] is treated as a taxable person in that State*'.¹⁰⁴ The AG Opinion supports the idea that it is the whole enterprise, and not only its FE, that becomes a single taxable person in the MS of its FE by virtue of the force of attraction of the latter. The same view was shared by AG Wathelet in *Skandia*, who made reference to the case of *Crédit Lyonnais*.¹⁰⁵ Namely, the AG cited the passage thereof that reads, '*a company which has its [HO] in one [MS] and [an FE] in another [MS] must be considered, by virtue of that fact, as being established in the last mentioned [MS] for the activities carried out there*'.¹⁰⁶ According to the AG, this excerpt should be interpreted as meaning that it was the company as a whole that, due to its FE, was established in the MS of the FE and not just the latter. As a consequence, the company as a whole should be seen as a person established in the territory of the MS implementing VAT grouping under Article 11. The Opinion of AG Wathelet comes across as coherent with the principle of

¹⁰³ Rules of this kind are in force in Belgium. See Vyncke 'VAT grouping in the European Union' (n 29) para 6.10

¹⁰⁴ Case C-210/04 (n 24) Opinion of AG Léger, para 54

¹⁰⁵ C-388/11 *Le Crédit Lyonnais v Ministre du Budget, des Comptes publics et de la Réforme de l'État* [2013] OJ C325/2, para 33 (emphasis added)

¹⁰⁶ *ibid* para 33 (emphasis added)

attraction.¹⁰⁷ With the HO and FE both established in the MS of the latter, the single entity that rejoins by virtue of the force of attraction of the FE on its HO is a person eligible for VAT grouping.

This evidence bears out the existence of a force of attraction that the FE exerts on its HO with the final result that the subject that arises from their rejoining in the MS of the FE is a legal person entitled to VAT grouping. Namely, the force of attraction implies that an FE plays the role of a legal proxy in the MS where it is established. Accordingly, the FE determines the establishment of its HO therein. Since the FE along with its HO form a person under Article 11 (i.e. a legal entity), the two of them, as a single legal person, become eligible for VAT grouping.

6.4 New scenarios

It has been demonstrated that, as far as VAT grouping is concerned, there exists a principle in the VAT system called the ‘all-in all-out’ principle that does not allow an FE to be part of a group in its own right. This implies that either the FE and the HO it belongs to are part of the group (‘all in’) or both are not (‘all out’). The former situation, i.e., HO and FE part of the group, opens the door to cross-border VAT grouping. In fact, by virtue of the ‘all-in all-out’ principle, where an HO is willing to become part of a VAT group along with its FE, the former can enjoy the effects of VAT grouping even if it is not physically present in the MS implementing the group.

Such a situation falls foul of the position of the Commission stated in the Communication. However, it has been proven in this research that the Commission’s view on the point at issue is plainly wrong. As a consequence, international groups relying on the ‘all in all out principle’ may avail themselves of new options opening out before them in order to plan their business structures abroad, especially as regards the outsourcing of services. The following cases of cross-border VAT grouping are derived from the practical application of the ‘all-in all-out’ principle. These can be considered in compliance with Article 11 of the VAT Directive as interpreted by the ECJ.

¹⁰⁷ see above ch 5

6.4.1 Some examples of cross-border VAT grouping

The following hypotheses are set in a common scenario where an FE is part of a VAT group in the MS of its establishment and the HO which it belongs to is established in another country.

The first cross-border scenario involves provisions of services between FE and HO. The provisions are out of the scope of VAT. Such treatment can be justified for two different reasons: (i) following the *FCE Bank* principle which applies in a VAT grouping setting, since HO and FE are still the same taxable person; (ii) by virtue of Article 11 of the VAT Directive, since these transactions are carried out within a VAT group. This second solution is borne out by the Dutch Supreme Court judgment discussed above.¹⁰⁸

The second cross-border scenario concerns transactions between HO and other members of the VAT group. The provisions are out of the scope of VAT. The reason for this is that the HO is part of the group by means of the force of attraction exerted by its FE, since the FE could not be part of the group in its own right. Therefore, being the HO part of the group, its transactions vis-à-vis other members of the VAT group are out of the scope of VAT under Article 11 of the VAT Directive. This solution is in line with the Dutch Supreme Court judgment discussed above.

7 CONCLUSION

It has been demonstrated that the Commission's point of view about the territorial limitation of VAT grouping is not compatible with the general principle of civil law ('single-legal-entity principle') pursuant to which an FE is not a legal entity apart from its HO and, accordingly, with case law based on this principle. Therefore, the Commission's position in the Communication, which states that by joining a VAT group the HO and its FE would become two separate subjects for VAT purposes,¹⁰⁹ has to be rejected. This implies that the *FCE Bank* principle, which affirms the non-taxability of transactions between HO and FE, is also effective in a VAT grouping scenario.

¹⁰⁸ see para 5.2.1

¹⁰⁹ cf COM(2009)325 (n 13) para 3.3.2.2

The splitting up of HO and FE due to VAT grouping is not reconcilable with the idea that is set out in the Communication itself. This states that by joining a VAT group '*the taxable person* becomes part of a new taxable person', i.e., the VAT group.¹¹⁰ The ECJ, abiding by the single-legal-entity principle, stated in *FCE Bank* that an HO and its FE '*constitutes a single taxable person*'.¹¹¹ Therefore, by admitting that by joining a VAT group it is the taxable person as a whole that becomes part of the VAT group equates to saying that both the HO and its FEs become part of the VAT group.

The research has indicated the existence of a force of attraction between HO and FE that derives from the application of the single-legal-entity principle in the VAT system. By virtue of this force, when an HO or its FE becomes part of a VAT group it attracts the other into the group, regardless of any consideration about the place of establishment. Contrary to the Commission's opinion,¹¹² this implies that the concept of 'person established' for VAT grouping purposes is not related to the concept of physical presence in the MS implementing the scheme at issue. Therefore, the exclusion from VAT grouping of FEs established abroad of businesses resident in the MS where a VAT group is registered, and of businesses non-established in this territory but with an FE situated therein, is not justifiable. In this regard, it has been proven that the protection of fiscal sovereignty of MSs to which the Commission referred in the Communication,¹¹³ is a reason not fit for justifying such territorial limitation. The correct meaning to be given to territoriality under Article 11 is that a VAT group is just recognised in the MS that allows its implementation.¹¹⁴ Accordingly, other MSs, in abiding by the same principle of territoriality but applied to their circumstances, have no obligations to recognise a VAT group set up abroad.

The research has also demonstrated that the notion of 'person' eligible for VAT grouping under Article 11 of the VAT Directive has to be interpreted as synonymous with 'legal entity'. Therefore, in conformity with the single-legal-entity principle, an FE cannot be part of a VAT group in its own right. This is

¹¹⁰ *ibid*

¹¹¹ Case C-210/04 (n 24) para 37 (emphasis added)

¹¹² cf COM(2009)325 (n 13) para 3.3.2.1

¹¹³ cf *ibid*

¹¹⁴ Glaser (n 56) 27

because an FE is not a legal entity per se but a legal entity *along with* its HO, i.e., FE and HO form a single legal entity that cannot be split up. This indicates that either both the HO and its FE are part of a VAT group or they are both outside the group. This principle has been called the 'all-in all-out' principle. From the application of the 'all-in all-out' principle stems the rule that when an FE becomes part of a VAT group it invariably becomes part of it along with its HO ('all in'). This implies that VAT grouping does not split up HO and FE that are still the same taxable person although rejoined within a new taxable person, i.e., the VAT group. In actual fact, from the application of the 'all-in all-out' principle derive cases of cross-border VAT grouping that, contrary to the Commission's point of view,¹¹⁵ are in compliance with the territorial limitation set out in Article 11. Furthermore, the 'all-in all-out' principle shows that the Commission's opinion which denies the effect of the *FCE Bank* principle in a VAT grouping scenario due to the alleged splitting up of HO and FE¹¹⁶ is unfounded. Therefore, provisions of services between HO and FE are out of the scope of VAT even when one of them is part of a VAT group.

To sum up, this research has demonstrated that cross-border VAT grouping is compatible with Article 11 of the VAT Directive and that the *FCE Bank* principle is also effective when either HO or FE becomes a member of a VAT group abroad.

¹¹⁵ cf COM(2009)325 (n 13) para 3.3.2

¹¹⁶ cf *ibid* para 3.3.2.2

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