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The implications of the judgment of the CJEU in the Danske Bank case (C-812/19) in the context of a VAT group registered in Malta, being a Member State which adopts a 'whole-entity' approach to VAT grouping

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This Position Paper sets out the MIT's views on the implications of the decision of the CJEU in case C-812/19 [Danske Bank] and in particular on the implications of that decision, if any, in the context of a VAT Group registered in Malta, being a Member State which adopts a 'whole entity' approach to VAT Grouping.

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On 11 March 2021, the CJEU delivered its decision in the *Danske Bank* case (C-812/19). The case was the second[1] to be brought before the CJEU on the matter of VAT grouping with a cross-border dimension. The CJEU followed the reasoning applied in the earlier *Skandia* decision, essentially confirming that, where an establishment of an enterprise located in a Member State joins a VAT group in that Member State, and the Member State considers only that establishment to be part of the VAT group, that establishment is to be regarded as forming part of a taxable person (being the VAT group) separate from any establishments of that same enterprise located in other jurisdictions.

A feature common to the VAT grouping systems in both the *Skandia* and the *Danske Bank* cases was the application of the so-called 'establishment-only' approach to VAT grouping. The question which therefore remains is the relevance, if at all, of the decision in the context of a so-called 'whole-entity' approach to VAT Grouping, such as that applied by Malta.[2]

Further to an analysis of the decision, it is the view of the Malta Institute of Taxation that:

- The Court's decision which effectively sanctions the notional splitting of the establishments of a single legal person (and the consequent non-application of the *FCE Bank* principle) was driven by the particular nature of the VAT grouping system in Denmark, which only considers the establishment and not the whole entity to form part of the Danish VAT group. This notional splitting of establishments of an entity is however not required and should not occur when that entity joins a VAT group in a Member State (in virtue of the fact that one of its establishments is located there) which considers the whole entity to form part of the VAT group.

- The CJEU in the *Danske Bank* case, when assessing the 'establishment-only' feature of the Danish VAT Grouping legislation in the light of article 11 of the VAT Directive, could only but conclude at para. 29 that the Swedish branch could not be regarded as forming part of the Danish VAT group, since, as recognised by the CJEU, only one of the establishments belonged to a VAT group. It is however contended that the conclusion of the CJEU in the *Danske Bank* case would not find application in a scenario in which the Member State in which the VAT group is registered considers the whole entity to form part of a VAT group (such as Malta).

- The decision in the *Danske Bank* case represents an acknowledgement by the CJEU of the compatibility of the 'establishment-only' approach to VAT grouping with article 11 of the VAT Directive, but it should not be construed to suggest - that the 'whole-entity' approach, on the other hand, is incompatible with article 11.

- It is the view of the MIT that the language of article 11, which permits a Member State to regard as a single taxable person any 'person' established within their territory, does in fact expressly support the whole-entity approach. By establishing a presence in a Member State, whether by having the place of central administration (primary establishment) or sufficient human and technical resources (fixed establishment), a 'person' (i.e. the company or entity, and not necessarily solely one particular establishment thereof) is to be regarded as part of a single taxable person with other related entities (satisfying the financial, economic and organisational links) which likewise have the relevant territorial connection with that Member State.

[1] The *Skandia* case (C-7/13) was the first
[2] https://circabc.europa.eu/sd/a/6b41df03-ea14-423c-a9a6-7834347595fc/942%20-%20MT%20Consultation%20on%20VAT%20grouping.pdf

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1. Facts of the case

Danske Bank, a company established in Denmark (i.e. principal establishment), operated in Sweden via a branch (fixed establishment). *Danske Bank* used a computer platform for all activities undertaken by all the company's establishments and, in the case of the Swedish branch, the costs of the use of the platform by the Swedish branch were attributed / (notionally) charged to it by the principal establishment.

Danske Bank formed part of a Danish VAT group. Denmark operates an 'establishment-only' approach to VAT grouping, such that it only considered the Danish principal establishment to form part of the Danish VAT group, and not any fixed establishments located outside Denmark.

The Swedish Tax Agency took the view that the VAT group of which *Danske Bank*'s principal establishment was a member, on the one hand, and the Swedish branch of that company, on the other, were to be regarded as being two separate taxable persons, and that therefore the services provided by *Danske Bank*'s principal establishment, the costs of which are attributed to the Swedish branch, were to be regarded as supplies of services for the purposes of VAT.

The question referred to the CJEU:

Does a Swedish branch of a bank established in a Member State other than [the Kingdom of] Sweden constitute an independent taxable person where the principal establishment supplies services to the branch and imputes the costs thereof to the branch, if the principal establishment is part of a VAT group in the other Member State, while the Swedish branch is not a member of any Swedish VAT group?'

CJEU Decision:

The CJEU concluded that *the principal establishment of a company, situated in a Member State and forming part of a VAT group formed on the basis of Article 11, and the branch of that company, established in another Member State, must be regarded as separate taxable persons where that principal establishment provides that branch with services and imputes the costs thereof to the branch.*

2. Analysis

The CJEU's decision in this case reflects, in essence, its decision in the *Skandia* case (C-7/13), albeit dealing with a slightly different fact pattern (in *Skandia*, the head office was established outside the EU, and the branch was in an EU Member State and formed part of a VAT group in that Member State).

It is noted that the two cases addressed different questions: the question addressed by the CJEU in the *Skandia* case was whether supplies of services from a main establishment to its branch constitute taxable transactions when the branch belongs to a VAT group. On the other hand, in the *Danske Bank* case, the CJEU was asked whether a branch constitutes an independent taxable person where the principal establishment supplies services to the branch and imputes the costs thereof to the branch, if the principal establishment is part of a VAT group in its Member State.

However, both cases share an important similar feature: specifically, that in both cases the Member State of the VAT group adopted an 'establishment-only' system of VAT grouping. In other words, they considered the establishment located in their territory to form part of the VAT group, and not the entire entity.

The CJEU's analysis of the question brought before it in the *Danske Bank* case included a review of the relationship between a branch and head office for VAT purposes (as set out in the *FCE Bank* case) in the context of VAT grouping.

Head Office-Branch relationship for VAT purposes: the *FCE Bank* principle and VAT grouping

It is an undisputed principle that a branch is not a separate entity distinct from its head office, but the two establishments constitute a single legal person. This was recognised the by CJEU in the *FCE Bank* case (C-210/04), which recognised that a branch "*has no legal personality of its own*"[3] and determined that "*a fixed establishment, which is not a legal entity distinct from the company of which it forms part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of the costs imputed to it in respect of those supplies.*" The CJEU considered that the branch could not be seen to be acting independently, as in fact had been noted by the Advocate General that it was "*hardly conceivable that within the same legal entity a fixed establishment could enjoy sufficient autonomy to act on its own behalf and bear the entire economic risk*".[4] The AG had noted that "*By definition the branch is simply a*

[3] C-210/04 Para 23
[4] C-210/04 Advocate General's Opinion para 43

place of business with no legal personality"[5], recognising that the branch did not carry on business on its own account but merely as an extension of the legal person of which it formed part.

It would follow that, as a point of principle:

- One establishment of a company is not an entity or 'person' separate from another establishment thereof; and
- A head office and its branch are two establishments of one entity, and together constitute one person.

It therefore follows that services performed by one establishment for another establishment of the same entity are not regarded supplies of services for consideration falling within the scope of VAT.

However, as already determined by the CJEU in the *Skandia* case, and reaffirmed in the *Danske Bank* case in para. 22, the disregarding of branch-head office transactions for VAT purposes (i.e. the *FCE Bank* principle) may not necessarily apply where one of the establishments forms part of a VAT group.[6]

The *Danske Bank* case dealt with a VAT grouping system pursuant to which, when a company incorporated and having its principal establishment within its territory joins a VAT group within that territory, the principal establishment is **notionally separated from any other establishment located outside the territory, to join a separate taxable person for VAT purposes**. We consider that this notional splitting of the establishments of a single legal person (and the consequent non-application of the *FCE Bank* principle) is driven by the particular nature of the VAT grouping system in Denmark (as was the case also with Sweden in the *Skandia* case), which fact was recognised by the CJEU at various stages of the decision, reiterating the fact that "*the branch is a member of a VAT group.*"

It is submitted that this notional splitting of establishments of an entity does not, however, occur when that entity joins a VAT group in a Member State (in virtue of the fact that one of its establishments is located there) which considers the whole entity to form part of the VAT group.

In a Malta context, this reasoning is supported by Regulation 7 of the VAT Grouping Regulations (S.L. 406.21)[7] which recognises that there are Member States which apply an 'establishment-only' approach to

[5] C-210/04 Advocate General's Opinion para 46

[6] In this regard, it is noted that the CJEU in para 22 of the *Danske Bank* case states: *"However, as regards the classification of the legal relationship between the principal establishment and the branch of a company, it is also necessary to take into account whether those companies belong to a VAT group constituted under the first paragraph of Article 11 of the VAT Directive."* It is assumed that the reference to "those companies" was intended to mean "the company" or "those establishments" since the principal establishment and its branch are in principle one company (one legal entity) and not two companies.

[7] *"Notwithstanding that the provision of services by one establishment of a taxable person to another establishment of the same taxable person shall not constitute a supply of services for consideration by a taxable person acting as such for the purposes of article 4 of the Act, the provisions of regulation 6(1) shall not apply to supplies of services made by or to an establishment situated outside Malta if that establishment is a member of a VAT group in a Member State that operates a system of VAT grouping in terms of which the establishment alone, and not the entire enterprise of*

VAT grouping pursuant to which an establishment which joins a VAT group in that Member State is seen to have joined a separate taxable person for VAT purposes. The said Regulation 7 essentially withdraws the application of the 'disregarded supply' rule between VAT group members (the rule in terms of which a supply between Malta VAT group members is disregarded) when an entity which has a non-Malta establishment supplies services through that establishment to other entities in the Malta VAT group and vice-versa, and that non-Malta establishment belongs to a VAT group in another Member State which operates a system of VAT grouping in terms of which the establishment alone, and not the entire enterprise of which it forms part, is incorporated in a VAT group. This anti-abuse measure in effect recognises that, notwithstanding the fact that, for Malta VAT purposes, a non-Malta establishment of an entity and the Malta establishment of that entity constitute a single legal person, even where that entity forms part of a Malta VAT group, the disregarding of intra-group supplies for Malta VAT purposes does not apply where the establishment is located in a Member State which applies an establishment-only system of VAT Grouping (such as as Denmark and Sweden).

The Territorial limitation in article 11 of the VAT Directive

The wording of article 11 contains a territorial limitation, such that a Member State may only include in a VAT group persons established in that Member State:

"each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links."

We understand that in practice there are currently two varying interpretations and applications of the territorial limitation in the context of an entity having a principal establishment or a fixed establishment forming part of a VAT group on the basis that one of those establishments is located in their territory:

(i) Those Member States which only consider the establishment located within their territory to form part of the VAT group, thus notionally splitting the legal person (for example Denmark and Sweden); and
(ii) Those Member State which adhere to the principle of the indivisibility of legal persons and consider the entire entity to form part of the VAT Group.

As abovementioned, the *Danske Bank* case dealt with a Member State that adopted the interpretation at (i) above, since, as submitted to the CJEU, under the Danish legislation transposing article 11, only permanent establishments situated in Denmark may form part of a Danish VAT group. The CJEU considered that, where the principal establishment and branch of a company are situated in different Member States and one belongs to a VAT group, the legal relationship between them must be assessed by

which it forms part, is incorporated in a VAT group, and, in such circumstances, supplies of services made by or to the establishment situated outside Malta shall be treated, for the purposes of the Act, as supplies made by or to a separate taxable person."

taking account, first, of the fact that that group is placed on the same footing as a single taxable person and, second, of the territorial limits of that group.[8] The Court concluded in para. 29 that: *"having regard to the territorial limits resulting from the first paragraph of Article 11 of the VAT Directive, the Swedish branch of Danske Bank cannot be regarded as forming part of the Danish VAT group in question."*

It is our view that para. 29 is to be read in the context of the specific question which the CJEU was asked to determine and the relevant feature of the VAT grouping system applied in the case under review, specifically, the so-called 'establishment-only' feature, which only considers the establishment (the principal establishment or the fixed establishment, as the case may be) located within the territory of the Member State of registration of the VAT group to form part of that VAT group.

The CJEU was asked whether a Swedish branch of a bank established in another Member State is an independent taxable person where the principal establishment supplies services to the branch, *if the principal establishment is part of a VAT group in the other Member State*. The very question put to the Court sets out the particular feature of the VAT grouping system and asks for the status of the principal establishment to be determined in that context.

In our view, the CJEU, when assessing the said feature of the Danish VAT grouping legislation in the light of article 11, could only but conclude at para. 29 that the Swedish branch could not be regarded as forming part of the Danish VAT group, since, as recognised by the Court in the earlier para. 26, only one of the establishments belonged to a VAT group, i.e. the Danish establishment, thus forming part of a single taxable person with the other VAT group members.

It would therefore appear that the CJEU has effectively, once again, implicitly acknowledged the compatibility of the 'establishment-only' approach to VAT grouping with article 11 of the VAT Directive, effectively recognising that, where the Member State only considers an establishment to join a VAT group, with that establishment forming part of a separate single taxable person (notionally split from the legal person of which it forms part), then the other establishment(s) of the same legal person cannot properly be regarded as forming part of that VAT group in the Member State concerned.

It is however submitted that the conclusion of the CJEU in the Danske Bank case should not find application in a scenario in which the Member State in which the VAT group is registered considers the whole entity to form part of a VAT group (such as Malta). The treatment, by the Member State of registration of the VAT Group, of the legal entity itself (i.e. the whole entity) as part of the VAT group, essentially implies that, for the purposes of the application of the VAT legislation in that Member State, the establishment in that Member State and any establishment of the same entity located outside that Member State, as a single legal entity, together with the other members of the VAT group, would

[8] Para. 26

constitute a single taxable person. As a result: (i) transactions between that entity (from any establishment thereof) and other VAT group members would be disregarded for VAT purposes; and (ii) the *FCE Bank* principle would apply to 'transactions' between two establishments of the entity.

In our view, while it would appear that, in the *Danske Bank* case, the CJEU has effectively acknowledged the compatibility of the 'establishment-only' approach to VAT grouping with article 11 of the VAT Directive, this does not imply that the 'whole-entity' approach, on the other hand, is incompatible with article 11.

Firstly, it is noted that the CJEU is bound by the facts presented and addresses the specific question submitted. It cannot and does not develop general rules.

Secondly, it is submitted that the so-called 'whole-entity' approach is compatible with the express language of article 11 of the VAT Directive, which permits Member States to "*regard as a single taxable person any persons established in the territory of that Member State.*" As recognised by the CJEU in the *FCE Bank* case, a fixed establishment is not a legal entity distinct from the company of which it forms part; thus, all establishments of an entity together comprise the 'person', and not merely one of the establishments taken alone.

On this basis, it is contended that, while article 11 provides a territorial limitation, the establishment requirement is one that provides the connection (of presence) between a person and a Member State so as to be eligible to join a VAT group. By establishing a presence in a Member State, whether by having a place of central administration (Article 10 of Regulation 282/11) – i.e. the primary establishment – or sufficient human and technical resources (article 11 of Regulation 282/11) – i.e. a fixed establishment – a 'person' (i.e. the company or entity, and not necessarily solely the establishment) may be regarded as part of a single taxable person with other related entities (satisfying the financial, economic and organisational links) which likewise have the relevant territorial connection with that Member State.

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