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German Tax and Legal News

Ministry of Finance issues draft guidance on implementation of CJEU Skandia decision

Services provided by a foreign head office to a German branch belonging to a VAT group would be taxable in Germany under the reverse charge procedure.

Germany's Federal Minister of Finance (MOF) released draft guidance to the tax associations (organizations that represent the interests of business and industry on tax matters) for comments in late July 2018, outlining the position it plans to take in revising Germany's VAT rules to reflect the Court of Justice of the European Union (CJEU) decision in the Skandia case. The CJEU held on 17 September 2014 that where a branch of a foreign company is a member of a VAT group in an EU member state, services provided by the foreign head office to the branch fall within the scope of VAT and should be accounted for under the reverse charge procedure by the VAT group. This decision has had a significant impact on the VAT grouping rules in a number of EU member states and on companies that take advantage of VAT grouping provisions.

Based on the MOF's draft guidance, the principles of the Skandia decision would apply in Germany only in circumstances similar to those considered in the Skandia case; under other circumstances, transactions between a foreign head office and its German branch could remain nontaxable.

Background
VAT grouping allows qualifying groups to be treated as a single taxable person for VAT purposes, which means that VAT does not have to be accounted for on goods or services supplied between group members, and the group can file a single consolidated VAT return.

Under German law, services provided by a foreign head office to its German branch are not taxable because the branch is part of the same legal entity (i.e. the foreign company). From the point of view of the head office, the branch is part of the head office and merely represents the German presence of the foreign head office. A cross-border service is, therefore, an internal, nontaxable transaction.

A domestic branch may belong to a domestic VAT group, e.g. with a domestic affiliate of the foreign head office as its parent company. In this case, the branch represents an "intersection" between the domestic parent company and the foreign head office—the relationship between the branch and the domestic parent company on one hand, and that between the branch and the foreign head office on the other, affects supplies between the domestic parent and the foreign head office. It is possible, e.g. to transfer software from the head office to the domestic parent without incurring VAT, which will result in lower costs where the recipient of the supply is not entitled to deduct input VAT (as in the case of a financial services provider).

The CJEU considered similar circumstances in the Skandia case, which involved Sweden's VAT grouping rules. Skandia America Corporation, a US entity, was the global purchasing company for information technology (IT) services for the Skandia group. The US company carried out its activities in Sweden through a Swedish branch, which processed the externally purchased IT services supplied to it by the US head office and then supplied these services to various entities in the Skandia group. The CJEU held that, where a branch of an overseas entity is part of a VAT group in an EU member state, any supplies of services made by an overseas head office in a non-EU country to the branch are considered to be made to the VAT group as a whole and, therefore, subject to VAT. The CJEU ruled that the VAT group was a separate taxable person from any of the group members, so the services could not be considered to be supplied within the same company. As a result, the VAT group was responsible for accounting for VAT on the supply under the reverse charge mechanism.

The German tax authorities have taken the position in the past that intra-entity services between a head office and its branch are not taxable even if the branch is part of a VAT

group (as provided in section 2.9, paragraph 2, sentence 2 of the German VAT Act Application Decree.). The Skandia decision has not been reflected in the relevant administrative instructions, although this is likely to change.

Draft MOF letter
According to the draft letter released by the MOF, the principles enunciated by the CJEU in the Skandia case should apply only to cases in which services are carried out between a head office in a third country and its branch belonging to a VAT group in an EU member state. Cross-border transactions within a company, particularly between a head office and its branches, or vice versa (with the exception of intracommunity shipments of goods) generally would be regarded as nontaxable internal transactions. However, services between a head office in a third country and its German branches that belong to a VAT group in Germany would not be considered internal transactions.

Once the tax associations have provided their comments on the draft letter, the MOF will consider the comments before publishing final guidance that will amend section 2.9 of the German VAT Act Application Decree to reflect the Skandia section. It is possible that the MOF may make further changes to the guidance based on comments by the associations.

Once finalized, the new rules would apply to all open cases, although the MOF would permit the existing version of section 2.9 German VAT Act Application Degree to be applied to transactions carried out before 1 January 2019.

Comments
According to the position reflected in the draft guidance, the affiliation of a branch with a VAT group would take precedence over the general principle that a head office and its branch are part of the same legal entity, with any transactions between the two disregarded. However, this treatment would apply only where services are provided between a head office in a third country and its domestic branches affiliated with a VAT group. The draft letter does not address "reverse Scandia" situations, where the part of the group of companies located abroad is a member of a VAT group, so whether a taxable transaction would be deemed to arise in these cases remains open. Since the draft guidance states that the Skandia principles would apply only to similar circumstances, this suggests that the MOF continues to take the position that, in principle, the branch is a dependent part of the head office and taxable services cannot be provided between the two (with an exception for intracommunity shipments, which are regulated by a special law).

In any case, services provided between a third country head office and a branch in a German VAT group should be reviewed before the “non-objection period” expires (i.e. the period during which the tax authorities can object to the application of the previous instructions in the VAT application decree) as to whether the change in administrative opinion will have specific consequences under the VAT law.

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