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Indirect Tax Alert

Spanish Central Tax Court issues resolution on services between head offices and branches

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Executive summary

The Spanish Central Tax Court (SCTC) has recently issued a paramount resolution[1] on the Spanish Value-Added Tax (VAT) implications related to services rendered by foreign head offices (HOs) to branches located in the Spanish territory (i.e., cost allocations between HO and branch), on the basis of several pronouncements of the European Court of Justice (ECJ).

First, this resolution states the need to perform independence tests when assessing whether transactions between HOs and branches are to be deemed within the scope of VAT. If, according to such test, the HO and its branch are considered as independent and, therefore, different VAT taxable persons, transactions performed would fall in the scope of the VAT.

Additionally, the resolution elaborates on the impact, in relation to the imposition of VAT on transactions performed between an HO and its branch in Spain, resulting from the inclusion of such branch in a Spanish VAT Group.

The resolution has to be interpreted in light of several intimately related ECJ judgements,[2] which are outlined below.

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While this is the first resolution issued by an administrative (tax) court on this matter, the conclusions set out in relation to the independence test are consistent with the views of the Spanish General Directorate of Taxes (GDT) embodied in several binding rulings issued from 2017 onwards.[3] Therefore, this position is now held by the entire tax administration, including the tax audit bodies, the GDT, and administrative courts.

Detailed discussion

Background

The case at hand relates to management support services rendered by XY PLC (XY), resident for tax purposes in Ireland, to its branch in Spain (XY Spanish Branch), who had in turn inherited the business formerly developed by a group subsidiary in Spain (X España), who belonged to a VAT group in Spain (VAT Group).

X España used to receive management support services, that were being rendered by the group's central headquarters in Switzerland (XY Switzerland), and was self-charging Spanish VAT upon their reception, under the application of the Spanish reverse-charge clause.

As a consequence of a branching process, X España was dissolved, and the totality of its assets and liabilities were transferred in full to a newly created branch, XY Spanish Branch, who would now be receiving the relevant services from its HO. The HO would have received, in turn, the relevant services from XY Switzerland, that were subsequently charged to XY Spanish Branch.

At the level of the SCTC, the analysis regarding the imposition of Spanish VAT on the HO-branch services is approached through two main cornerstones:

1. The need to perform an **independence test** when determining whether a branch may be deemed as independent from its HO for VAT purposes (ECJ's judgment in the *FCE Bank* case), not being sufficient to conclude on the basis of the branch not having a separate legal personality from its HO, but rather requiring an analysis of risks assumed by the branch and the means assigned or available for such risk-bearing.
2. The importance of the branch belonging to a **Spanish VAT Group** (ECJ's judgment in the *Skandia* case), in terms of determining that an HO and a branch do not necessarily have to be deemed as a single taxable payer.

ECJ's reasoning

Independence

The SCTC begins its reasoning by referring to a wide number of ECJ judgments,[4] and establishes the milestone of the independence analysis by introducing that, even if it is apparent from the ECJ's case law that a principal establishment and a branch constitute a single taxable person subject to VAT (legal personality approach), it is necessary to determine whether the branch carries out an independent economic activity, in terms of bearing the economic risk arising from its business. Therefore, the SCTC opts for an economic independence approach based on the assumption of risks by a branch.

The SCTC then considers the criterion in other ECJ cases,[5] where the ECJ provides a comprehensive explanation of aspects that determine the independence in the activity performed by different types of entities, irrespective of legal personality. The SCTC concludes that the existence (or the absence) of different legal personalities is not related with the condition of taxpayer, which in turn relies on the features of the activity performed.

The SCTC then addresses the independence in the risk assumption stating that, besides the fact that at some level a branch will have a certain dependency to its HO as it lacks legal personality for itself, it will be deemed as acting on an independent basis where it is assuming the result of the activity in the first instance (e.g., income and expenses), irrespective of the fact that, subsequently, any risk arising from the activity will be transferred to the entity who, having a legal personality of its own, has incorporated the branch.

This statement is applicable regardless of the fact that a permanent establishment, lacking legal personality, has or does not have the relevant assets allocated to afford hypothetical losses derived from its activity.

Other aspects considered by the SCTC refer to the permanent establishment having:

(i) Disposal of all the necessary assets to perform the activity

(ii) Decision taking powers in relation with the normal development of its business

(iii) Necessary human resources

(iv) A risk policy, regarding the normal performance of its activity, comparable to that of any other entity with legal personality that carries out an equivalent activity

Considering the above, the SCTC concludes that independency must be predicated of XY SB with respect to its HO, and therefore the costs allocated to the branch are deemed as services within the scope of VAT, triggering the reverse-charge mechanism.

Among others, the particular features of XY SB on which the SCTC focuses to base its conclusion are the following:

- XY SB relies on the exact same assets for the development of its business as those that used to be held at the level of X España before the branching process, and XY SB has continued its activity in identical terms as the previous subsidiary.
- With respect to the functions performed, and attending to the group's transfer pricing documentation, XY SB continues to perform the same functions as used to be performed by X España, in particular:
  - It covers in identical terms the insurance risks it writes.
  - It retains a central team in charge of casualty management.
  - From the transfer pricing documentation, it may be determined that the branch constitutes an independent technical insurer.
- XY SB assumes both market and financial risks derived from its business, as not only it has its own risk management policy, but also has the necessary technical reserves for the risk assumption.
- The decision taking powers of XY SB's directives and employees is reflected also in a variable retribution scheme, based on the fulfillment of objectives.

VAT grouping

In a different line of argument, the SCTC considers the ECJ's judgment in the *Skandia* case, and with respect to the particular characteristics of the Spanish VAT Grouping regime clarifies that even if the Spanish VAT legislation does not configure the VAT Group as a single taxpayer from a formal perspective, the Skandia doctrine applies to Spanish VAT groups opting for the advanced modality.

In summary, this special modality provides for a number of rules regarding the calculation of the tax base of intra-group transactions and the deductibility of input VAT that, even though it allows the existence of different taxpayers from a VAT perspective, it is based on the principles set out by the VAT Directive for the grouping schemes, according to the SCTC.

Therefore, Spanish VAT Groups that have opted for the advanced modality (as opposed to the basic, which only implies the aggregation of VAT results) qualify for the application of the Skandia doctrine and, accordingly, services rendered by an HO to its branch belonging to a VAT Group should be regarded as different taxpayer, to the extent that transactions should no longer be deemed as taking place between the HO and its branch, but rather between the HO and the VAT Group.

Recipient of the services

The SCTC's resolution does not address an additional aspect that is however pointed out by the tax audit body and refers to the consideration of XY SB as the recipient of the services provided by XY Switzerland.

Indeed, the tax audit body argued that XY SB should be the recipient of the services rendered by XY Switzerland, instead of its HO, on the basis that most of the concepts for which the branch is charged correspond to material and human resources allocated to the Swiss entity, which also holds the legal position of the services provider.

While the tax audit body accepts that a certain amount of management fees are charged by the HO to XY SB, it considers that most of the costs allocated to the branch (e.g., Investment Management dealings, IT, Trademark) are deemed to be services rendered by XY Switzerland, which holds the resources for the provision of such services, directly to XY SB.

This argument would imply that, in relation with services rendered to an HO by third parties that are subsequently charged to its branches, such branches could be deemed the direct recipients of the services irrespective of whether these are deemed as independent from its HOs or if they are included within a VAT Group. In summary, this position is triggered when the HO does not have the relevant resources and means to render the services that are charged to the Branch.

The SCTC does not develop this argument as, considering its conclusions, XY SB has to apply the reverse-charge mechanism either way due to the application of the FCE Bank and Skandia principles.

However, this position should be carefully considered, to the extent that it may allow Spanish branches to be deemed as the direct recipients of the services provided by third parties to their HOs, and therefore, not requiring consideration of the referred FCE Bank or Skandia principles.

Implications

From the SCTC resolution it may be concluded that the automatic consideration of HOs and branches being deemed as a single taxable person has been overcome, and that either the independence test or the application of the Skandia principle could imply that such entities are deemed as independent for VAT purposes and, consequently, the transactions performed are subject to VAT. This analysis should be made on a case-by-case basis.

The independence test has to be performed from the study of different strands of an activity, in terms of the assets required, liabilities and risks assumed, functions performed, and availability of human and material means.

The SCTC has place a very significant importance on the information contained in the transfer pricing documentation, not only because it can be descriptive of the functions performed by a branch, but also because the assignations of results or resources relies on an analysis of the functions it performs. Accounting and legal information are also considered for these purposes.

It is important to highlight that the SCTC's resolution is the first explicit manifestation on the applicability of the Skandia doctrine to the Spanish VAT Grouping system and addresses a matter of great concern within the Spanish VAT doctrine. A wide number of questions arise, especially when it comes to the different characteristics triggering the Skandia principle in each of the jurisdictions involved. Particular mention should be made to the different approaches adopted by the European Union Member States in relation with the Skandia principle, which should be considered in order to adopt a reasonable position within a multinational group.

Endnotes

1. SCAC Resolution of 23 January 2020 (00/05047/2016/00/00).
2. Namely cases C-210/04 (*FCE Bank*), C-7/13 (*Skandia*), C-16/17 (*TGE Gas Engineering*), and most recently, C-165/17 (*Morgan Stanley*).
3. Among others, binding rulings V1704-17, issued on 30 June 2017 and V-3350-19, issued on 10 December 2019.
4. Highlighting *FCE Bank*, *Morgan Stanley*, see references above, and cases C-393/15 (ESET) and C-388/11 (*Le Crédit Lyonnais*).
5. Cases C-276/14 (*Gmina Worclaw*), C-23/98 (*Heerma*) and C-340/15 (*Nigl*).

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