



KMLZ VAT NEWSLETTER

Reverse-charge for cross-border internal supplies

1. The problem

Cross-border supplies of services between a company's head office and its foreign fixed establishment are usually to be treated as non-taxable supplies, as the concept of a taxable person does not stop at the border. To date, this principle has only been broken in the case of the movement of goods across the border. This movement of goods is an intra-Community self-supply. A different rule applies for the cross-border supply of services. In these cases, the reverse-charge-scheme, in accordance with sec. 13b of the German VAT Act, was not applicable.

This situation was especially of interest to companies if the establishment or head office was not entitled to full input VAT deduction in accordance with sec. 15 para. 2 of the German VAT Act. By treating these supplies as non-taxable, no VAT burden existed for the company.

Caution required for foreign establishments

To date, supplies carried out in the form of services between a company's head office and its foreign fixed establishment, have been treated as non-taxable supplies. The principle of unity of the taxable person even applied internationally. The ECJ has now restricted this principle. The reverse-charge-system may apply if the foreign establishment belongs to a VAT group in another country.

2. Restrictions by the ECJ

By judgment of 17 September 2014 in the case C-7/13 – *Skandia*, the ECJ decided that the services are indeed subject to VAT if the establishment is part of a VAT group in another country. In this case, the reverse-charge-system is applicable.

Although this judgment was handed down regarding Swedish law, it is also important for German VAT law as the national case law and fiscal authorities have taken a different view on this matter.

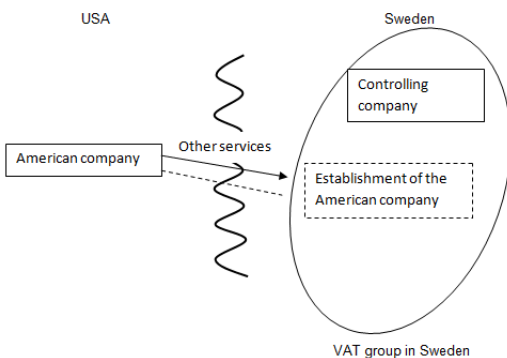
The judgment is based on the following facts: An American company was the central purchasing company for IT services in an affiliated group. The said company supplied IT services within the group, inter alia, to a Swedish establishment. What was of special significance in this case, however, was the fact that the Swedish establishment belonged to a Swedish VAT group.



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The Swedish establishment treated the purchased services as non-taxable supplies and therefore did not apply the reverse-charge-system.

The ECJ rejected this treatment. According to the ECJ's point of view, the establishment was a dependent part of the VAT group. It stated, "the establishment forms one individual taxpayer together with the other members". For this reason, the services cannot be regarded as purchased by the establishment but rather, are to be qualified as services carried out for the VAT group. Therefore, the VAT group owed VAT as the reverse-charge-scheme did in fact apply.



3. Consequences of the judgment

The judgment has far-reaching consequences for affiliate groups. It is essential to apply the reverse-charge-scheme with respect to both supplies of a foreign head office to a German establishment and for supplies of a German head office to an establishment in a foreign EU Member State.

If the foreign establishment is part of another VAT group, the supplies can no longer be regarded as non-taxable supplies. In this case, the supplies are "normal" supplies, which are subject to the reverse-charge-scheme.

As a consequence, the supplies have to be identified and accordingly posted as the relevant supplies need to be included in the EC Sales List. Furthermore, the establishment has to report the reverse-charge-supplies.

At least, this will be the case if the German fiscal authorities decide to implement this judgment. At this stage, it is to be assumed that this will happen, as the ECJ made clear statements regarding this matter. The fiscal authorities will have to adapt these regulations in sec. 2.9 para. 2 sentence 2 of the German Administrative Circular. It is to be hoped that a transitional period will be granted.

This new system may be workable, from an organizational point of view, however, it might be difficult if a particular establishment or head office is not entitled to a full VAT deduction, as this will naturally lead to additional VAT burdens. Financial service providers will, especially, be affected by this. It will no longer make financial sense for them to purchase IT services from a foreign establishment as they will no longer be able to charge the services as non-taxable supplies to the German head office. This particularly applies, if the foreign establishment is part of another VAT group. The only possibility would then be to dissolve the VAT group in the other EU Member State.