

United Kingdom: The emergence of a "new" fixed establishment for VAT grouping – Insights from Barclays

In brief

It is widely recognised that UK VAT grouping rules are "business friendly" due to the whole establishment concept, which allows for overseas entities to join a VAT group through the prism of a UK fixed establishment (or branch). By contrast, most EU VAT groups recognise the establishment only concept whereby overseas entities are not allowed to join a domestic VAT group. However, in recent years, HMRC seem to have seriously reconsidered the UK approach by developing lines of arguments which effectively seek to directly or indirectly apply the so-called Skandia doctrine. This was apparent in the decision issued by the First-tier Tribunal on 29 August 2024 in the Barclays case in which the judge agreed with HMRC that an offshore group entity did not meet the requirements to have a fixed establishment for UK grouping purposes.

Sadly for taxpayers, this judgment, read in conjunction with the decision from the Upper Tribunal in HSBC on similar issues, is likely to cast shadow on the use of grouping as a VAT optimisation vehicle. Luckily, at this stage, one can find some comfort on the non-binding nature of the decision as well as some positive implications arising from the judgment.

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In depth

Introduction

The decision of the First-tier Tribunal (**FTT**) in Barclays Service Corporation and others v HMRC [2024] UKFTT 00785 (TC) is yet another piece of the jurisprudential jigsaw relating to VAT grouping. There are various issues addressed in the judgment, but the central issue is concerned with the eligibility requirements related to the concept of "fixed establishment" of an offshore entity under s43 of the Value Added Tax Act 1994 (**VATA**). In particular, the FTT was asked to consider under which conditions is an offshore entity, through its UK branch, capable of belonging to a UK VAT group.

Similar to HSBC Electronic Data Processing (Guangdong) Ltd and Others v HMRC [2022] UKUT 41 (TCC), there are a number of cases sitting behind Barclays. It will therefore come as no surprise that the Barclays case will be closely scrutinised by many in the industry with a similar fact pattern.

Background to the case

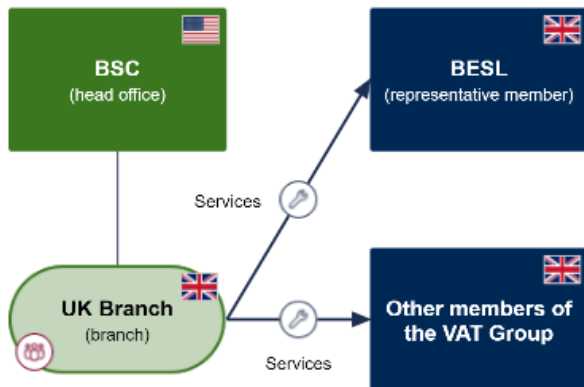
This was an appeal made by Barclays Services Corporation (**BSC**) and Barclays Execution Services Limited (**BESL**) (together, the **Appellants**) against the decision of HMRC to reject the VAT group application made by BESL, acting as representative member of a VAT group (**VAT Group**), for BSC to join the VAT Group.

BSC is a company with limited liability that is registered in the United States of America (**US**). BSC was incorporated in the US in 1993. BSC and BESL are under the same common indirect ownership of Barclays plc. BSC carries out services to other members of the Barclays group, including BESL and other members of the VAT Group.

BSC has a UK branch (**UK Branch**), which was registered with Companies House as a UK establishment of BSC since July 2017. On 1 December 2017, the Appellants submitted an application for the UK Branch to join the VAT Group in accordance with s43B(2) VATA. The UK Branch had four people under an employment contract (from Head of to Vice President roles). These employees

previously held other roles within the Barclays organisation in the UK. The initial place of work of these employees was Radbroke Hall in Cheshire. The cost of these premises was recharged by a Barclays group entity to the UK Branch.

The structure can be depicted as follows:



On March 2018, HMRC issued a notice to the Appellants stating that the application was refused on the grounds that:

- BSC was not eligible to be treated as a member of the VAT Group because it is neither established nor has a fixed establishment in the UK; and
- Alternatively, that if BSC does have a fixed establishment in the UK, it was nevertheless necessary to refuse the application for the "protection of the revenue".

This decision was challenged by the Appellants subsequently, but HMRC stood its ground, which ultimately led to an appeal before the FTT. In the context of the case, the parties agreed the following list of issues:

1. Does the UK Branch constitute a fixed establishment under s43A VATA (the "**fixed establishment issue**")?
2. Does the wording of VATA contain a territorial limitation such that a UK VAT group does not include establishments outside the UK (the "**Danske Bank**" issue)?
3. Alternatively, is it the case that HMRC could not reasonably have been satisfied that it was necessary for the protection of the revenue to refuse the Appellants' application (the "**protection of the revenue**" issue)?

The fixed establishment issue

Both parties accepted that BSC and the members of the VAT Group were under common control. It was also agreed that BSC – which is a US company – is not established in the UK. The crucial point was whether the UK Branch constituted a "fixed establishment" in the UK.

HMRC's case on the fixed establishment issue in Barclays is very similar to that it had advanced in HSBC. HMRC argued that there is no jurisprudence of the CJEU on the meaning of the phrase "persons established in the territory of that Member State" unlike phrases such as "has established his business" and has "fixed establishment" (concerned with the place of supply) and that jurisprudence should inform the interpretation of established and a fixed establishment in s43A VATA. Therefore, on the basis of the case law relating to the meaning of fixed establishment, primarily in the context of the place of supply rules, a UK branch must meet the following three conditions:

1. it must have a real trading presence in the UK and must supply goods or services in its own right, those goods or services being neither preparatory or auxiliary, but material to the business of the person in question;
2. it must have sufficient permanent resources to be able to supply those goods or services; and
3. it must have sufficient permanent resources to receive the supplies required to enable it to provide those goods or services.

By contrast, Barclays argued that, although it is clear from the Upper Tribunal's decision in HSBC that the concept of fixed establishment in the context of place of supply should "inform", and therefore should be taken into account, it cannot simply be imported and applied. Barclays contended that since the place of supply rules and the VAT grouping legislation serve different purposes and have a different focus, it is necessary, given the observations by the Upper Tribunal in HSBC, for the place of supply principles to be adapted accordingly.

In the context of grouping, Barclays contended that the only question to address is whether a person is established in a Member State characterised by a "sufficient degree of permanence and a suitable structure in terms of human and technical resources". Interestingly, Hitchmough KC, acting for Barclays, brilliantly argued that the reference to the need for "human and technical resources" goes to the question of whether there is an establishment in the UK and the reference to "sufficient degree of permanence" goes to the question of whether any establishment that might exist was fixed (see paragraph 155 of the decision). As such, nothing more is required provided the human and technical resources in the UK make a meaningful commercial contribution to the business of the non-UK company.

In determining the fixed establishment point, the FTT analysed whether the UK Branch had the sufficient human and technical resources in the UK to make a meaningful commercial contribution to the non-UK company, ie BSC, when the VAT grouping application made on 1 December 2017. The FTT referred to the AG Kokott in Welmory at paragraph 48 in which she applied a "comparable control" approach, ie "even if a fixed establishment does not necessarily require its own human and technical resources, the taxable person must nevertheless—based on the requirement for a sufficient degree of permanence in relation to the establishment—have **comparable control over the human and technical resources.**" (emphasis added) This was upheld in *Hastings Insurance Services Limited v HMRC* [2018] UKFTT 27 (TC) in which the FTT asserted that a requirement for some element of control of the relevant resources is an essential element of the fixed establishment test.

When applying the law to the facts, the FTT considered the following (it must be noted that Barclays submitted a large amount of evidence in relation to the contextual backstop related to the creation of the UK Branch):

- human resources: while accepting that the employment contracts for the various employees had a starting date of 1 December 2017, none of them actually started on that day except one employee. In respect of the latter, the FTT noted that (i) the vast majority of this employee's time was allocated to a function she had with another entity of the group, and (ii) she was under the supervision of an employee of that other group entity rather than a manager from BSC. Therefore, the FTT held that it was unable to find that there was the required "comparable level" of control by the UK Branch over that employee.
- technical resources: the FTT pointed out that there was no evidence of the UK Branch having "comparable control" to an owner of any assets as at 1 December 2017. There was also no evidence of any formal arrangement by which the UK Branch was permitted to occupy the space allocated to it at Radbroke Hall.

In the absence of such comparable control over the human and technical control resources by the UK Branch, the FTT concluded that the UK Branch does not, as a matter of fact, satisfy the criteria necessary to be a fixed establishment of BSC.

The Danske Bank issue

This issue concerns the construction of s43A VATA and whether it allows the entire eligible non-UK entity into a UK VAT group – ie the whole establishment construction – or only that part of the non-UK entity established in the UK – ie the domestic establishment construction.

HMRC contended that the whole establishment construction has been brought into question by the decision of the CJEU in *Danske Bank* (Case C-812/19). In *Danske Bank* the issue was whether the head office of a company, situated in a Member State and forming part of a VAT group, and the branch of that company, established in another Member State, constitute separate taxable persons so that any supply between the two establishments falls within the scope of VAT. The CJEU concluded that the branch in Sweden cannot form part of the Danish VAT group where the head office belongs.

Interestingly enough, the FTT held that it was not equipped to analyse whether the whole establishment construction was the right one, and that any change "would give rise to important practical repercussions". It therefore follows that because of its broad and far-reaching effect, it is not possible for the FTT to give a conforming construction to s43A VATA.

The protection of the revenue issue

HMRC may refuse an application for a company to be treated as a member of an existing VAT group under s43B(5)(c) VATA if that refusal is "necessary for the protection of the revenue." However, the Tribunal cannot allow an appeal unless it considers that HMRC "**could not reasonably have been satisfied** that there were grounds for refusing the application" (emphasis added) (see s84(4A) VATA).

Based on *Lloyds Banking Group plc and others v HMRC* [2019] STC 1134, Barclays contended that VAT grouping is a business facilitation measure allowing a business choice over its corporate structuring, enabling complex multinationals to group and be taxed in the same way as a single company organised in divisions. By contrast, HMRC argued that it is to remove complexity in relation to VAT accounting.

Referring to HSBC, the FTT held that the issue is whether HMRC "could" reasonably have decided to refuse the application of BSC to join the VAT Group, not whether they had reasonably done so in this case. Even if HMRC had actually been unreasonable, it would not be determinative as HMRC are entitled to refuse the application on the basis that it was necessary to do so for the protection of the revenue.

The FTT concluded that, had it found on the facts that, as at 1 December 2017, the UK Branch had the necessary human and technical resources to be a fixed establishment of BSC, the VAT savings on its admission to the VAT Group would be those that fell within the normal consequences of VAT grouping.

Where does that leave us?

Although the conclusion reached by the FTT is on balance disappointing overall, it deserves some unpicking. First, on the fixed establishment issue, the FTT seemed to have been persuaded by Barclays (the judge refers to "Assuming that Mr Hitchmough (Barclays' KC) is correct" at paragraph 156 and then applies his proposition) that, in order for the UK Branch to constitute a fixed establishment, it should make a meaningful contribution to the business via its human and technical resources but "nothing more". Even though the FTT stated that "the precise meaning of the terms 'established' and 'fixed establishment' should be determined in a subsequent case" at paragraph 156, this interpretation suggests that a fixed establishment under s43A VATA has a different scope *ratione materiae* than a fixed establishment usually defined by reference to the place of supply rules (which would deviate from the approach in HSBC).

If this is correct – and perhaps leaving aside what one should construe by "meaningful" – it potentially puts the bar lower for a fixed establishment to crystallise for VAT grouping purposes since there is no need for such establishment to make or receive supplies. Whilst it is unfortunate that not all the resources were up and running on 1 December 2017 when the application for VAT grouping was made by Barclays, it is perhaps not entirely bad news since, if taxpayers can evidence that a UK branch has its own resources or comparable control over those resources (whether on the day of VAT group application or during membership) from the day of the application, the UK branch should arguably meet the threshold for a "VAT group fixed establishment". This is particularly helpful for businesses that have been challenged by HMRC on the grounds that the branch did not make or receive supplies, even though it possesses an adequate amount of human and technical resources. On the flip side, admittedly, it creates two types of fixed establishments: one for VAT grouping purposes and one for the place of supply rules. No one said VAT was straightforward though.

The Danske Bank issue was remarkably quashed by the UT in HSBC (mostly for procedural reasons) but HMRC have hammered on it once again in Barclays. This comes as a real surprise for two reasons. First, as the FTT rightly points out, the UK has always applied a whole establishment construction of s 43A VATA and stood out as the most friendly jurisdiction in that regard (together with few other Member States at the time of EU membership). It is therefore disappointing to see that HMRC are now somewhat reversing course, singularly post-Brexit, in order to apply the "Skandia and reverse-Skandia" doctrine in the UK VAT landscape, with no apparent consideration for the wider legal and economic implications for businesses and UK plc as a whole. Second, the author remains unconvinced that the whole establishment construction is actually nipped in the bud by Danske Bank. There are legal arguments for the existing UK interpretation to withstand the judgment of the CJEU on the grounds that Danske Bank does not define the concept of "person" set out in Article 11 of the VAT Directive, *de facto* not expressly ruling out the whole establishment approach. It is remarkable that the FTT recognised being ill equipped to tackle the immense backdrop underpinning the whole establishment approach, and decided not to give a confirming construction. An elegant example of kicking the can down the road.

It is not all disturbing news, however. In respect of the protection of the revenue issue, the FTT clearly rejected the proposition put forward by HMRC that VAT grouping was only an administrative simplification confined to accounting resulting in grouping being rejected where there is any loss of revenue. This is obviously welcome since grouping pursues a wider objective of allowing taxpayers to freely structure their affairs pursuant to their commercial needs while still normally taxing transactions made to and from the VAT group as single taxable person. As a result, there are no reasonable grounds for HMRC to refuse an application to join a VAT group solely based on the expected – ie normal – VAT savings deriving from intra-group "supplies" made between establishments of the same person since these savings are at the core of normal grouping benefits (ie excluding evasion or avoidance scenarios). Had the FTT concluded that the UK Branch constituted a fixed establishment for grouping purposes, HMRC would have lost this argument. This is potentially helpful for other taxpayers whose applications have been refused or group membership have been terminated based on the protection of the revenue if their only "sin" is to benefit from the normal consequences of grouping. That said, life is not that simple and defining what is "normal benefit" may be subject to debate. Nonetheless, this interpretation seems to be more generous for taxpayers than the one in HSBC in which the Upper Tribunal concluded that the protection of the revenue was not limited to abusive scenarios.

At this juncture, the future of UK VAT grouping hinges on hope, and hope is the last thing lost.

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