JUDGMENT OF THE COURT (Second Chamber)

23 March 2006 *

In Case C-210/04,

REFERENCE for a preliminary ruling under Article 234 EC, from the Corte Suprema di Cassazione (Italy), made by decision of 18 February 2004, received at the Court on 12 May 2004, in the proceedings

Ministero dell'Economia e delle Finanze,

Agenzia delle Entrate

v

FCE Bank plc,

* Language of the case: Italian.

THE COURT (Second Chamber),

composed of C.W.A. Timmermans, President of the Chamber, J. Makarczyk, R. Silva de Lapuerta, P. Kūris (Rapporteur) and G. Arestis, Judges,

Advocate General: P. Léger,
Registrar: H. von Holstein, Deputy Registrar,

having regard to the written procedure and further to the hearing on 9 June 2005,

after considering the observations submitted on behalf of:

— FCE Bank plc, by B. Gangemi, avvocato,

— the Italian Government, by I.M. Braguglia, acting as Agent, assisted by G. De Bellis, avvocato dello Stato,

— the Portuguese Government, by L. Fernandes, Â. Seiça Neves and R. Laires, acting as Agents,

— the United Kingdom Government, by R. Hill, Barrister,

— the Commission of the European Communities, by D. Triantafyllou and M. Velardo, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 29 September 2005,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 2(1) and 9(1) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, 'the Sixth Directive').

2 The reference was made in the course of proceedings between the Ministero dell'Economia e delle Finanze (Ministry of Economic Affairs and Finance) and the Rome Agenzia delle Entrate (Revenue Agency) ('the Agency'), and FCE Bank plc, a bank established in the United Kingdom ('FCE Bank'), concerning the repayment of sums paid in respect of value added tax ('VAT') by its subordinate entity established in Italy ('FCE IT').

Law

Community law

The Sixth Directive

3 Article 2 of the Sixth Directive states:

'The following shall be subject to value added tax:

1. the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such;

...'

4 Article 4(1) of the Sixth Directive provides:

'"Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.'

5 Article 9(1) of the Sixth Directive states:

'The place where a service is supplied shall be deemed to be the place where the supplier has established his business or has a fixed establishment from which the service is supplied or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides.'

The Eighth Directive 79/1072/EEC

6 Article 1 of Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in the territory of the country (OJ 1979 L 331, p. 11, 'the Eighth Directive') provides:

'For the purposes of this Directive, "a taxable person not established in the territory of the country" shall mean a person as referred to in Article 4(1) of Directive 77/388/EEC who, during the period referred to in the first and second sentences of the first subparagraph of Article 7(1), has had in that country neither the seat of his economic activity, nor a fixed establishment from which business transactions are effected, nor, if no such seat or fixed establishment exists, his domicile or normal place of residence, and who, during the same period, has supplied no goods or services deemed to have been supplied in that country ...'

Directive 2000/12/EC

7 Article 13 of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking-up and pursuit of the business of credit institutions (OJ 2000 L 126, p. 1), which concerns the branches of credit institutions authorised in another Member State, provides:

'Host Member States may not require authorisation or endowment capital for branches of credit institutions authorised in other Member States. ...'

OECD Convention

8 Article 7(2) of the Organisation for Economic Cooperation and Development's Model Convention with respect to taxes on income and on capital ('the OECD Convention') provides:

'... [W]here an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment'.

9 Article 7(3) of that convention provides:

'In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.'

National law

10 Articles 7(2) and (3) of Law No 329 of 5 November 1990 ratifying and implementing the convention between the Government of the Italian Republic and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, with exchange of notes, signed at Pallanza on 21 October 1988 (ordinary supplement to the GURI, No 267 of 15 November 1990, p. 107), adopt the corresponding provisions of the OECD Convention.

11 Article 1 of the Basic Law on VAT, Presidential Decree No 633 of 26 October 1972 (ordinary supplement to the GURI, No 292 of 11 November 1972, p. 2) provides:

'Value added tax shall be imposed on supplies of goods and services effected in the territory of Italy in the exercise of an activity, trade or profession and on imports effected by any person.'

12 Article 3 of that decree states:

'The supply of services means supplies for consideration under various contracts, including for the supply of public services, transport, agency, shipping, brokerage, deposit, and generally under obligations to do or refrain from doing or permit something to be done, whatever the basis thereof.'

13 Article 7(3) of the same law provides that '[services] shall be deemed to be supplied in Italy where they are made by persons who are domiciled in Italy or who are established there and who have not taken up domicile abroad and also where they are made by permanent establishments in Italy of persons domiciled or established abroad'.

The main proceedings and the questions referred for a preliminary ruling

14 FCE IT is a subordinate entity, resident in Italy, of FCE Bank, a company established in the United Kingdom whose objects include supplying financial services exempt from VAT.

15 FCE IT received supplies of services from FCE Bank in the form of consultancy, management, staff training, data processing and the supply and management of application software. It claimed repayment of the VAT on those supplies for the years 1996 to 1999 on the basis of invoices which it issued to itself (a process known as 'self invoicing').

16 Following an implied refusal of that application by the tax authority, FCE IT brought an action before the Commissione tributaria provinciale di Roma (Rome Provincial Tax Court) which upheld its application. The Agency lodged an appeal against that decision on the grounds, first, that the application in respect of 1996 and 1997 was time barred and, second, that the application for repayment in respect of 1998 and 1999 lacked merit.

17 By decision of 29 March/25 May 2002, the Commissione tributaria regionale di Lazio (Lazio Regional Tax Court) dismissed the appeal on the grounds, first, that the limitation period did not apply in respect of a payment made in breach of Community law and, second, that transactions, for which no consideration was provided, performed by the parent company for its establishment could not constitute a 'supply of services' since the objective requirements for VAT liability were not met. The passing on of the costs of FCE Bank's services to FCE IT was an allocation of costs within a company.

18 The Ministero dell'Economia e delle Finanze lodged an appeal in cassation against that decision before the Corte Suprema di Cassazione (Supreme Court of Cassation). The ground of appeal is based on the liability to VAT of supplies made by FCE Bank plc by virtue of FCE IT's own independent tax status. Thus, payments made to the parent company must be treated as consideration and therefore constitute the taxable amount.

19 FCE Bank argued conversely that FCE IT has no legal personality and is therefore merely a point of reference for the purposes of liability to VAT of the transactions within that company's objects. Moreover, no VAT is payable in respect of supplies between two entities which constitute a single taxable person.

20 It is in those circumstances that the Corte di Cassazione decided to stay the proceedings and refer for a preliminary ruling the following questions:

'1. Must Articles 2(1) and 9(1) of the Sixth Directive be interpreted as meaning that the branch of a company established in another State (belonging to the European Union or otherwise), which has the characteristics of a production unit, may be regarded as an independent person and thus that a legal relationship between the entities can be said to exist with consequent liability for VAT in relation to supplies of services effected by the parent company? Can the "arm's length" standard laid down in Article 7(2) and (3) of the OECD Model Convention on double taxation and the Convention of 21 October 1988 between Italy and the United Kingdom of Great Britain and Northern Ireland be used to define that relationship? Can a legal relationship be said to exist where there is a cost-sharing agreement concerning the supply of services to the subordinate entity? If so, what conditions must be satisfied for such relationship to be considered to exist? Must the notion of legal relationship be dealt with under national law or Community law?

2. Can the passing on of the costs of such services to the branch concerned be regarded as consideration for the services supplied for the purposes of Article 2 of the Sixth Directive, regardless of the proportion of the costs passed on and the resulting profit to the company, and if so to what extent?

3. If the supply of services between the parent company and the branch are regarded in principle as being exempt from VAT because the recipient is not independent and consequently a legal relationship between the two entities cannot be said to exist, is a national administrative practice which considers that the supply is taxable in such a case contrary to the right of establishment laid down in Article 43 EC where the parent company is established in another Member State of the European Union?'

The questions

The first question

21 It is established case-law that, in the procedure laid down by Article 234 EC providing for cooperation between national courts and the Court of Justice, it is for the latter to provide the referring court with an answer which will be of use to it and enable it to determine the case before it (see Case C-334/95 *Krüger* [1997] ECR I-4517, paragraph 22, and Case C-88/99 *Roquette Frères* [2000] ECR I-10465, paragraph 18). To that end the Court of Justice may have to reformulate the question referred to it (see *Krüger*, paragraph 23, and Case C-62/00 *Marks & Spencer* [2002] ECR I-6325, paragraph 32).

22 It should be noted in this connection that the referring court asks to what extent do supplies of services made by a company established in the United Kingdom to its branch in Italy fall within the scope of the Sixth Directive. It follows that it is of no use to the referring court to make a ruling on the situation in which the company is established in a non-Member State.

23 It should also be noted that it is common ground between the parties that FCE IT, a subordinate entity of FCE Bank, has no legal personality of its own and is therefore a branch of FCE Bank.

24 By its first question, the referring court asks essentially whether Articles 2(1) and 9 (1) of the Sixth Directive are to be interpreted as meaning 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, must be treated as a taxable person by reason of the costs imputed to it in respect of those supplies.

Observations of the parties

25 FCE Bank, the United Kingdom Government and the Commission of the European Communities submit that services provided within the same legal entity are not supplies of services subject to VAT.

26 FCE Bank submits that no legal relationship can exist between itself and FCE IT since they form a single taxable person. There cannot therefore be a supply of services for consideration between the two establishments established in two separate Member States. FCE Bank is not remunerated for the performance of internal transactions which are carried out in the interests of the company for uniform accounting, marketing and other purposes.

27 The Commission submits that supplies of services between a parent company established in a Member State and an entity not registered as an independent legal entity and which is a fixed establishment in another Member State should not be considered as transactions liable to VAT.

28 The Italian Government submits that even if, as a matter of civil law, the parent company and its branch are part of the same legal person and that fact might constitute an obstacle to the enforcement of the obligations which are the subject of the taxable transaction, that does not preclude them from being separate taxable persons for the purposes of tax law in general and for VAT in particular.

29 Given the terms of Article 2(1) of the Sixth Directive, which states that supplies must be effected for consideration if they are to be subject to VAT, services can only be exempt from that tax if they are provided for free. It follows that the conditions

for a legal relationship capable of giving rise to a taxable supply are those arising from the principles laid down by the Sixth Directive.

30 Furthermore, according to Article 9(1) of the Sixth Directive and Article 1 of the Eighth Directive, a fixed establishment in the host Member State must be treated as an independent taxable person, which precludes any repayment of VAT to the parent company.

31 According to the Portuguese Government, notwithstanding its high level of harmonisation, VAT is a national tax of the Member States, which are therefore free to treat establishments in their territory as taxable persons. Furthermore, a fixed establishment which satisfies the human and technical requirements to carry out taxable supplies is an economic reality and a sufficiently independent entity so as to be the subject, by itself, of relations and rights and obligations in respect of VAT.

Findings of the Court

32 First, it should be noted that Article 2(1) of the Sixth Directive states that supplies of services effected for consideration within the territory of the country by a taxable person acting as such are subject to VAT.

33 Second, Article 4 of the Sixth Directive defines 'taxable person' as any person who 'independently' carries out an economic activity. Article 4(4) thereof states that the word 'independently' excludes from the tax persons bound to an employer by a contract of employment or by any other legal ties creating the relationship of

employer and employee as regards working conditions, remuneration and the employer's liability (see Joined Cases C-78/02 to C-80/02 *Karageorgou and Others* [2003] ECR I-13295, paragraph 35).

34 In that regard, according to the case-law of the Court, a provision of services is taxable only if there exists between the service provider and the recipient a legal relationship in which there is a reciprocal performance (see Case C-16/93 *Tolsma* [1994] ECR I-743, paragraph 14, and Case C-174/00 *Kennemer Golf* [2002] ECR I-3293, paragraph 39).

35 To establish whether such a legal relationship exists between a non-resident company and one of its branches so that the supplies made may be subject to VAT, it is necessary to determine whether FCE IT carries out an independent economic activity. It is necessary in that regard to determine whether a branch such as FCE IT may be regarded as being an independent bank, in particular in that it bears the economic risk arising from its business.

36 As Advocate General Léger noted in point 46 of his Opinion, the branch does not itself bear the economic risks associated with carrying on the business of a credit institution, such as, for example, a customer defaulting on the repayment of a loan. The bank, as a legal person, bears that risk and is therefore the subject of supervision of its financial strength and solvency in the Member State of origin.

37 As a branch, FCE IT does not have any endowment capital. Consequently, the risk associated with the economic activity lies wholly with the FCE Bank. Consequently, FCE IT is dependent upon that company and, with it, constitutes a single taxable person.

38 That finding is not undermined by Article 9(1) of the Sixth Directive. That provision concerns the determination of the taxable person in transactions between a branch and third parties. It is therefore irrelevant for the purposes of the present case which concerns transactions between a company resident in a Member State and one of its branches established in another Member State.

39 It should be noted that the OECD Convention is irrelevant since it concerns direct taxation whereas VAT is an indirect tax.

40 Lastly, any agreement on the sharing of costs is also irrelevant for present purposes since such an agreement was not negotiated between independent parties.

41 In the light of the foregoing, the answer to the first question must be that Articles 2 (1) and 9(1) of the Sixth Directive are to be interpreted as meaning 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 second question

42 By its second question the referring court asks whether Article 2 of the Sixth Directive should be interpreted as meaning that the passing on of the costs of services supplied to the subordinate entity by the non-resident company constitutes consideration, regardless of the amount of the costs passed on and the pursuit of profit.

43 According to paragraph 37 of the present judgment, the branch in question is not independent of the company. There is therefore no need to reply to the second question.

The third question

44 By its third question, the referring court asks whether a national administrative practice which subjects to VAT a supply of services by a parent company to a subordinate entity, situated in another Member State, is contrary to the principle of the freedom of establishment laid down by Article 43 EC.

Observations of the parties

45 FCE Bank, the United Kingdom Government and the Commission claim that the Italian administrative practice infringes the freedom of establishment guaranteed by Article 43 EC.

46 FCE Bank submits that the national practice in question has the effect of consolidating the VAT which becomes non-deductible. That represents an additional and final cost which an Italian bank which supplies the same services to its branches established in Italy does not bear and which cannot be regarded as a proper measure for ensuring the efficacy of fiscal controls.

47 The United Kingdom Government shares the Commission's view that the Italian administrative practice infringes the principle of non-discrimination inherent in the freedom of establishment where the fiscal regime in respect of VAT is more costly for the subsidiary of a foreign bank than for that of a national bank — there being no

other objective differences between those two types of subsidiary. Moreover, to make supplies between a parent company and a subsidiary, domestic or foreign, subject to VAT is a restriction of the freedom of establishment in the form of a branch, which cannot be justified by any 'general' interest within the meaning of the case-law (see, to that effect, Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32, and Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 37).

48 The Italian Government made no submission on that point, considering that a fixed establishment is an independent entity liable to VAT.

49 The Portuguese Government submits that it follows from the purpose and the rules establishing the common system of VAT that the matter does not depend solely on national administrative practices. There is therefore no need to reply to the third question on the freedom of establishment set out in Articles 43 EC to 48 EC.

Findings of the Court

50 As Advocate General Léger pointed out in point 74 of his Opinion, a finding that a national law or practice is incompatible with the Sixth Directive dispenses with the need to consider whether the fundamental freedoms laid down by the Treaty, such as the freedom of establishment, have been infringed.

51 It has been held in paragraph 37 of the present judgment that the branch of a non-resident company is not independent and therefore there is no legal relationship between them. They must be considered as one and the same taxable person within the meaning of Article 4(1) of the Sixth Directive. FCE IT is therefore a part of FCE Bank.

52 It follows from the foregoing that the Italian administrative practice is incompatible with the Sixth Directive and it is not necessary to rule on the breach of Article 43 EC.

Costs

53 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

Articles 2(1) and 9(1) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, must be interpreted as meaning 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.

[Signatures]