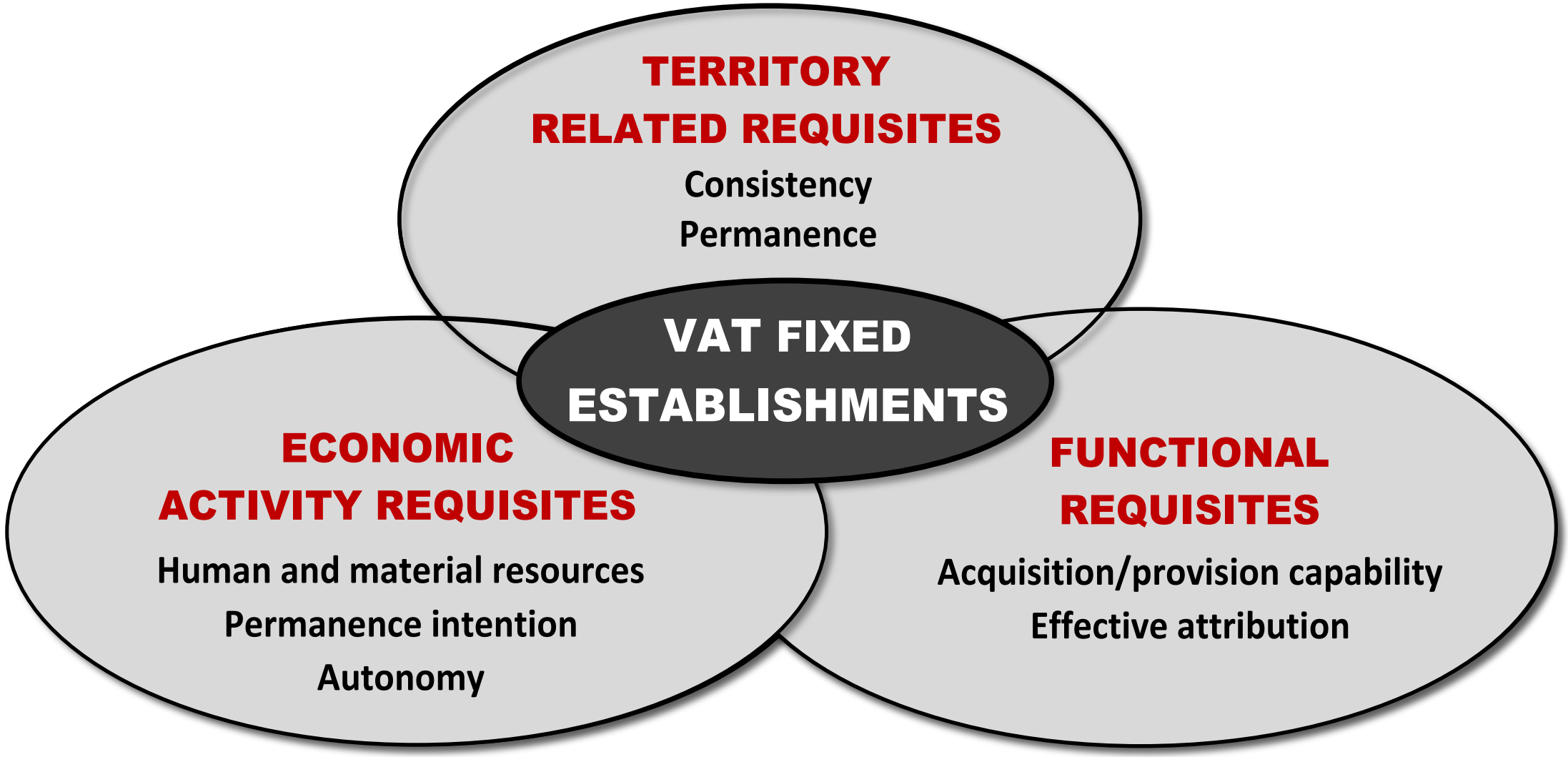
VAT and FIXED ESTABLISHMENTS



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SOME GENERAL COMMENTS

- The fixed establishment constitutes a **basic concept** in the application of VAT, as it affects several of its elements.
- Its definition can be found in the **Implementing Regulation 282/2011/EU art.11.1**, according to which for the application of the VAT Directive art.44 a 'fixed establishment' shall be any establishment, other than the place of establishment of a business, characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use services supplied to it for its own needs. For the supplied services, art.11.2 includes a similar approach.
- Those definitions follow closely the **ECJ case-law** on the matter.

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TERRITORY RELATED REQUISITES

- A fixed establishment will only exist if it has the necessary and sufficient productive resources for the development of the concerned economic activity. The referred resources must include material and human means of production, so that there is that **minimum consistency** the case-law has pointed out, as well as Implementing Regulation EU/282/11 art.11 confirms.
- The fixed establishment is characterized by some degree of **permanence**. This requirement can be put in relation to the certain aim of continuity to a fixed establishment to flourish. Only if there is this intention of continuity will the requirement of existence of a fixed establishment be fulfilled, without this permanence being referred to a specific period of time.

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ECONOMIC ACTIVITY REQUISITES (I)

- The necessary means of production to consider the existence of a fixed establishment must be **material** and **human** such that, integrated into the productive structure of the taxable person, constitute its presence in the concerned Member State. The two sections of the Implementing Regulation EU/282/11 art.11 coincide at this point; the fixed establishment must have the adequate structure of material and human means of production. It is not enough, therefore, with the provision of only one of these elements, both must concur.
- Precisely the case that we will talk about later refers to the way in which said resources must be available to the fixed establishment, analyzing whether the fact that they are **resources of a third entity** can prevent, as such, the conclusion that there is a fixed establishment in the State in question.

ECONOMIC ACTIVITY REQUISITES (II)

- The aforementioned means of production must be linked to the State in question with an **intention of permanence**. It is important to fix, assuming that there is such a permanence intention, the moment from which it can be considered that said taxable person can be considered to have a fixed establishment, both for the correct taxation of operations in terms of their location and for the indication of who has the condition of the liable to enter and to pass the tax on.
- The material and human means must have the **adequate level of autonomy** to develop the concerned economic activities. This operational autonomy can be analyzed from an organizational point of view, relative to the sufficiency of means for the development of the activity.

FUNCTIONAL REQUISITES

- Assuming that the requirements above analyzed are met, there is a third category of requirements whose necessary concurrence will be that which will make it possible to link an "active" or "passive" operation to a specific fixed establishment.
- The fixed establishment must be **capable of** receiving and using or carrying out the operations in question, involving the material and human means of production at its disposal.
- This functional perspective is the one that gives rise to the difference that exists between the first two sections of Implementing Regulation EU/282/11 art.11, which qualify it according to the nature of the operations, passive or active.
- This element, related to the **attribution of operations**, which we comment on below, is also studied in case C-333/20.

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ADDITIONAL TOPICS (I)

- B2B services between companies are placed **where the recipient is located** (assumed that he is the real client, art.22 of the Implementing Regulation EU 282/2011 of the VAT Directive and judgment of 20-6-2013, Newey, C-653/11).
- With this premise, it could well be thought that art.53 of the referred Regulation 282/2011 faces the issue satisfactorily when, once the service is located where the client is based, it indicates whether the tax should be charged to the client or the **reverse charge** should be applied.
- The question, however, is somewhat **more complex**.
- Firstly, because an adequate attribution of the operations affects other areas, such as the **national turnover volume** -sometimes with formal obligations consequences-, their billing regime, etc.

ADDITIONAL TOPICS (II)

- More serious is, however, the proper attribution of operations when there are **limitations on the right to deduction**, whether due to the existence of exemptions, or for other reasons (such as the application of the tour operators margin scheme).
- In this case, the provisions of the aforementioned art.53 are not enough, since it is necessary to determine if the operation is to be allocated to the headquarter or to a fixed establishment.
- In case the **TOMS** regime applies, it will be the State where the fixed establishment is the one that collects VAT on the margin corresponding to the operation (judgment of 20-2-1997, DFDS, C-260/95, is a good example of the tension that this can generate).
- Also, in case we face exempt operations, the impact on the right to deduction must take into account the place to which the operations are attributed. If this is not the place to which the goods and services for which VAT has been borne have been allocated, the **dysfunction** is evident, as the Morgan Stanley case clearly demonstrates.

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ADDITIONAL TOPICS (III)

- Some criteria to **link inputs and outputs** (as the ECJ has ruled to admit the deduction of overheads VAT, judgments, of 8-6-2000, C-98/98, Midland Bank, 26-5-2005, Kretztechnik, C-465/03, 22-10-2015, Sveda, C-126/14, 14-9-2017, Iberdrola Inmobiliaria Real Estate Investments, C-132/16, or 17-10-2018, C-249/17, Ryanair), requiring their cost be part of the price of the sold goods and services, are needed.
- Assumed that the OECD's work on direct taxation is not directly transferable to this area, nor its complete exclusion seems reasonable. The analyses based on functions, assets and risks, traditional in **transfer pricing methodologies**, should be taken into account, with two additional important problems:
  - Increasingly, these works move away from the most transactional approaches to go to **profit sharing schemes**, residual or not, making difficult to transfer their results to taxes linked to operations, such as VAT.
  - The European case-law on the relations between **headquarters** and **fixed establishments**, if understood as an unquestionable axiom, with the rupture in the chain of utility generation that this implies, leads to situations of incoherence, some of them already presented to it ECJ (vide the Morgan Stanley case).

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THE CASE C-333/20, THE FACTS (I)

- A **German company** marketing pharmaceutical products in Romania concluded a contract with a Romanian company.
- The main business of the **Romanian company** was management consultancy in the field of public relations and communication, as well as secondary activities, like the wholesale supply of pharmaceutical products, management consultancy, advertising agency activities, market research and carrying out opinion polls.
- Indirectly, this company was **95% owned by the German company**, which was its sole customer.
- Both of companies entered into a marketing, regulatory, advertising and representation **services contract**, under which the Romanian company undertook to promote actively the products of the German company in Romania through, inter alia, marketing activities, in accordance with the strategies and budgets established and developed by the German company.
- Furthermore, the Romanian company took orders for pharmaceutical products from wholesale distributors in Romania and forwarded them to the German company. It also dealt with the invoices which it sent to the German company's customers.

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THE CASE C-333/20, THE FACTS (II)

- The Romanian company invoiced the concerned services exclusive of VAT, taking the view that the **place of supply** of those services was **Germany**.
- The Romanian tax authorities took the view that the disputed services, **supplied** by the Romanian company to the German oner, were **received** by the latter in Romania, where the German company had a fixed establishment.
- They equally understood that that **fixed establishment** consisted of sufficient technical and human resources to carry out regular supplies of taxable goods or services.
- The assessment was made principally on account of the technical and human resources which belonged to the Romanian company, but to which the German company had **continuous access**. In particular, the German company had access to technical resources owned by the Romanian company, such as computers, operating systems and motor vehicles.

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THE CASE C-333/20, THE REASONING (I)

- The ECJ has come to analyze if according to arts.44 of the VAT Directive and 11(1) of Implementing Regulation 282/2011, a company which has its registered office in one Member State has a **fixed establishment** in another Member State because that company owns a **subsidiary** there that provides it with human and technical resources under contracts stipulating that that subsidiary provides, exclusively to that company, marketing, regulatory, advertising and representation services that are capable of having a direct influence on the volume of its sales.
- As previously explained, ECJ jurisprudence, such as Implementing Regulation 282/11, require, for the existence of a fixed establishment, a **sufficient degree of permanence,** a **suitable structure** in terms of **technical and human resources**. These requirements are recalled by the ECJ in its decision.

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THE CASE C-333/20, THE REASONING (II)

Based on tis decision of 7-5-2020, **Dong Yang Electronics**, C-547/18, the ECJ has understood that:

- For VAT purposes, consideration of the **economic and commercial reality** is a fundamental criterion. The classification of an establishment as a 'fixed establishment' cannot depend, thus, solely on the legal status of the concerned entity
- While **it is possible that a subsidiary constitutes the fixed establishment** of its parent company, such a classification depends, however, on the substantive conditions set out in Implementing Regulation 282/2011/EU, in particular, in art.11 thereof.
- The existence of a fixed establishment **may not be deduced merely** from the fact that that company has a subsidiary in the territory of a Member State.
- Although it is not a requirement for a taxable person itself to own the human or technical resources, it is however **necessary** for the taxable person to have the **right to dispose** of the concerned human and technical resources in the same way as if they were its own, on the basis, for example, of employment and leasing contracts **which make them available** to it and cannot be terminated at short notice.

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THE CASE C-333/20, THE REASONING (III)

- To make the existence of a permanent establishment subject to the condition that the staff be bound by an employment contract to the taxable person itself and that the material resources belong to it in its own right would amount, on the one hand, to a **very restrictive application** of the referred criterion.
- Such a criterion would not contribute to a high level of **legal certainty** in determining the place where services are deemed to be supplied for tax purposes, if, in order to transfer the taxation of supplies of services from one Member State to another, it were sufficient for a taxable person to cover its staffing and material needs by having recourse to various service providers.
- Even when the German company is the only one customer of a third party, it can only be assumed to use the technical and human resources at its disposal for its own needs if it were established that, by reason of the applicable contractual provisions, that company had the technical and human resources of the Romanian entity at its disposal as if they were its own.

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THE CASE C-333/20, THE REASONING (V)

- Once the conditions for the **existence** of a fixed establishment have been determined, the EJC has come to analyze an important issue, which is the **attribution** of operations to fixed establishments.
  - As a general criterion, the fixed establishment is characterized by a structure which is capable, in terms of human and technical resources, of enabling it to **receive** the services supplied to it **and to use them** for its own business needs.
  - It is important to distinguish the services supplied by the Romanian company to the German company from the goods which the German company sells and supplies in Romania. They are **distinct supplies** of services and goods, subject to different schemes of VAT.
  - As regards the main proceedings, the human and technical resources which were made available to the German company by the Romanian company were also those through which the Romanian company supplied the services to the German company. Yet, the same means cannot be used both to **provide** and **receive** the same services.
- The operation described can be seen more easily in the following **flowchart**. It corresponds, more specifically, to the part that is indicated in red, related to the business model named as D.

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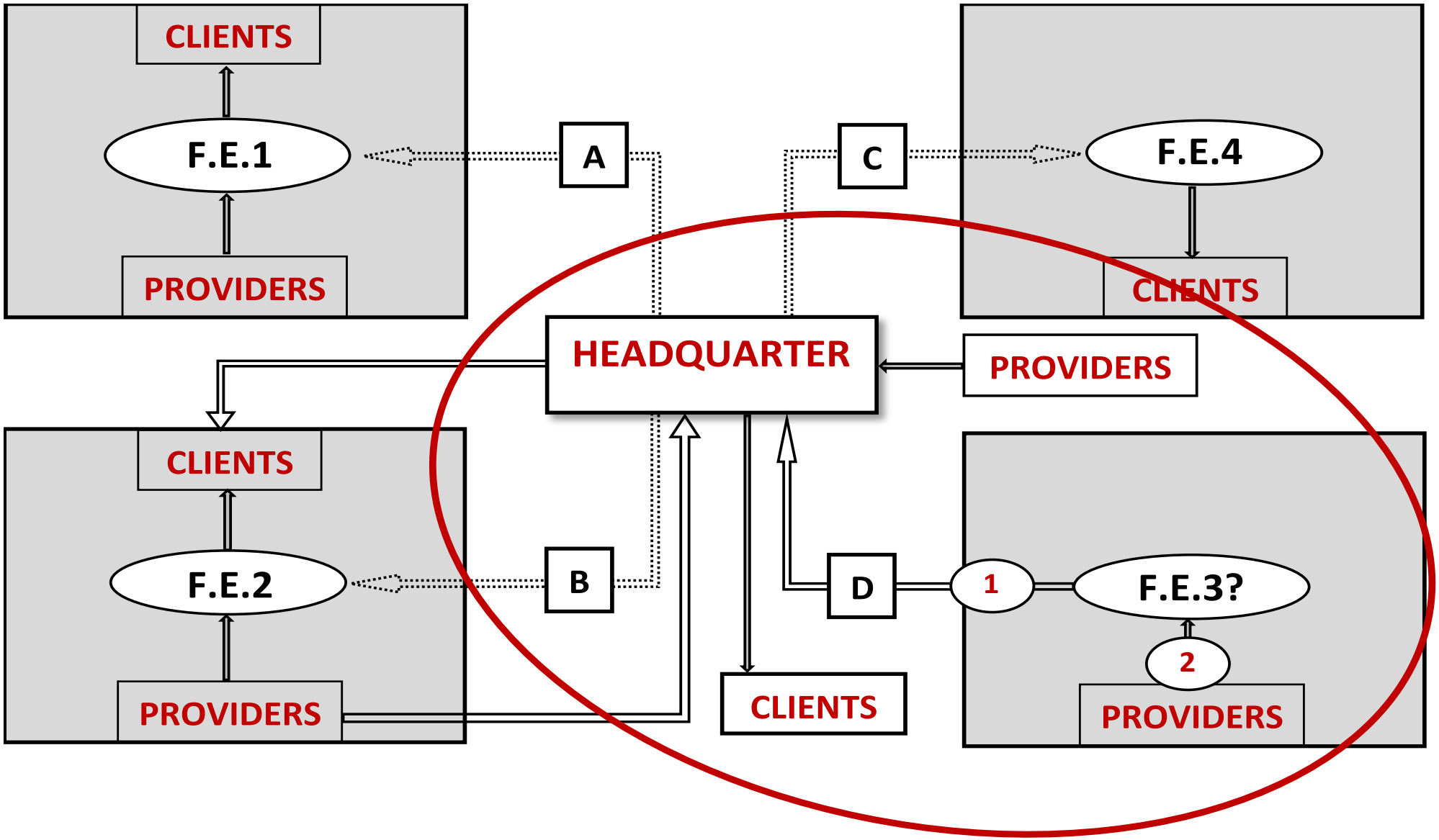
AND SPECIFICALLY, THE RELATIONSHIPS HEADQUARTERS-FIXED ESTABLISHMENTS



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THE CASE C-333/20, CONCLUSION

Somehow, what the ECJ has come to say is that **arrows 1 and 2** of the flowchart cannot be confused.

Consequently, and even assuming that the requirements to consider the Romanian company as a fixed establishment of the German entity could be fulfilled, it cannot be understood that the material and human resources whose availability lead to the existence of a such a fixed establishment in Romania at the same time give rise to a service received by said fixed establishment that must be taxed by VAT in this country as placed in its territory.

As a **final conclusion**, it has been declared that according to arts.44 of the VAT Directive and 11(1) of Implementing Regulation 282/2011, a company with its registered office in one Member State does not have a fixed establishment in another Member State on the ground that that company owns a subsidiary there that makes available to it human and technical resources under contracts by means of which that subsidiary provides, exclusively to it, marketing, regulatory, advertising and representation services that are capable of having a direct influence on the volume of its sales.

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SOME FINAL COMMENTS

- The ECJ has excluded that the mere fact that the business structure in a country is attributed to a **subsidiary** excludes by itself the existence of a permanent establishment, explaining in detail how irrational it would be to conclude otherwise.
- The foregoing must be understood without prejudice to the fact that in order to proceed in this way, it must be verified that the **means of production** are really **available** to the entity that uses them and its going to be considered as having a fixed establishment in the concerned Member State, which must be able to use them as if they were its own.
- Additionally, the ECJ has come to analyze the necessary functional requirement for the **attribution of operations** to the permanent establishment, excluding that it could proceed in this way in the case that had been raised. This analysis of the attribution of operations and business models is especially relevant, as illustrated in the slide 16.

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