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VAT EXPERT GROUP[1]

VEG NO 108

VEG opinion on Fixed Establishments

[1] Group of experts on value added tax to advise the Commission on the preparation of legislative acts and other policy initiatives in the field of VAT and to provide insight concerning the practical implementation of legislative acts and other EU policy initiatives in that field.

1. INTRODUCTION - PUTTING THINGS INTO PERSPECTIVE

Legal certainty is an important and critical asset for both business and tax authorities alike to plan, to build and to move into a future that fosters global trade, global tax revenues and global welfare.

The risk of penalties, and of double taxation and also the developments in the Member States (MS) both when it comes to court cases and administrative rulings greatly outline, that there is an increasing degree of legal uncertainty on the topic of "fixed establishment" (FE), impacting the collection of VAT (tax liable person) but also in some scenarios the place of taxation.

As a result, VAT, which is a tax borne by the final consumer, becomes more and more a tax on business as tax collectors. This is a fundamental breach of the neutrality principle.

This is of even greater concern as, at its center, in a B2B context, particularly where there is a full right to deduct input VAT, the FE topic should only be relevant when it comes to determine who is liable to charge and collect the VAT – is it the supplier who has the obligation to charge VAT to his business customer and to collect it from him, or is it the business customer who has the liability to account for VAT? This decision has to be made by the supplier. It is important to understand that when it comes to B2B scenarios it should be not about the allocation of taxing rights: in VAT this is done to the far greatest extent by the application of the destination principle. Given recent developments in the Member States (see various court cases) the reality however is, that the allocation of the taxing rights aspect has become more and more the center of the discussions.

When it comes to business-to-consumer (B2C) transactions, the concept of FE - despite the increased application of the destination principle to B2C transactions - remains still relevant for the place of taxation due to the incomplete adoption, as yet, within the EU of the destination principle in relation to such supplies.

Our main focus of the paper is B2B, and as mentioned above, there is an increasing degree of legal uncertainty on the topic of "fixed establishment" in the area of (B2B), despite full input VAT recovery, having as well impacts on the place of taxation where there are disputes as to the place of establishment of the recipient of the service – this is technically and systematically not correct and causes big issues in practice.

As mentioned above, in the VAT system, it is the supplier who has the obligation to charge VAT to his business customer and to collect it from him, he has to decide about if and where to charge VAT by applying the destination principle for VAT purposes based on the commercial reality of the relationships between the supplier and his customer(s). This decision must be taken at the time when the supply takes place. A wrong decision may expose the parties to sanctions, penalties and even difficulties with achieving a full input VAT deduction (or VAT recovery) by the customer.

Looking at the application of the destination principle in a B2B context, the place of taxation is determined by the customer's location, which is either the business recipient´s main business location or the location of the business recipient´s FE, where one exists. It is the business recipient who, based on the contractual arrangements, needs to provide the supplier

with the relevant information regarding his location by sharing comprehensive details as to his place of establishment and relevant VAT Id-No with the supplier, so that the latter can determine the proper place of taxation and can draw the appropriate VAT conclusions. The supplier has to rely on the information received from the business customer – the supplier cannot look into the 'customer's kitchen'[1].

Furthermore, looking at things holistically and with the future developments in mind, the following questions should be considered:

- How will technology now and in the future impact on the notion of FE?
- How will new business models impact on the notion of FE?
- What can be done to increase legal certainty for business and administrations in the evolving nature of the FE concept?
- What can be done to create a better understanding of the differences between the PE and FE concepts in direct tax and VAT?

As these developments show, there is an urgent need to create legal certainty for businesses that operate cross-border when it comes to the criteria that constitute a FE for VAT purposes and its application in practice.

We as VEG therefore urge the EU Commission to start work on this topic. The members of the VEG are very happy to actively support the EU Commission to find a solution that works for all parties involved in order to increase legal certainty and safeguard VAT revenues.

2. THE FE ISSUE IN B2B SCENARIOS – WHY IS IT IMPORTANT TO START WORKING ON THIS TOPIC NOW?

Where there are differences of opinion between tax authorities and taxpayers on the existence of an FE, the impact on the liability to collect the VAT due can cause significant administrative burdens for both[2]. In addition, where there are differences of opinion between tax authorities in different MSs double taxation may arise. In all those situations the financial consequences almost always fall entirely on taxpayers. These divergent opinions undermine the principle of neutrality of VAT for business.

The complexity of this topic today is amplified by globalization and technology: the way business is structured, is operating and is conducted, has significantly changed over the past decades and will continue to evolve putting stress on concepts such as fixed establishments. The same goes for the way taxes are and should be designed, collected and administered. Looking at the even greater changes to come, particularly due to evolving technological developments in VAT administration, we see an urgent need to start working on this topic now and to explore whether and how we can ease the complexity of the system in the years and decades to come and reinstate the high level of legal certainty required by business and administrations.

[1] See for example point 37 in case Dong Yang Electronics sp. z o.o. C-547/18
[2] See for example the recent CJEU cases, Titanium Ltd C-931/19 and Berlin Chemie C-333/20

In the area of direct tax, the term "establishment" (also known as permanent establishment 'PE') is used currently[3] as a key mechanism to allocate taxing rights to different jurisdictions. The nature and meaning of this concept have been worked on and developed over the last 100 years. The importance of this concept in direct tax and the fact that some Member States qualify a permanent establishment for direct taxation purposes as a fixed establishment for VAT and vice versa, has influenced the evolving nature of FE developments in EU VAT. These two concepts are clearly not the same[4]. The one is taxing profits, the other is taxing the consumption of each single transaction/supply. This leads to issues involving the definition of the two distinct concepts due to different and unclear criteria, and lack of clear and sufficient jurisprudence at the level of the CJEU. The VEG notes with concern that the VAT collection mechanism is, by national courts and administrations, being aligned to the direct tax position (for example where the reverse charge regime is denied). Additional confusion between the 2 concepts might be caused by the fact that in many EU Member States it is the same word that is used for FE and PE.

In international VAT, we have seen a big change in the last few decades, when it comes to the allocation of taxing rights. We have moved more and more away from the origin principle (ie the place where the supplier is established – hence the critical importance of determining where it is established) to the destination principle, i.e. the place where consumption takes place. In B2B scenarios, the taxing rights are allocated to the place where the business customer is established and in many B2C scenarios to the place where the final consumer resides, apart from certain services which are physically supplied locally and certain non-digital services. This change in the area of international VAT has secured the positioning of VAT for the future when it comes to the allocation of taxing rights, as it fits well with both business and technological developments and the increased servitization of the economy as a whole and indeed our entire lives. VAT is a reliable source of tax revenue for governments, particularly important in post-Covid times as government budgets come under even greater pressure.

More and more tax authorities (in some MS), by ignoring the contractual and commercial reality, apply the FE criteria in a way that undermines the destination principle, which as highlighted allocates the taxing rights for VAT. They try to qualify FEs in their MS with the intention of extending their own revenue base, and are, therefore, affecting the place of taxation, despite the fact that in a fully vatable B2B context, this VAT is refundable, so there is no gain for the budget (other than penalties and interest) but only bureaucracy created both for business and the tax authorities. On the other hand – this situation can cause potential serious financial consequences for the parties – with the application of possible sanctions, penalties and interest.

In the Dong Yang[5] case the question was, is a subsidiary of a company (LG Poland) a fixed establishment of a company from a third country (LG Korea), with the consequence that, if that would have been the case, the service from a 3rd party supplier in Poland (Dong Yang Poland) would have been supplied to the fixed establishment of LG Korea in Poland and would, therefore, have been vatable in Poland. The VAT chargeable by Dong Yang would be

[3] See work on Pillar 1 at the OECD where this concept is evolving. https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

[4] FCE Bank plc case C-210/04 – point 39

[5] Dong Yang Electronics sp. z o.o., case C-547/18

fully recoverable by LG Korea. The position adopted by the tax authorities would therefore, have created a significant amount of bureaucracy in practice for both business and tax administrations without any revenue impact. As this shows, the qualification of an FE on the side of a business recipient of a service can lead to place of taxation issues and can cause important issues of legal uncertainty. It can change the recipient of the service and therefore the place of taxation.

FE is a community concept, so there is an imperative need to understand, interpret and apply this concept uniformly across all EU Member States. If the concept is understood differently by the tax authorities in the different MSs the risk of double taxation increases significantly.

Therefore, to ensure legal certainty clear criteria as to what constitutes an FE for VAT purposes and what not are required.

We would like to address a number of specific issues first before elaborating on a more holistic approach.

3. SPECIFIC ISSUES CONCERNING VAT FIXED ESTABLISHMENTS

As mentioned earlier, some MS tax administrations and courts in the MS appear to attach significant attention and relevance to the FE concept in B2B transactions particularly when it comes to the allocation of taxing rights – which based on a correct application of the destination principle should to the largest possible extent not impact on the place of taxation for VAT purposes.

Why is this the case?

- Is it because VAT abuse related to FEs is extensively happening in practice?
- Is it because of potential disputes on the allocation of taxing rights in VAT, as we see it happening in direct tax?

VAT abuse through FEs in the B2B area is, in our view, very limited in practice. If the destination principle is applied correctly, the biggest relevance of the FE topic in VAT is related to when it comes to determining the person liable to collect the VAT – this aspect is very often overlooked when courts and tax administrations look at the FE concept. However, as mentioned above, recent developments in some Member States also impact the allocation of taxing rights for VAT purposes, causing quite some legal uncertainty, particularly when it comes to the business customer side and whether there exists an FE or not.

So why is so much legal uncertainty created in the area of VAT, and what is it that creates this legal uncertainty?

Looking at the criteria to be applied for qualifying an establishment as an FE for VAT purposes, it is necessary to consider both older and more recent decisions of the CJEU on this topic, the "definitions" of fixed establishment in Council Implementing Regulation (EU) No 282/2011 of March 15th, 2011 (which effectively 'codified' a number of earlier CJEU decisions) as amended, and also real life examples that businesses have experienced in many MS across the EU. This provides a wide variety of criteria, in addition to which the concept

of PE in direct tax and the concept of FE in VAT are often confused by tax administrations and by national courts[6].

The Implementing Regulation provides certain rules to be applied to determine the location of the business establishment (article 10) and the place where the recipient is established (article 11). Articles 20-22 then provide a set of 'rules' to determine where the services supplied are to be treated as received. The Implementing Regulation does not set out detailed rules to be applied to determine the place of the fixed establishment of the supplier supplying services within article 44, as the place of its establishment will not impact the place of taxation. In terms, however, of determining who is the tax liable person (the person liable for the payment of the VAT – article 192a and following of the Directive) in relation to B2B supplies of services (and in certain cases the place of establishment of the recipient of the services supplied), the question of the existence of an FE of the supplier in the country of establishment of the recipient of the service is clearly critical and a major source of dispute.

However, when it comes to determine whether his business customer has an FE in the MS of the supplier the latter is dependent on the information that he receives from his business customer, who might not know or might qualify incorrectly whether the supplier has supplied his transaction to the main business location of the business customer or to his FE.

Even though from a supplier´s perspective the FE issue should rather just be a collection issue it has also become in reality a place of taxation issue.

To further clarify the FE concept and its consequences for VAT purposes, we would like to highlight the below essential building blocks that should be worked upon to provide greater clarity and legal certainty on the concept of FE for VAT purposes:

- Human and technical presence test[7] (A),
- further combined with the possibility of an independent entity being deemed to be an FE of another taxable person (B).
- Permanence test (C).
- Rationality test – we do not develop this point further as its relevance for the determination of the place of establishment of the supplier, to determine the place of taxation, in the case of a supply of B2B services is limited.

This has been done by raising key questions on them – see attached annex. Addressing these key questions should stimulate further work on the topic in order to seek answers and provide solutions.

4. FUTURE APPROACH IN THE JOURNEY TO LEGAL CERTAINTY

Transformation through technology – change of business models, supply chains and operational set ups – requires a new way of thinking about the topic "establishment". The traditional economy and the virtual/platform economy will further converge in the years to come, making a new start now to help clarify this topic, essential.

[6] See for example point 15 Conversant International Ltd – French Supreme Court N° 420174

[7] See Titanium Ltd C-931/19 which confirms the need for the existence of both the necessary human and technical resources – point 42.

In parallel to the work on the notion of fixed establishment in the B2B context, we also need to bring more clarity as regards certain VAT specific aspects related to the practical implications of the existence of an FE:

- Clarify the FE 'intervention' rules (article 192a VAT Directive) and in this context as well the existence of an FE and the inversion of the taxable person via the reverse charge mechanism, in for example, article 194.
- Consider the VAT treatment of FE to HO transactions (FCE Bank plc[8]) and vice versa, and the VAT treatment between two or more FEs, taking account of MS's views on the notion of 'dependent' versus 'independent' FEs.
- Impacts of FEs on VAT grouping and cost-sharing arrangements. Combination of VAT grouping and FE to HO transactions and HO to FE (Skandia[9], Danske Bank[10]) and non-EU VAT groups.
- The existence of an FE and its impact on different VAT regimes: eg application of the TOMS, triangulation, VAT refunds, tax exemptions (SME), OSS and the requirement to appoint an intermediary for the use of the IOSS.
- FE concept and the e-mobility sector
- Interaction between VAT and customs rules on the concept of an FE, as the concepts are not the same

Some of the above-mentioned aspects have already been addressed by the VEG and discussed in the VAT Committee but no unanimous binding positions have been taken and, therefore, need to be followed up on in further detail to establish end to end legal certainty for businesses and administrations.

We as the VEG are very happy to actively support the Commission and MS on this and other topics regarding fixed establishments.

5. CONCLUDING REMARKS

In this document, the VEG discussed specific issues regarding the current interpretation of the concept of fixed establishment, as well as a future 'proof' approach to this concept. In the opinion of the VEG, the specific issues (Section 3 and Annex) raised should be clarified in the short term in order to create a higher degree of legal certainty for businesses and administrations.

We have put forward an approach to start working on the key building blocks for this topic (see Annex), that could result in clear rules to be set out in a VAT Implementing Regulation or through unanimously adopted VAT Committee guidelines. The future of the concept of fixed establishment, the relationship with the concept of permanent establishment in direct taxation and the more fundamental overarching issues will probably take more time. At the same time, we should seize the moment now and address these fundamental topics.

8 FCE Bank plc case C-210/04
9 Skandia America case C-7/13
10 Danske Bank A/S case C-812/19

As a next step, we as the VEG would be pleased to highlight to the Commission and the GFV why we think that this topic is so important for us all to urgently work on together, looking at the past - where we are coming from – the present - where we are today - and where the future will take us.

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ANNEX

BUILDING BLOCKS & QUESTIONS

A. Human and technical presence test

I. First of all, it is important to address whether it is mandatory for the existence of an FE that both conditions (human and technical resources) are fulfilled cumulatively in any case, even if for certain transactions no or minimal human intervention is necessary to supply the services or certain goods under consideration.

Examples:

- Can a pipeline, windfarm[1], a server or a data processing center be an FE?
- Can a customer activated terminal/fueling station selling fuel be an FE? The same question arises also for a charging station for e-mobility.
- Can the provision of fully automated digital/IT-services (industrial measure and control services with equipment installed on industrial plant) create an FE?
- A rented out building without any human resources as an FE[2]?
- Can a foreign company which has a local fleet of e-scooters and is managing the fleet electronically from abroad be seen as constituting a fixed establishment by the location of the scooters?

II. Secondly in the case where human resources must (in addition to the presence of the necessary technical resources) exist to create an FE, must those human resources be on site/nearby/in the same country and in what quantity or quality?

Examples:

- Can an assembly operation/construction site PE automatically be an FE?
- What about the case of the presence of field service engineers for assembly in situ, all technical, planning, consulting and contractual aspects being handled abroad where the supplier has his business establishment.
- How about building/apartment rental[3] or a Server building operated from abroad, with no personnel in situ?

III. To what extent must both technical and human resources be “own” resources of the taxable person, so that the taxable person has direct “control” over both resources as if they were his own? What level of control over human and technical resources which are not “own resources” of a taxable person should be treated as sufficiently “comparable"? Can purchased, leased, “outsourced” technical and human resources from third parties/related parties (subsidiaries, sub-subsidiaries etc.) create an FE for example?

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1 As noted in the Titanium case C-931/19 – point 29 - several German tax courts have held a windfarm to be an FE!

2 See Titanium Ltd C-931/19 – point 42

3 See case of Titanium Ltd – point 42.

IV. Should there be a different test applied between supplies of goods and supplies of services in order to create an FE for VAT purposes? Up till now all CJEU cases about FEs have dealt with services.

V. There should, however, not be a different concept of FE depending upon the relevant purpose of the legislation, ie whilst article 11.2 of the Implementing Regulation delimits a number of services for which the concept of FE is relevant to determine the place of taxation, the list is not exhaustive, e.g. it does not include article 307.

B. Legally independent entity as an FE of another taxable person?

I. Increasing disputes between taxpayers and tax authorities, resulting in for example the DFDS, Welmory, Dong Yang (as to the place of establishment of the recipient) and Titanium case, addressed the existence of an FE in the cases of a controlled subsidiary (or in the case of Titanium a third-party mandated agent). This triggers a number of additional questions when evaluating the presence of human and technical resources.

We, as the VEG, are of the view that the position adopted by AG Mme Kokott in the Dong Yang case must be the correct approach (although her opinion was not followed by the Court) – as she stated: point 45 …" it also serves the purpose of legal certainty in regard to the person liable for tax if a person with its own legal personality cannot at the same time be the fixed establishment of a different person with its own legal personality."

However, if there is a need to consider whether a separate legal entity can create an FE in a case not involving abuse then in our view the following must be considered[4].

II. Where a "principal" legal entity makes use of a legal entity in a country where it does not have any establishment or own human and technical resources (as discussed in A III. above), under what circumstances would there be comparable control over the resources of the other legal entity that could result in this legal entity becoming a fixed establishment of the principal legal entity?[5]

Examples:

- Financial dependency from the principal legal entity, either through a controlling shareholding or through equivalent financial links between the two entities?
- Strong links between the two entities at the level of the management?
- Economic influence over the complete activities of the legal entity: principal legal entity is the sole customer, exclusivity obligation against the principal legal entity, lack of autonomy to enter into contractual relationships? The fact that instructions must be followed in the performance of obligations towards the principal legal entity should not be sufficient in itself.

[4] Mrs Kokott was very clear in her Opinion in Dong Yang when she stated at paras 64 et sub
64. Fourthly, as correctly observed by the Commission, the facts of the DFDS decision were characterised by the particular circumstances of the risk of abuse of services …
65. Finally, the Court has already distanced itself from the DFDS decision and made clear that a wholly owned subsidiary is a taxable legal person on its own account….

[5] See as a further example the recent referral from the Liège Appeal Court case 2020/RG/20 – CJEU referrence C-232/22

- Transfer of all economic and financial risk to the principal legal entity?
- Combination of minimum # criteria? If so, which ones?

III. Where there is comparable control over a legal entity in a country (addressed under I) from where the principal legal entity is performing supplies of goods or services, under what circumstances does this lead to a situation whereby the principal legal entity is regarded as performing its activities from a local fixed establishment (for services, in the case of supplies of services that would be taxable in that country in case the supplier is established there)?

Examples:

- Dependent legal entity is able to bind the foreign principal legal entity towards customers for the supplies?
- Dependent legal entity is performing the essential functions of the supplier of the goods or services that would allow the supply to be performed without the involvement of the principal legal entity?
- Dependent legal entity is involved in the supply of goods or services beyond mere administrative and back-office functions?

IV. Where there is comparable control over a legal entity in a country (as addressed under I) but this legal entity is not capable of delivering the supplies of goods or services of the principal legal entity (as addressed under II) towards third parties, is it possible that the principal legal entity is capable of acquiring services through the presence of the dependent legal entity and qualifies as a FE under article 11 (1) VAT Implementing Regulation?

Examples:

- Where a dependent legal entity performs warehousing services for the principal legal entity, can there be a fixed establishment of the principal capable of purchasing these services where the dependent legal entity cannot render itself the supplies of goods from the warehouse to third parties?
- Where a dependent legal entity performs toll manufacturing services for the principal legal entity, can there be a fixed establishment of the foreign principal created by the presence of the toll manufacturer capable of purchasing these services where it cannot render itself the supplies of goods (produced by the toll manufacturer) to third parties?
- Where a dependent legal entity puts at the disposal of the principal legal entity essential and necessary tangible or intangible infrastructure, can there be a fixed establishment of the principal capable of purchasing these services where it cannot render itself the services towards third parties?

C. Permanence test

The permanence test has not been explained in detail in the CJEU case law, the VAT Directive or the VAT Implementing Regulation. For direct tax purposes, there is a distinction between permanence as regards place and permanence as regards time.

I. As VAT is a transactional tax, the VEG assumes that the permanence test should be assessed upfront based on the intentions of the taxable person. If not, taxing powers may retrospectively shift between Member States during the existence of the fixed establishment (e.g. when it can be established that the fixed establishment meets the required absolute period).

II. For permanence as regards place, a link between the establishment and a specific geographical point is required that cannot be purely temporary in nature. Is a link with a special geographical point required or can a moving object be a fixed establishment?

Example: if a person established outside the EU operates a moving enterprise, for example a library where you can hire a book on a train, should the library on the train be regarded as a fixed establishment in order to tax the supply in the country of consumption? What are the practical consequences of regarding the library on the train as a fixed establishment?

III. In the same vein the question can be raised as to whether a fixed establishment can cover multiple locations when these locations are organizationally linked? Reason for this multiple location approach can be the neutrality principle and preventing abusive situations.

IV. It is unclear what permanence as regards time means for VAT purposes? Is it possible to set an absolute criterion for example 1,5 years? Or should the number of supplies provided, the scale of the supplies provided and the nature of the business be relevant as well? An absolute criterion would provide legal certainty for businesses.

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