Can a Group Company Constitute Fixed Establishment? - Decoding the ECJ Ruling

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The concept of fixed establishment (FE) is one of the limbs for identifying the location or a point of reference of a supplier or recipient for determining the taxing jurisdiction in the context of indirect tax laws. While the concept of FE was borrowed and prevalent under the European Union Value-Added Tax (VAT) law, it was introduced in the erstwhile service tax law (under the negative list regime), with its applicability being limited to a determination of taxing jurisdiction of cross-border transactions. With the concept being carried forward under the Goods and Services Tax (GST) law, it assumes increasing significance for determining the taxing jurisdiction of domestic as well as cross-border transactions.

Under the GST law, taxable persons would normally register all locations from where they undertake 'supplies'. Given the dynamic and evolving business models, there could be certain locations which may constitute a FE and might also be required to be registered if taxable supplies are made therefrom. This needs to be examined since this would impact the taxing jurisdiction and may also accordingly trigger assessments and litigation by tax authorities.

An analysis of the EU VAT decisions on this concept of FE reveals that while the courts had initially provided a restricted interpretation to the term, in some of the recent rulings, courts have interpreted the concept in a wide manner. Some of the notable principles emerging from these rulings include the following:

- Permanent presence of both human and technical resources[1] is necessary;
- Human and technical resources not employed by a taxpayer may also constitute FE, so long as they are supporting the taxpayer in the furtherance of economic activities[2];
- Non-existence of personnel resources may also be held to be an FE[3];
- Mere presence is not sufficient – involvement in supply or receipt necessary[4].

Given the above relevance of the concept of FE, it becomes imperative to understand the meaning and track the evolving jurisprudence or guiding principles to determine applicability in various practical scenarios.

In a recent reference before the European Court of Justice (ECJ or court) in the matter of Cabot Plastics[5], the court dealt with the interpretation of the term FE in the context of a tolling arrangement between two group companies which were legally independent and registered in different countries.

Facts of the Ruling

Cabot Switzerland GmbH (the service recipient or SR), a Swiss company, entered into a tolling agreement with its group company Cabot Plastics SA (the service provider or SP), which was located and registered in Belgium. The key aspects emerging from the agreement are as follow:

- SP used its own equipment to process the raw materials of SR into products used in the manufacture of plastics under the direction of SR.
- SP also stored the manufactured products before they were further sold by SR from Belgium to various customers in the Belgian market or the European market or for export.
- SP also provided a series of additional services to SR in the form of storage of products, carrying out internal and external technical checks and assessments, etc.

It is also notable from the facts that the services provided by SP to SR almost entirely constituted SP's turnover. In the aforesaid fact pattern, the Belgian tax authorities demanded VAT to be paid in Belgium on the basis that the service recipient has an FE in Belgium within the premises of the service provider for the tolling and additional services received from the service provider. The decision of the tax authority was appealed before the Court of First Instance, and subsequently, before the Court of Appeal. Thereafter, it was ultimately referred to the ECJ.

Issues placed before ECJ

The question referred to the court was whether the SR located outside the state of the SP and receiving services in that state has an FE in the state on account of the following factors:

- The human or technical resources belonged to SP but based on the contractual undertaking, SR undertook to exclusively use them to provide those services.
- Pursuant to an exclusive contractual undertaking, SP provided ancillary and additional services to SR contributing to the business of the SR in the state of the SP.
- Whether it is correct to treat the SP as also constituting human and technical resources of the SR for the same supply? Whether the staff of SP acting on the direction of SR can be regarded as 'own staff' of SR?

Decision of the court

Object and purpose of EU legislation on FE

Article 44 of the VAT Directive is a rule determining the place where provision of services are taxed by designating a point of reference for tax purposes. This is intended to avoid conflicts of jurisdiction which may result either in double taxation or non-taxation. While the primary point of reference for determining the place of supply is the **business establishment**, the second point of reference is more like an exception and based on the fulfillment of certain conditions which are evolving with jurisprudence. It is only in cases involving a different rational result or a conflict with another member state that the secondary point of reference comes into picture. The court referred to an important principle propounded in *Welmory*[6], i.e. the presumption is that the services are provided at the place where the taxable person receiving them has established its business.

Suitable structure with human and technical resources

Right of disposal of human resources

Unless it is established that SR had the resources of SP at its disposal as if they were its own, it could not be regarded as having a suitable structure with a sufficient degree of permanence, in terms of human and technical resources, in the state where SP has established its business. Another interesting observation in this regard is that even if a legal person has only one customer, it is assumed to use the technical and human resources at its disposal for its own needs. In this context, the court referred to the ruling in *Berlin Chemie A. Menarini*[7].

Linkage between SP and SR

On the legal linkage of the two companies, the court observed that classification as an FE must be assessed in light of the economic and commercial reality, and it cannot depend solely on the legal status of the entity concerned. The fact that a company has a subsidiary in a state does not, by itself, mean that it also has its FE there.

Determination on the basis of recipient and not provider – dissection of the two supplies

The key rationale of the decision is that the issue of whether the SR has an FE in the state of the SP **must be determined by reference to the SR and not to the SP**.

The tolling services provided by the SP are required to be distinguished from the sale by the SR of products resulting from the tolling work. It is necessary to identify the place where the human and technical resources of the SR for the purpose of receipt of services are situated and not the place where the SP's resources using it for its sales activity are located.

The same means cannot provide and receive the same services

Another logical corollary of the above dissection of supplies pointed out by the court is that the same means cannot be used both to provide and receive the same services[8]. In relation to this, it was observed that it is not possible to distinguish the resources used by the SP for its tolling services from those that are supposedly used by the SR to receive those services in Belgium, within its alleged FE. Even the fact that the results of ancillary activities essentially benefitted consumers in Belgium where the SP had its place of business was not material for determining whether SR possesses an FE in Belgium.

Verdict

The court held that the SR did not have a suitable structure in Belgium for receiving tolling services and that these services were received and used by the service recipient in Switzerland, for its business of selling the goods resulting from those services. This is irrespective of whether the SP provided a series of ancillary or additional services, contributing to the business of SR in Belgium.

Takeaways and conclusion

The underpinning rationale of the decision lies in the dissection of the two supplies, i.e. tolling services **provided to** the service recipient and the ultimate sale of goods **by the service recipient,** and the FE test has to be applied based on the recipient and not the provider.

It is pertinent to note that the definition of FE under the GST law not only includes a suitable structure capable of supplying services but **also includes a suitable structure capable of receiving and using services for its own needs**.

The applicability of the principles laid out in this *Cabot Plastics* ruling in the Indian context for testing the existence of FE in case of group companies or subsidiaries or even branch offices treated as separate registrations for GST purposes needs to be analysed, as it has been held that the legal status of the provider or recipient is immaterial. Such an analysis is not only relevant in case of cross-border transactions but under the GST regime, such determination would arise in innumerable domestic scenarios, such as EPC or construction contracts requiring a site office, contract manufacturer providing support or ancillary services from a different state, work-from-home arrangements etc. This would also determine the consumption state and the taxing jurisdiction and can also impact the revenue collection of states. Another interesting aspect being debated is the interplay between the concept of FE under the GST law and PE under the corporate tax law.

While there is not much Indian jurisprudence on the concept of FE, considering the similarity in the definitions, some of the guidelines and principles laid out in the ECJ rulings may serve as a guide to interpret the meaning of FE in the Indian context as well.

The views expressed in the article are personal views of the authors.

[1] ECJ EC 4 Jul. 1985, 168/84, ECLI:EU:C:1985:299 (Günter Berkholz), European Court Reports 1985, p. 02251, para. 17 and ECJ EC 2 May 1996, C-231/94, ECLI:EU:C:1996:184 (Faaborg-Gelting Linien), European Court Reports 1996, p. I-02395, para. 16

[2] ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (Welmory), Official Journal 2014, C 462

[3] FG Cologne, 2 K 920/14 and FG Münster, 5 K 1768/10 U)

[4] Dong Yang Electronics (C-547/18, 7 May 2020); ECJ EC 20 Feb. 1997, C-260/95, ECLI:EU:C:1997:77 (DFDS A/S)

[5] Cabot Plastics Belgium SA v. État belge (Belgian State), Case C-232/22

[6] (C-605/12, EU:C:2014:2298)

[7] C-333/20, EU:C:2022:291, paragraphs 37 and 41

[8] Judgment of 7 April 2022, Berlin Chemie A. Menarini, C-333/20, EU:C:2022:291, paragraph 54