

# VAT and fixed establishments: mysteries solved?

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## VAT and Fixed Establishments: Mysteries Solved?

M.L. Schippers & J.M.B. Boender\*

*The authors discuss European case law and the VAT Implementing Regulation with regard to the concept of the fixed establishment and question whether, thirty years after it was introduced into the field of VAT, all the mysteries surrounding the fixed establishment have now been solved.<sup>1</sup>*

### I INTRODUCTION

The Sixth Value Added Tax (VAT) Directive<sup>2</sup> introduced the concept of the fixed establishment in VAT. For a long time, the criteria for classifying activities as a fixed establishment seemed relatively clear. However the introduction in 2011 of the VAT Implementing Regulation<sup>3</sup> (hereinafter the 'Implementing Regulation') changed this situation by providing various definitions of the concept. Since then, new European case law on the fixed establishment has arisen, including the judgments in the cases of *Welmory*,<sup>4</sup> *Skandia America Corporation (Skandia)*<sup>5</sup> and *Le Crédit Lyonnais (LCL)*.<sup>6</sup>

Section 2 of this article first examines the purpose of the fixed establishment and second, analyses the criteria applying in respect of the fixed establishment and the definitions laid down in the Implementing Regulation. Section 3 discusses the judgment in *Welmory*, while also examining the relationship between the passive and the active fixed establishment. Section 4 looks at the relationship between the head office (also referred to as the 'main business establishment') and the fixed establishment, with specific reference to the *Skandia* case. This section also provides an overview of how the various

Member States have chosen to apply the judgment in *Skandia*. Section 5 considers the *LCL* case and specifically the right of the head office and the passive fixed establishment to deduct input VAT. Our conclusion is set out in section 6.

We should emphasize that this article takes account, in principle, only of European Union (EU) legislation and regulations on VAT, as well as European Court of Justice (ECJ) case law on the subject. Unless explicitly stated otherwise, therefore, no consideration is given to case law of the Member States or local VAT legislation.

### 2 THE FIXED ESTABLISHMENT BEFORE AND SINCE THE INTRODUCTION OF THE IMPLEMENTING REGULATION

#### 2.1 Purpose of the Fixed Establishment in VAT<sup>7</sup>

The purpose of the fixed establishment in VAT is somewhat unclear, given that the legislative history fails to state an unequivocal reason for its introduction. The concept would seem, however, to have been introduced in

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<sup>1</sup> This article is an adaptation of an article previously published in Dutch. See M.L. Schippers & J.M.B. Boender, 'Btw en vaste inrichting: mysteries solved?' *MBB* 2015 No. 3, p. 92–103. Authors would like to express their gratitude to the persons that provided input for the table regarding the interpretation of the *Skandia* case in several EU Member States.

<sup>2</sup> Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, *Official Journal* 1977, L 145.

<sup>3</sup> Council Implementing Regulation (EU) No. 282/2011 of 15 Mar. 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, *Official Journal* 2011, L 77, as amended most recently on 26 Oct. 2013, *Official Journal* 2013, L 284.

<sup>4</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462.

<sup>5</sup> ECJ EU 17 Sep. 2014, C-7/13, ECLI:EU:C:2014:2225 (*Skandia America Corporation*), *Official Journal* 2014, C 421.

<sup>6</sup> ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000.

<sup>7</sup> The purpose as described in this section is based on VAT legislation and international developments initiated by the OECD.

order to attribute due weight to the assumptions and principles underlying VAT when determining the place of supply of goods and services.<sup>8</sup> Given that the destination principle – in other words, taxation in the country in which the goods or services are used – is becoming increasingly decisive in VAT, the purpose of introducing the fixed establishment would implicitly seem to be to enable activities liable to VAT to be taxed in their country of use.<sup>9</sup>

The purpose of introducing the fixed establishment can also be seen as a concession to the neutrality principle, with various authors arguing that its purpose is to ensure that enterprises liable to VAT and resident in one Member State and enterprises liable to VAT and resident in another Member State are treated equally when supplying goods or services in the same Member State.<sup>10</sup>

Various developments relating to the fixed establishment are also underway at an international level, primarily in the field of direct taxation, where the term ‘permanent establishment’ rather than ‘fixed establishment’ is used. The OECD’s Base Erosion and Profit Shifting (BEPS) project, for example, is seeking to identify opportunities and provide solutions for avoiding base erosion and tax evasion.<sup>11</sup> This project has also given some (lateral) consideration to VAT because the OECD regards it as undesirable for transactions between establishments of a single legal entity to remain untaxed if this would result in a legal entity artificially segregating digital supplies so that they are obtained – possibly wrongfully – ‘free of VAT’.<sup>12</sup> These problems arise primarily in situations involving a ‘multiple location entity’ (MLE), being a legal entity with establishments in more than one jurisdiction. The OECD’s International VAT/GST Guidelines (VAT Guidelines)<sup>13</sup> state that the place of taxation should be determined by the destination, also in the case of MLEs. Three approaches are presented

for ensuring MLE compliance with this principle with regard to the place of supply. In each case, the approach adopted has to respect the basic principles of VAT.<sup>14</sup> In the case of the neutrality principle, as elaborated in VAT Guidelines 2.1 to 2.6, equality is of primary importance. These various international developments would also seem to respect this second purpose of the fixed establishment; in other words, the wish to ensure compliance with the principle of neutrality in all its facets.

## 2.2 The Fixed Establishment before the Introduction of the Implementing Regulation

The Sixth VAT Directive introduced the concept of the ‘fixed establishment’, without providing any specific guidance on how this concept should be interpreted. It is hardly surprising, therefore, that the ECJ has been asked on several occasions to rule on when a fixed establishment can be said to exist.

The first occasion on which the ECJ was asked to rule on the existence of such an establishment was in the *Berkholz* case, in which it stated that an establishment should be regarded as a fixed establishment ‘[...] if the establishment entails the permanent presence of both the human and technical resources necessary for the provision of those services [...]’.<sup>15</sup> In the judgment in *ARO Lease*, it subsequently stated that ‘[...] an establishment must possess a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis’.<sup>16</sup>

It also follows from the above case law that the existence of a fixed establishment should be taken into account only if reference to the place where the supplier has established his business:

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<sup>8</sup> The recitals to the Sixth VAT Directive state that ‘[...]the determination of the place where taxable transactions are effected has been the subject of conflicts [...]’ [*antibors*: in the Second Council Directive]. The same Directive refers to the concept of the fixed establishment in the Articles determining the place of supply of goods and of services (Arts 8 and 9 respectively).

<sup>9</sup> There are also other ways of achieving taxation in the destination country, including, for example, the new place of supply rules for broadcasting, telecommunication and electronically supplied services. The argument frequently raised against applying these other solutions is that they increase the administrative burden. For a detailed report on the imposition of VAT in the destination country, see the recently published report entitled *Implementing the ‘destination principle’ to intra-EU B2B supplies of goods—Feasibility and economic evaluation study* (EY, 30 Jun. 2015), *taxud/2013/DE/319* – Final Report.

<sup>10</sup> G.J. van Norden, ‘The Allocation of Taxing Rights to Fixed Establishments in European VAT Legislation’, in: H.P.A.M. van Arendonk, J.J.M. Jansen & R.G.N. van der Paardt, *VAT in EU and International Perspective—Essays in honour of Han Kogels*, Amsterdam: IBFD 2011, p. 47. See also M.E. van Hilten, ‘Vaste inrichting en btw: (on)zelfstandig en niet onafhankelijk’, *WFR* 1997/1369, part 3.

<sup>11</sup> OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, *OECD Publishing*, p. 106–109 and 135–140.

<sup>12</sup> OECD (2014), Public discussion draft, BEPS Action 1: Address the Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, *OECD Publishing*, p. 47.

<sup>13</sup> OECD (2014), OECD International VAT/GST Guidelines (April 2014), *OECD Publishing*. Public consultations on this publication were held from 18 Dec. 2014 to 20 Feb. 2015, followed by a meeting on 25 Feb. 2015 and the OECD’s publication of ‘Comments received on public discussion drafts—International VAT/GST Guidelines on place of taxation for business-to-consumer supplies of services and intangibles’ (February 2015), *OECD Publishing*.

<sup>14</sup> In other words, neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness and fairness; see Guideline 3.2 in OECD (2014), OECD International VAT/GST Guidelines (April 2014), *OECD Publishing*, p. 23.

<sup>15</sup> See ECJ EC 4 Jul. 1985, 168/84, ECLI:EU:C:1985:299 (*Günter Berkholz*), *European Court Reports* 1985, p. 02251, para. 18 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. 17.

<sup>16</sup> ECJ EC 17 Jul. 1997, C-190/95, ECLI:EU:C:1997:374 (*ARO Lease*), *European Court Reports* 1997, p. I-04383, para. 16.

- (1) does not lead to a rational result for tax purposes; or  
 (2) creates a conflict with another Member State.<sup>17</sup>

To determine whether a result for tax purposes is rational, we first have to analyse the consequences of referring to the main place of business ('head office') as the place of supply. The results of this analysis have to be assessed against the purposes of VAT. This in turn means looking at the economic reality rather than the legal structures, while also finding solutions that do not distort competition.<sup>18/19</sup> Even if a solution results in the non-imposition of VAT, the chosen route can nevertheless be regarded as irrational for VAT purposes.<sup>20</sup> In those cases, the place of supply of services has to align with the country of the fixed establishment.<sup>21</sup>

The above case law, which predates the introduction of the VAT Directive<sup>22</sup> and the most recent VAT Implementing Regulations, is subsequently also referred to in this article as the 'standard case law' on the fixed establishment.

### 2.3 The Fixed Establishment since the Implementing Regulation

The Implementing Regulation introduced a legal definition of the fixed establishment, with this concept being defined in the Regulation on several occasions.<sup>23</sup>

#### Fixed establishment within the meaning of Article 11(1) of the Implementing Regulation

First, Article 11(1) of the Regulation defines the 'passive fixed establishment' for the application of Article 44 of the VAT Directive (B2B services) as:

*any establishment, other than the place of establishment of a business referred to in Article 10 of this Regulation, characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs.*

Interestingly, this definition would at first sight appear to diverge from the ECJ's 'standard case law'. Section 3 of this article considers the passive fixed establishment and the recent *Welmory* case in more detail.

#### Fixed establishment within the meaning of Article 11(2) of the Implementing Regulation

Article 11(2) of the Implementing Regulation defines the 'active fixed establishment' for the purposes of applying Articles 45 (business-to-consumer (B2C) services), 56(2) second paragraph (short-term letting of pleasure craft) and 192a (applicability, or otherwise, of local reverse charge mechanisms) of the VAT Directive. This second type of fixed establishment is defined as any establishment:

*{...} other than the place of establishment of a business referred to in Article 10 of this Regulation, characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to provide the services{...}.*

Our comments on these above definitions are set out below.

#### Comments on the definitions

- As outlined in section 2.1, the concept of a fixed establishment for VAT purposes would seem to have two objectives: the first of these – taxation in accordance with the destination principle – would ideally seem to be achieved through the passive fixed establishment. The same applies with regard to an active fixed establishment insofar as the services provided are B2C. The second objective – seeking to ensure neutrality – would seem to apply only in respect of an active fixed establishment.
- The definition of the active fixed establishment would seem to align with the concept of the fixed establishment as laid down in the 'standard case law', albeit with the words 'to supply the services in question

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<sup>17</sup> See ECJ EC 4 Jul. 1985, 168/84, ECLI:EU:C:1985:299 (*Günter Berkolz*), *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.

<sup>18</sup> In the judgment ECJ EC 20 Feb. 1997, C-260/95, ECLI:EU:C:1997:77 (*DFDS A/S*), *European Court Reports* 1997, p. I-01005, paras 25–26, the ECJ ruled that a subsidiary could also qualify as a fixed establishment. According to the ECJ, the fact that a subsidiary was a separate legal entity was not relevant.

<sup>19</sup> Preamble, para. 4, Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, as amended most recently by Implementing Decision 2014/797/EU of 7 Nov. 2014 (*Official Journal* L330, p. 48–49), *Official Journal* L347, p. 1–118.

<sup>20</sup> See also the Opinion of A-G Maduro 27 Jan. 2005, C-452/03, ECLI:EU:C:2005:65 (*RAL (Channel Islands)*), *European Court Reports* 2005, p. I-03947 and M.L. Schippers, *Regels plaats van prestatie btw 21ste eeuw proof?—Een onderzoek naar het thema verbodend hoofdhuus-vaste inrichting binnen het btw-onderwerp plaats van prestatie* (Master's thesis, Rotterdam ESL), 2014, p. 23–24.

<sup>21</sup> As far as the place of supply of services is concerned, the fixed establishment is primarily important for the application of any local reverse-charging mechanisms under Art. 194 of the VAT Directive. Here we primarily use the term 'place of supply'.

<sup>22</sup> Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, as amended most recently by Implementing Decision 2014/797/EU of 7 Nov. 2014 (*Official Journal* L330, p. 48–49), *Official Journal* L347, p. 1–118.

<sup>23</sup> Various authors have argued that there appear to be several types of fixed establishments. See, for example, G.J. van Norden, 'The Allocation of Taxing Rights to Fixed Establishments in European VAT Legislation', in: H.P.A.M. van Arendonk, J.J.M. Jansen & R.N.G. van der Paardt, *VAT in EU and International Perspective—Essays in honour of Han Kogels*, Amsterdam: IBFD 2011, p. 45–49.

- on an independent basis' being replaced by 'to enable it to provide the services which it supplies'. Based on the Implementing Regulation, this could point to an establishment more rapidly qualifying as a fixed establishment, given that, assuming a grammatical interpretation, there is no longer any need for services to be provided independently. The judgment in the *ARO Lease* case suggests that the ECJ sees the question of whether services are provided independently as being reliant on the existence of a '[...] framework in which agreements may be drawn up or management decisions taken'.<sup>24</sup> It would seem difficult to us in practice for an enterprise to operate without at least one of these features being present. The criterion of 'independence' would thus seem implicitly to be included in the definition provided in the Implementing Regulation.<sup>25</sup>
- The question arises as to whether the definitions of the fixed establishment in Article 11(1) and (2) of the Implementing Regulation cover all the relevant provisions of the VAT Directive. Articles 38 and 39 of the Directive (supplies of goods through various distribution systems) also refer to the fixed establishment. The question thus arising is why these supplies are not specifically mentioned in Article 11(1) and (2) of the Implementing Regulation, even though the said Articles in the VAT Directive relate to supplies of goods rather than services. As we see it, this also applies to supplies by the fixed establishment of B2B services, for which no definition is provided either. In these cases, it would seem to us, recourse has to be sought to ECJ case law, even though this would not seem to differ substantively from the provisions of Article 11(2) of the Implementing Regulation.<sup>26</sup>
  - Irrespective of whether all the provisions are covered, the question arises as to whether the Implementing Regulation actually provides 'only' two definitions of the fixed establishment, given that Article 53 of the Implementing Regulation goes into more detail on the fixed establishment by stating that:
 

*For the application of Article 192a of Directive 2006/112/EC, a fixed establishment of the taxable person shall be taken into consideration only when it is characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to make the supply of goods or services in which it intervenes.*
  - The literal text of this provision suggests that involvement in a transaction requires: (i) the existence in itself of a fixed establishment, and (ii) this fixed establishment also to be able to supply the service in which it is involved. It is conceivably possible, at least theoretically, for a fixed establishment in a Member State to be unable to supply the services of, for example, its head office or another fixed establishment.<sup>27</sup> The concept of the 'fixed establishment' is also referred to in other VAT Directives, specifically those concerning VAT refunds.<sup>28</sup> The question is whether the above provisions provide additional definitions of the concept of the fixed establishment, or simply represent a further elaboration of one or more existing concepts. We incline towards the latter interpretation.
  - The next question is whether the BEPS developments will result in the criteria to be met by a permanent/fixed establishment converging with regard to corporate income tax and VAT. It is important in this respect to take account of the differences in the legal nature of the two forms of taxation as these differences make it complicated to use these criteria as a point of reference.<sup>29</sup> This can be seen in the example of the difference in interpretation of 'having personnel and resources'. It is not always necessary for corporate

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<sup>24</sup> ECJ EC 17 Jul. 1997, C-190/95, ECLI:EU:C:1997:374 (*ARO Lease*), *European Court Reports* 1997, p. I-04383, para. 19.

<sup>25</sup> Cf. W. de Wit, 'The Fixed Establishment after the VAT Package', in: H.P.A.M. van Arendonk, J.J.M. Jansen & R.N.G. van der Paardt, *VAT in EU and International Perspective—Essays in honour of Han Kogels*, Amsterdam: IBFD 2011, p. 28–29.

<sup>26</sup> The VAT Committee expresses a different opinion. It argues that under EU VAT legislation, there is still one single definition of the fixed establishment and that it is provided under Art. 11 of the Implementing Regulation. Furthermore, the VAT Committee acknowledges that concept of fixed establishment also appears under other provisions of the VAT Directive and of the VAT Implementing Regulation, whereas the only definition of this notion is contained in Art. 11 of the VAT Implementing Regulation. However, tax administrations and other interested parties can only conclude to the existence of a fixed establishment if the conditions set out under Art. 11 of the VAT Implementing Regulation are fulfilled. See Clarification on the concept of fixed establishment (VAT Committee of 6 May 2015), *taxud.c.1(2015)2177802* – Working paper No. 857, VAT Committee – Question, p. 3. We also refer to our comments in para. 3.3.2.

<sup>27</sup> G.J. van Norden, 'The Allocation of Taxing Rights to Fixed Establishments in European VAT Legislation', in: H.P.A.M. van Arendonk, J.J.M. Jansen & R.N.G. van der Paardt, *VAT in EU and International Perspective—Essays in honour of Han Kogels*, Amsterdam: IBFD 2011, p. 49. Clarification on the concept of fixed establishment (VAT Committee 31 Mar. 2014), *taxud.c.1(2014)88957*–Working paper No. 791 VAT Committee–Question, p. 4.

<sup>28</sup> Council Directive 2008/9/EC of 12 Feb. 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State, *Official Journal* 2008, L 44/23. Thirteenth Council Directive 86/560/EEC of 17 Nov. 1986 on the harmonization 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 Community territory, *Official Journal* 1986, L 326, p. 40–41.

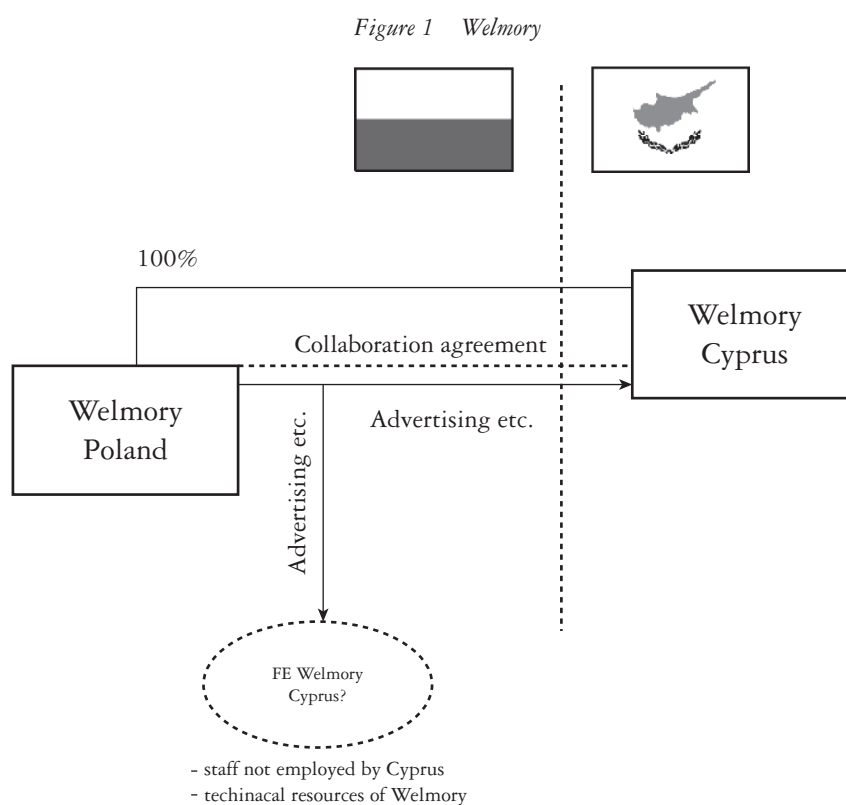
<sup>29</sup> For a comparative analysis, see the differences in the criteria for accepting a permanent/fixed establishment for corporate income tax and VAT purposes: M.L. Schippers, 'De vaste inrichting: een veelgebruikte term verschillend ingevuld', *Forfaitair* 2013/232, p. 24–28.

income tax purposes to have personnel, whereas this would appear to be a minimum requirement in the case of VAT.<sup>30</sup> Some signs of convergence would seem, however, to be perceptible with regard to duration. The required minimum duration of six months or in any event an existence of at least eighteen months or longer for a foreign enterprise's activities to rise to the level of a permanent establishment<sup>31</sup> seeming to be becoming less important than before.<sup>32</sup>

### 3 PASSIVE FIXED ESTABLISHMENT – WELMORY CASE

#### 3.1 Facts of the Case

The question at the heart of the *Welmory* case concerned whether a website operated by a Cypriot company in Poland could qualify as a fixed establishment within the meaning of Article 11(1) of the Implementing Regulation. If the activities in Poland qualified as a fixed establishment, the taxation rights would be attributed to Poland, while otherwise the right to charge VAT would accrue to Cyprus. The facts of the case are summarized in figure 1.



The facts of the case were as follows:

- Welmory Poland and Welmory Cyprus signed a collaboration agreement, whereby the latter managed a website in Poland, using Welmory Poland staff and resources.
- On this website, Welmory Poland offered and sold products by auction for its own account.
- Customers wanting to submit a bid for these products first had to acquire the right to do so from the Cypriot company. The amounts paid for the products were subsequently collected by Welmory Poland.

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<sup>30</sup> There are various exceptions in corporate income tax regarding the requirement for personnel. Under point 42.6 of the commentary on Art. 5 of the OECD Model Convention, for example, it is stated that '[...] a permanent establishment may exist even though no personnel of that enterprise is required [...]. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business [...].'

<sup>31</sup> A.A. Skaar, *Permanent Establishment*, Deventer, Boston: Kluwer Law and Taxation Publishers, 1991.

<sup>32</sup> OECD (2014), BEPS Action 7: Preventing the Artificial Avoidance of PE Status, OECD/G20 Base Erosion and Profit Shifting Project, *OECD Publishing*, p. 21–22. An update was published on 15 May 2015: OECD (2015), BEPS Action 7: Preventing the Artificial Avoidance of PE Status, *OECD Publishing*.

- Under the collaboration agreement, Welmory Cyprus also had to pay fees to Welmory Poland for sales-related services, such as advertising, performed by the Polish company.
- Welmory Poland had been a wholly owned subsidiary of Welmory Cyprus since 19 April 2010.

The question for the ECJ was whether the fact that Welmory Cyprus used Welmory Poland's infrastructure meant that Welmory Cyprus had a passive fixed establishment in Poland.<sup>33</sup>

### 3.2 ECJ Judgment

The ECJ ruled that Welmory Cyprus's activities which was making use of the Welmory Poland's infrastructure could, under certain circumstances, be regarded as a fixed establishment for the application of Article 44 of the VAT Directive, within the definition of the fixed establishment as stated in Article 11(1) of the Implementing Regulation.

Like the referring court, the ECJ acknowledged that the 'standard case law' operated from the perspective of the taxable supplier of the service and not – as in the case at hand – from the perspective of the taxable recipient of the service.<sup>34</sup> Nevertheless the ECJ saw scope for applying the 'standard case law', given that this also involved determining where supplies were deemed to be provided for VAT purposes.<sup>35</sup> The question of whether a fixed establishment can be said to exist in such cases must be assessed on the basis of 'standard case law', as well as on the basis of the Implementing Regulation. According to the ECJ, the Implementing Regulation was intended to serve solely as clarification and to be applied accordingly, even though this Regulation was not yet in force at the time of the facts in the main proceedings.<sup>36</sup>

Subsequently, the ECJ went through the steps outlined in section 2.1 to establish whether VAT should be imposed at the level of the fixed establishment,<sup>37</sup> with the primary point of reference continuing to be the head office, given that this 'appears to be a criterion that is objective, simple and practical and offers great legal

certainty [...]'.<sup>38</sup> If the head office does not constitute a useful point of reference, the question of whether there can be said to be a fixed establishment within the meaning of Article 44 of the VAT Directive should be considered. This would be the case for Welmory Cyprus if it had in Poland at least a structure '[...] characterised by a sufficient degree of permanence, suitable in terms of human and technical resources to enable it to receive in Poland the services supplied to it by the Polish company and to use them for its business[...]'.<sup>39</sup>

### 3.3 Implications of Welmory

#### 3.3.1 General

The result of the *Welmory* judgment was no surprise, given that provision for the passive fixed establishment was already included in Article 11(1) of the Implementing Regulation. Similarly, the application of the Implementing Regulation prior to its publication was also unsurprising in view of the *Susanne Leichenich* case.<sup>40</sup> From a procedural law perspective, questions can certainly be raised about the 'introduction' of the passive fixed establishment in this way. Indeed, an article by Van Slooten devotes extensive attention to the question of whether it is possible, from a procedural law perspective, for the Implementing Regulation, which is presented as clarification, actually to extend the scope of the VAT Directive.<sup>41</sup> He concludes that European law does not permit the Implementing Regulation to go beyond clarifying the provisions of the VAT Directive and so sees scope for taxable persons to claim in law that the Implementing Regulation is invalid insofar as it extends beyond providing clarification of the VAT Directive. As explained in section 3.2, the judgment in *Welmory* confirms that the fixed establishment differs for the purposes of applying Article 44 of the VAT Directive from the way it is applied in the 'standard case law', if only because of the difference in perception (i.e., the perspective of the supplier of the service as opposed to that of the recipient). This would seem to confirm that, as far as the

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<sup>33</sup> Interestingly, several parties have claimed that the actual question for the ECJ was whether VAT should be levied on the 'bidding rights' sold by Welmory Cyprus to Polish customers. Given, however, the wording of the request for a ruling submitted by the Polish court, we regard the ECJ as correctly not having considered this question.

<sup>34</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462, paras 28 and 39.

<sup>35</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462, paras 43 and 47.

<sup>36</sup> *Welmory*, paras 44–46. See also ECJ EU 15 Nov. 2012, C-532/11, ECLI:EU:C:2012:720 (*Susanne Leichenich*), *Official Journal* 2013, C 9, in which the ECJ states that although the Implementing Regulation is 'not applicable *ratione temporis* to the case in the main proceedings, [it] nevertheless explains and clarifies concepts appearing in the VAT legislation and applicable since its inception'.

<sup>37</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462, para. 52.

<sup>38</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462, para. 55.

<sup>39</sup> ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), *Official Journal* 2014, C 462, paras 58–59. It is up to the referring court to assess this. In L. de Groot & Michael Bolt, 'Welmory: Possible Increase in Fixed Establishments of Businesses for VAT?', *BNA International*, Indirect Taxation, bna-it A0G0B1M1U3, the authors point out that the fact that Welmory Cyprus held shares in Welmory Poland could result in the referring court ruling that Welmory Cyprus had a suitable structure. This would mean the operations in Poland qualifying as a fixed establishment.

<sup>40</sup> ECJ EU 15 Nov. 2012, C-532/11, ECLI:EU:C:2012:720 (*Susanne Leichenich*), *Official Journal* 2013, C 9.

<sup>41</sup> G.J. van Slooten, De BTW-Verordening: Mogen wijzigingen vermomd gaan als 'verduidelijking?', *WFR* 2012/6937, p. 86–97.

concept of the fixed establishment in Article 11(1) is concerned, the Implementing Regulation goes beyond mere clarification. In view of the claims made in Van Slooten's article, it would seem purely a matter of time, therefore, before the ECJ is asked to rule on the status and scope of the Implementing Regulation.

Prior to the *Welmory* judgment, there were fears that the passive fixed establishment would result in an increased administrative burden.<sup>42</sup> Purchase activities could quickly (or too quickly) result in qualification as a fixed establishment, and this would substantially increase the reporting requirements for establishments that lacked the necessary degree of expertise. In practice, however, these fears would seem exaggerated, given that the ECJ states (and indeed reiterates) in the *Welmory* judgment that the head office should continue to be the primary point of reference, while qualification as a fixed establishment also continues to require a sufficient degree of permanence and a suitable structure to enable it to receive and use services supplied to it for its own needs. With a view to legal certainty, A-G Kokott noted, also with regard to the concept of a fixed establishment as referred to in Article 11(1) of the Implementing Regulation, that a certain degree of caution should be observed when determining whether there is a fixed establishment, just as in the 'standard case law'. We agree, however, with De Groot and Bolt that qualification as a fixed establishment is now more likely than before the Implementing Regulation came into force.<sup>43</sup> This view would also seem to be reflected in the BEPS project referred to in section 2.3 with regard to the permanent establishment for corporate income tax purposes.<sup>44</sup>

### 3.3.2 Passive Fixed Establishment v. Active Fixed Establishment

Another question arising in response to the judgment in *Welmory* is whether a passive fixed establishment is simultaneously also an active fixed establishment and vice versa. It could be argued that a passive fixed establishment must, by definition, also supply services to third parties.<sup>45</sup> In that situation, we would see passive and active fixed establishments as being equivalent. However, in our view a distinction between the two would also seem possible,

even after the *Welmory* case. An example of such a distinction would be a representative office that does not perform any taxable services, but does purchase services liable to VAT and has a structure with a sufficient degree of permanence as referred to in Article 11(1) of the Implementing Regulation. This view is supported by the VAT Committee, which stated in an opinion on that subject that a passive fixed establishment was not simultaneously an active fixed establishment:<sup>46</sup>

*A structure that would have the necessary human and technical resources to receive and use services supplied to it for its own needs would not necessarily have sufficient resources to provide those services on its own. Therefore, a structure that qualifies as a 'passive fixed establishment' must not be automatically treated as an 'active fixed establishment', nor should it be automatically considered to intervene in supplies made by the main place of business.*

It is however unclear to which extent the above still communicates the view of the VAT Committee. This since in the most recent Working Paper of the VAT Committee concerning the application of Article 11 of the Implementing Provision it is stated that:

*These two requirements (authors: 'receive and use the services' and 'provide the services') should not be seen as creating two different definitions of the concept of fixed establishment for 'purchasing' and 'supplying' fixed establishments. There is only one single definition of the concept of fixed establishment requiring on the one hand a sufficient degree of permanence and, on the other hand, a suitable structure in terms of human and technical resources which however has to be assessed on a case-by-case basis with regard to the circumstances at stake.<sup>47</sup>*

If indeed there should only be one definition, it would seem odd to argue that it would be possible to only form a passive fixed establishment without being an active fixed establishment. In any case, it seems to us that both quotes of the VAT Committee are somewhat contradictory.

In our view, an active fixed establishment should at least be considered also to constitute a passive fixed establishment because if such a structure is able to supply services to third parties, it should also have the capacity to supply services for its own needs and to use such services locally. However, as mentioned above, at least theoretically

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<sup>42</sup> See, for example, M.M.W.D. Merckx, 'Btw-uitvoeringsverordening uitvoerbaar?' *WFR* 2011/1308.

<sup>43</sup> L. de Groot & Michael Bolt, 'Welmory: Possible Increase in Fixed Establishments of Businesses for VAT?', *BNA International*, Indirect Taxation, bna-it A0G0B1M1U3. The authors note that the *Welmory* judgment gives tax authorities grounds for classifying business activities more rapidly as a fixed establishment. For a different view, see J.Th. Sanders, 'Een ondergeschoven kind in de btw?', *NTRFB* 2015/3, in which the author claims that the conditions created make it extraordinarily difficult, if not impossible, to qualify as a fixed establishment.

<sup>44</sup> This refers to more rapid qualification as a fixed establishment. In the case, however, of the passive fixed establishment, this view should be somewhat nuanced, given that Art. 5(4) of the OECD Model Convention would seem to exclude the passive fixed establishment for corporate income tax purposes.

<sup>45</sup> Commentary in Dutch Tax Journal; see *Redactie Vakstudie Nieuws* on ECJ EU 15 Oct. 2014, C-605/12, ECLI:EU:C:2014:2298 (*Welmory*), V-N 2014/57.13.

<sup>46</sup> Clarification on the concept of fixed establishment (VAT Committee of 31 Mar. 2014), *taxud.c.1(2014)88957* – Working paper No. 791, VAT Committee – Question, p. 4.

<sup>47</sup> Clarification on the concept of fixed establishment (VAT Committee of 6 May 2015), *taxud.c.1(2015)2177802* – Working paper No. 857, VAT Committee – Question, *supra* note 5 on p. 4.



it would be possible for a company to only have a passive fixed establishment without necessarily having an active fixed establishment. Whether our view will prevail is far from certain, however. The final decision in *Welmory* is now a matter for the national court, while we await further case law from the ECJ which may clarify the above. Finally, we also believe, based on the *FCE Bank* case discussed below, that the fact that a passive fixed establishment supplies services solely to its head office should not automatically result in its qualifying as an active fixed establishment.

## 4 RELATIONSHIP BETWEEN THE HEAD OFFICE AND FIXED ESTABLISHMENT

### 4.1 General – FCE Bank Case

Alongside the concept of the fixed establishment, there have also been developments in ECJ case law on the relationship between the fixed establishment and the head office with regard to: (i) the taxability of reciprocal services, and (ii) the right of these establishments to deduct input VAT.

Irrespective of exactly how the concept of a fixed establishment is interpreted, case law has already answered the question of whether services provided between a fixed establishment and a head office are liable for VAT. Back in 2006 the ECJ issued its judgment in the case of *FCE Bank*,<sup>48</sup> which concerned the United Kingdom (UK)-resident company FCE Bank and its fixed establishment in Italy, FCE IT.<sup>49</sup> The latter received various services from FCE Bank, for which invoices including VAT were issued. According to FCE IT, however, services supplied within the same legal entity were not liable to VAT, as a result of which it requested a refund of VAT. The referring court requested the ECJ to rule *inter alia* on whether a fixed establishment<sup>50</sup> of a company with an establishment in another Member State could be regarded as independently liable for VAT.

Before the ECJ announced its answers to these questions, it confirmed that the party involved was a taxable person established within the EU. It then went on to state that a service was taxable only if there was a legal relationship between the service provider and the recipient and the relationship included reciprocal supplies. In order

to establish whether such a legal relationship existed in the *FCE Bank* case, the question of whether FCE IT carried out an independent economic activity had to be examined. This meant determining whether FCE IT could be regarded as an independent bank and specifically whether it bore the economic risks arising from its business. According to the ECJ, it is the legal person that bears this risk and that is consequently subject to supervision of its financial strength and solvency in its Member State of origin. As a branch, FCE IT had no endowment capital and was therefore entirely reliant on the UK-resident head office. As a result, FCE Bank and FCE IT were considered to constitute a single taxable entity. Reciprocal services between these two parties were thus ruled, in principle, to be outside the scope of VAT.

In corporate income tax, profits are, in principle, attributed to a head office and a permanent establishment on the basis of the separate entity approach.<sup>51</sup> In specific circumstances, fictitious transactions – *dealings* – between the head office and permanent establishment may also be recognized.<sup>52</sup> In its *FCE Bank* judgment, the ECJ explicitly expressed its views on the relationship between VAT and the OECD Model Convention; in other words, its view that the Model Convention is of no direct relevance to VAT. This then makes it more difficult to see signs of convergence, as referred to in section 2.3, between the fixed establishment in direct and indirect taxation.

#### 4.1.1 DFDS

In principle, a head office and fixed establishment constitute part of the same legal entity. However, the *DFDS* case<sup>53</sup> would seem to have created scope for divergence in this respect. The head office and fixed establishment in this case were not part of the same legal entity because the fixed establishment constituted a separate legal entity.

The English company DFDS Ltd. acted as an agent in selling tour packages for the account of its Danish parent company DFDS A/S. Under the travel agency regulations then applying, the services supplied were in principle taxable, pursuant to Article 26(2) of the Sixth Directive, in Denmark, the country of the party supplying them. By selling in the name of DFDS A/S, the DFDS group seems to have been seeking to sell tour packages free of VAT to

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<sup>48</sup> ECJ 23 Mar. 2006, C-210/04, ECLI:EU:C:2006:196 (*FCE Bank*), *European Court Reports* 2006, p. I-02803.

<sup>49</sup> ECJ 23 Mar. 2006, C-210/04, ECLI:EU:C:2006:196 (*FCE Bank*), *European Court Reports* 2006, p. I-02803, paras 23 and 24. In the request for a preliminary ruling, however, the referring court used the term 'branch'. In his Opinion, A-G Léger concluded that this constituted a 'fixed establishment'. See Opinion of A-G Léger, 29 Sep. 2005, C-210/04, ECLI:EU:C:2005:582 (*FCE Bank*), *European Court Reports* 2006, I-2803, paras 26 and 27.

<sup>50</sup> See footnote 49.

<sup>51</sup> This is the method preferred by the OECD. See 'Report on the attribution of profits to permanent establishments' (OECD 2008), Paris: *OECD Publishing* 2008.

<sup>52</sup> From a specifically Dutch perspective, see, for example, the Dutch Supreme Court of 7 May 1997, No. 30 294, *BNB* 1997/263; Dutch Supreme Court of 7 May 1997, No. 31 795, *BNB* 1997/264, and the Decree of the State Secretary of Finance of 15 Jan. 2011, No. IFZ2010/457M, on the attribution of profits to permanent establishments, *Dutch Government Gazette*. 2011, 1375.

<sup>53</sup> ECJ EC 20 Feb. 1997, C-260/95, ECLI:EU:C:1997:77 (*DFDS A/S*), *European Court Reports* 1997, p. I-01005.

consumers in the UK and Ireland because Denmark had availed itself of the opportunity to exempt travel agency services from VAT. If Denmark was the place of supply, no VAT would be payable. The UK, by contrast, had opted not to exempt travel agents from VAT. This case focused on the question of whether DFDS Ltd., as a separate legal entity, could be regarded as a fixed establishment of DFDS A/S.

Given that using the head office as the point of reference for the place of supply in this case would not produce a rational result for tax purposes, and also in view of the economic reality, the ECJ ruled that, in these circumstances, the English subsidiary should not be regarded as independent of its parent. This dependence and the fact that the subsidiary met the other requirements for constituting a fixed establishment – under the ECJ’s ‘standard case law’ – meant that the subsidiary had to qualify as a fixed establishment of the parent.

Whether the fact that a head office and fixed establishment are not part of the same legal entity should result in reciprocal services being categorized as taxable services is open to dispute. We see this, however, as primarily an academic discussion, given that, in our view, a situation such as that of DFDS will not reoccur in practice. This view is supported by the joined cases of *Daimler* and *Widex*,<sup>54</sup> in which the ECJ established that a wholly owned subsidiary is a legal person with an independent liability for tax. The *DFDS* case took account of the economic reality, rather than the independent status of the subsidiary, purely in order to determine which party had actually supplied the taxable services and, therefore, which Member State should tax these transactions. Normally, the issue of independent status would be given

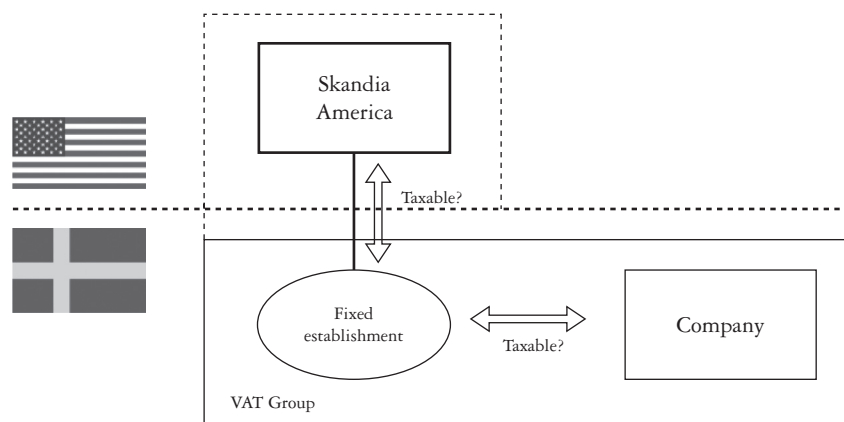
priority, thus avoiding any discussion of whether a legally separate party constitutes a fixed establishment. The ECJ’s considerations, however, in the *Daimler*, *Widex* and *FCE Bank* cases show, in our view, that if and insofar as the head office and fixed establishment are not part of the same legal entity, reciprocal services should be taxable. This is because: (i) each ‘party’ comprises a separate legal entity that is exposed to economic risks on its own account,<sup>55</sup> and (ii) the court disregarded the independent status of the subsidiary in the *DFDS* case purely in order to determine which ‘party’ supplied the services.<sup>56</sup>

## 4.2 Skandia – Creating Clarity, or Not?

### 4.2.1 Facts of the Case

Skandia America Corporation was a United States (US)-registered company that supplied IT services. These services were purchased from a third party and then distributed, with a 5% mark-up, to other parts of the Skandia group, including the fixed establishment in Sweden, which is part of a Swedish VAT group. The IT services were processed by the fixed establishment and then distributed, with a mark-up, to other parts of the VAT group and also to persons not comprising part of the VAT group. Essentially the ECJ was asked to rule on: (i) how the IT services distributed to the fixed establishment should be treated for VAT purposes, and (ii) how the IT services distributed to other companies should be treated in this respect.

Figure 2 Skandia



## Notes

<sup>54</sup> ECJ EU 25 Oct. 2012, C-318-11 and C-319/11, ECLI:EU:C:2012:666 (*Daimler* and *Widex*), *Official Journal* 2012, C 399.

<sup>55</sup> See also M.M.W.D. Merckx, *De woon- en vestigingsplaats in de btw*, Deventer: Kluwer 2011, p. 425–426 and M. Schrauwen, ‘De FCE-zaak: de vaste inrichting a contrario btw-belast’, *BtwBrief* 2006, 12 (No. 1).

<sup>56</sup> Van Kesteren and Soltysik attribute the somewhat strange reasoning to the (seemingly) ‘lack’ at the time of an abuse of law doctrine. Examination against this doctrine became possible only after the judgment in ECJ EC 21 Feb. 2006, C-255/02, ECLI:EU:C:2006:121 (*Halifax*), *Official Journal* 2006, p. I-01609. The authors assume that the ECJ would now examine such a case in the light of this doctrine. The result of the judgment in the *DFDS* case – taxation in the UK – would, however, be the same even if a claim of abuse of law were to succeed. See H.W.M. van Kesteren & M.W.C. Soltysik, ‘Misbruik en de onvoltooide harmonisatie’, *WFR* 2007/6718, p. 481–491.

#### 4.2.2 Opinion of A-G Wathelet

According to the Advocate-General, a fixed establishment of a third-country company could not belong to a VAT group of its own right and independently of the company.<sup>57</sup> The A-G considered that this would be undesirable in that it could result not only in the transactions between the head office and the fixed establishment falling outside the scope of taxation, but also in the subsequent transactions with other members of the VAT group not being liable to VAT. Member States could avoid such situations with reference to the second paragraph of Article 11 of the VAT Directive, which allows them to adopt measures needed to prevent tax evasion or avoidance. The inclusion of the fixed establishment in the VAT group in this case had to be considered ‘unlawful’. The A-G stated that this unlawfulness could have four possible consequences, all of which would result in transactions between the head office in the US and the fixed establishment in Sweden being liable to VAT.

#### 4.2.3 ECJ’s Judgment

Although the ECJ’s judgment in this case built on its judgment in the *FCE Bank* case in that it considered the fixed establishment not to have an independent liability for tax, this does alter the fact that the fixed establishment and the members of the VAT group together constitute a single taxable person.<sup>58</sup> Supplies by the head office were consequently ruled to be taxable transactions supplied not to the fixed establishment, but to the VAT group.<sup>59</sup> These supplies were therefore regarded as being supplied to a third party and thus within the scope of VAT.

#### 4.2.4 Comments on *Skandia*

– At first glance, the judgment would appear to have only limited applicability, given that the ECJ took it as fact that the Swedish VAT grouping provisions do not allow a head office established outside Sweden to be part of the Swedish VAT group to which the fixed

establishment belongs. The ECJ’s judgment covered only the question of whether transactions between the head office and the fixed establishment in such a situation should be liable to VAT, while no explicit pronouncement was made on whether a fixed establishment could be included in a VAT group without its foreign head office, or vice versa.

- The question that has to be asked, however, is what the ECJ was seeking to achieve in this judgment. Was it purely wishing to establish a liability for VAT in such situations within the EU, given that full application of the *FCE Bank* judgment to this specific case would have resulted in supplies of IT services between the head office (in the US) and the fixed establishment (part of the Swedish VAT group) being without levying VAT?<sup>60</sup> The subsequent supplies by the fixed establishment to other parts of the Swedish VAT group would then potentially also have been outside the scope of VAT. In short, the reasoning applied would seem to involve a case of the ends being seen as justifying the means; in other words, of the ECJ choosing this route purely as a means of establishing a liability to VAT in the EU. If this is the argument, it is surprising that the ECJ did not apply the abuse of law doctrine in accordance with the A-G’s Opinion. Instead, it opted for a different route, with the result – as the following demonstrates – that the exact scope of the judgment is unclear.
- In contrast to Sweden, the VAT grouping provisions applied in countries such as the Netherlands<sup>61</sup> and the UK allow a foreign head office to be included in the VAT group to which a fixed establishment of the head office belongs. The question then arising is whether the judgment in *Skandia* also applies to such VAT grouping provisions. Within Europe, views on this matter differ. The Netherlands, for example, would seem (at least informally) to believe that the judgment does not affect the Dutch VAT grouping provisions in any way and that transactions between the head office and the fixed establishment – irrespective, at first sight, of the ‘type’ of grouping provisions applying in the other country – remain outside the scope of VAT.<sup>62</sup> The UK tax authorities (HMRC), however, have indicated that the judgment may indeed have an impact in certain

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<sup>57</sup> Opinion of A-G Wathelet, 8 May 2014, C-7/13, *NFR 2014-1594* annotated by A.J. Blank (*Skandia America Corporation*), paras 39–59. As we discuss later, the ECJ would seem to have disregarded this issue.

<sup>58</sup> ECJ EU 17 Sep. 2014, C-7/13, ECLI:EU:C:2014:421 (*Skandia America Corporation*), *Official Journal* 2014, C 421, para. 28.

<sup>59</sup> ECJ EU 17 Sep. 2014, C-7/13, ECLI:EU:C:2014:421 (*Skandia America Corporation*), *Official Journal* 2014, C 421, paras 30–32.

<sup>60</sup> This would not normally have any implications, given that the VAT can also be deducted. In this case, however, the enterprise was liable to VAT but supplied VAT-exempt services, which meant that the right to deduct input VAT would (at least largely) be refused.

<sup>61</sup> See Dutch Supreme Court, 14 Jun. 2002, No. 35 976, *BNB 2002/287*.

<sup>62</sup> The Dutch Ministry of Finance informally made this view known on 10 Feb. 2015. Similarly, it follows from the report that the Dutch view will also apply if it is not the fixed establishment, but specifically the head office that is part of the Dutch VAT group (i.e., a ‘reverse Skandia’). It has been reported that this view will also be officially

situations.<sup>63</sup> According to HMRC, the impact will depend on whether the other EU Member State involved applies the *Skandia* judgment. If that is the case, transactions between the head office and the fixed establishment will be within the scope of VAT from a UK VAT perspective.

– We have sought to summarize the views of the various Member States in table 1 by showing: (1) whether the Member State has implemented Article 11 of the VAT Directive, (2) whether foreign parts of a company can also be included in a VAT group, and (3) whether the Member State applies the *Skandia* judgment.

Table 1 Various Views on Taxation Intra-company Service Supplies<sup>64</sup>

EU Member States <sup>65</sup>	Foreign Business Establishment Part of Domestic VAT Group?	Intra-company Service Supplies Taxable?
Austria	No	No <sup>66</sup>
Belgium	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>67</sup>
Cyprus	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>68</sup>
Czech Republic	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>69</sup>
Denmark	No	Yes, if the local branch is part of a VAT group <sup>70</sup>
Estonia	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>71</sup>
Finland	No	No <sup>72</sup>
Germany	No	No <sup>73</sup>
Hungary	No	No <sup>74</sup>
Ireland	Yes	No <sup>75</sup>
Latvia	No	No <sup>76</sup>
Netherlands	Yes	No <sup>77</sup>

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published by amendment of the existing Dutch policy decision on the fixed establishment in VAT (Decree of State Secretary of Finance of 21 Nov. 2003, No. DGB2003/6237M).

<sup>63</sup> Revenue and Customs Brief 2/2015 (10 Feb. 2015).

<sup>64</sup> We have included the views of the various EU Member States to the best of our knowledge. These views may change over time, however, given that not every Member State's tax authorities have published specific guidance.

<sup>65</sup> We have only included EU Member States that implemented Art. 11 of the VAT Directive.

<sup>66</sup> No further specific guidance on the impact of the *Skandia America* case is published yet. The current interpretation is based on § 2 Abs 2 Umsatzsteuergesetz 1994.

<sup>67</sup> Administratief standpunt van 3 Apr. 2015 (beslissing E.T. 127.577).

<sup>68</sup> No further specific guidance on the impact of the *Skandia America* case is published yet. The current interpretation is based on Art. 32 VAT Law 95(I)/2000.

<sup>69</sup> [http://www.financnisprava.cz/assets/cs/prilohy/d-seznam-dani/2015-06\\_Informace\\_Skandia.pdf](http://www.financnisprava.cz/assets/cs/prilohy/d-seznam-dani/2015-06_Informace_Skandia.pdf).

<sup>70</sup> <http://www.skat.dk/SKAT.aspx?oId=2049569>.

<sup>71</sup> [http://www.fin.ee/public/pressiteated/KMS\\_kommentaariid\\_seis\\_01\\_01\\_2015\\_ules.pdf](http://www.fin.ee/public/pressiteated/KMS_kommentaariid_seis_01_01_2015_ules.pdf).

<sup>72</sup> Further guidance on intra-company transactions and VAT grouping would be published during Q1 2015. See also [https://www.vero.fi/fi-FI/Tietoa\\_Verohallinnosta/Tiedotteet/Yritys\\_ja\\_yhteisoasiakkaat/Euroopan\\_uniionin\\_tuomioistuimen\\_tuomio\\_v\(34212\)](https://www.vero.fi/fi-FI/Tietoa_Verohallinnosta/Tiedotteet/Yritys_ja_yhteisoasiakkaat/Euroopan_uniionin_tuomioistuimen_tuomio_v(34212))). However, no guidance has been published to date.

<sup>73</sup> No further specific guidance on the impact of the *Skandia America* case is published yet. The current interpretation is based on: [http://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF\\_Schreiben/Steuerarten/Umsatzsteuer/Umsatzsteuer-Anwendungserlass/Umsatzsteuer-Anwendungserlass-aktuell-Stand-2015-07-07.pdf?\\_\\_blob=publicationFile&v=66](http://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Steuerarten/Umsatzsteuer/Umsatzsteuer-Anwendungserlass/Umsatzsteuer-Anwendungserlass-aktuell-Stand-2015-07-07.pdf?__blob=publicationFile&v=66).

<sup>74</sup> Act CXXXVII of 2007 on Value Added Tax, S. 8.

<sup>75</sup> Further specific guidance is envisaged. Please also see Revenue and Customs Brief 37/2014 (October 13) and Revenue and Customs Brief 2/2015 (10 Feb. 2015).

<sup>76</sup> Noteikumi par pievienotās vērtības nodokļa deklarācijām, 64.pants. Nosacījumi PVN grupas reģistrācijai Valsts ieņēmumu dienesta pievienotās vērtības nodokļa maksātāju reģistrā un dalībnieku reģistrācijai PVN grupā.

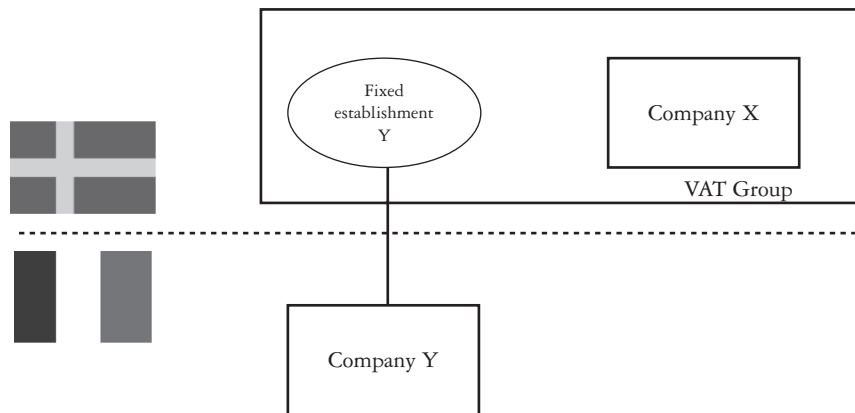
<sup>77</sup> Dutch Supreme Court, 14 Jun. 2002, No. 35 976, BNB 2002/287. Further, the Dutch Tax Authorities informed the Dutch Association of Tax Advisers by e-mail. Basically, the Dutch Tax Authorities disregard the *Skandia* until further guidance from the EU has been published. However, this policy is not broadly publicized.

<i>EU Member States</i> <sup>65</sup>	<i>Foreign Business Establishment Part of Domestic VAT Group?</i>	<i>Intra-company Service Supplies Taxable?</i>
Slovakia	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>78</sup>
Sweden	No	Yes, if either the fixed establishment or the head office is part of a VAT group <sup>79</sup>
United Kingdom	Yes	Yes, per 1 January 2016 if: 1. either the fixed establishment or the main business establishment is part of a VAT group; and 2. the other country has implemented a Swedish 'establishment only' VAT grouping system. <sup>80</sup>

– Irrespective of the views in the Netherlands and the UK, other differences of opinions may obviously also arise in the other Member States. These may in turn result in mismatches and, therefore, in double or

non-taxation, particularly given that not every Member State has yet implemented the VAT grouping provisions. This is illustrated in the following example:

Figure 3 Example of Mismatch



– France does not yet have any VAT grouping provisions. Say, therefore, that the results of the *Skandia* judgment, from the Swedish perspective, were to be applied in a situation in which the head office is established within the EU (specifically France). If the French head office were to supply both taxable and exempt services and to purchase services for (or partly for) the Swedish fixed establishment (part of the Swedish VAT group), the practice from a French VAT perspective would be to apply the doctrine prevailing as a result of the *FCE Bank* case. That means, again from a French VAT perspective, that no taxable services would be supplied. From a Swedish perspective, however, reverse charged

VAT would have to be reported. If the Swedish VAT group is not entitled to deduct input VAT in full, the VAT paid will accrue to the Swedish treasury. On the other hand, the French tax authorities could take the view that the French head office is not entitled to deduct VAT on supplies purchased for the Swedish fixed establishment, given the absence of any corresponding taxable supplies.<sup>81</sup> In that way, therefore, a double liability for VAT would arise at a European level.

– The reverse situation is obviously also possible, with the Swedish fixed establishment then supplying services to the French head office. If it were to be decided that

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<sup>78</sup> [https://www.financnasprava.sk/\\_img/pfsedit/Dokumenty\\_PFS/Podnikatelia/Dan\\_z\\_pridanej\\_hodnoty/ Informovanie/mp\\_upl\\_dph\\_skupina0210.pdf](https://www.financnasprava.sk/_img/pfsedit/Dokumenty_PFS/Podnikatelia/Dan_z_pridanej_hodnoty/Informovanie/mp_upl_dph_skupina0210.pdf).

<sup>79</sup> ECJ EU 17 Sep. 2014, C-7/13, ECLI:EU:C:2014:421 (Skandia America Corporation), *Official Journal* 2014, C 421, para. 16.

<sup>80</sup> <https://www.gov.uk/government/publications/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment>.

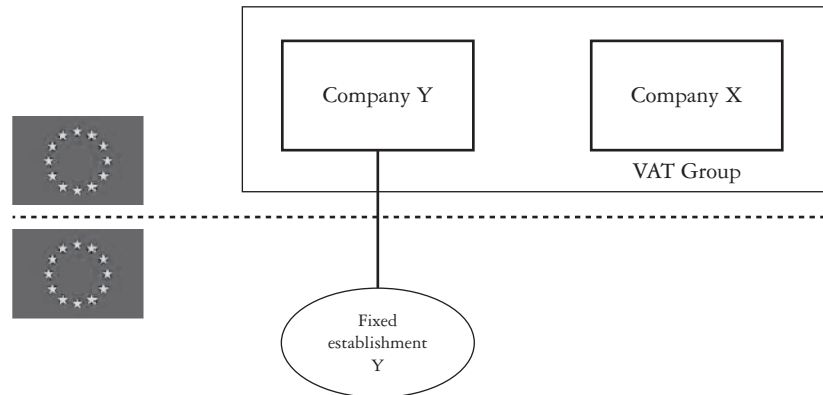
<sup>81</sup> This effect may be reinforced by ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000.

these services were also supplied by the VAT group rather than by the fixed establishment, the view from a Swedish VAT perspective would be that a service was being supplied to a third party. If these services are liable to VAT, the input VAT can in principle be deducted by the Swedish VAT group. From a French VAT perspective, however, no services are received as

France has no provision for VAT grouping. In such a situation, therefore, no VAT would be levied.

- As well as the double taxation and non-taxation situations outlined above, a ‘reverse Skandia’ situation, as shown below in figure 4, could also arise.

Figure 4 Reverse Skandia



- An additional question arising in this case would be whether the doctrine established in the *FCE Bank* judgment would apply, or whether supplies would be recognized in accordance with the *Skandia* case.
- So what happens next? In order to ensure an unambiguous interpretation of the *Skandia* judgment and thus avoid potential mismatches, agreement needs to be reached – at least at an EU level – on the scope of the judgment and its implications.<sup>82</sup> Despite ECJ judgments normally having *ex tunc* application, we would prefer, for reasons of legal certainty, to see each EU Member State applying the same rules from a specific date onwards.<sup>83/84</sup> The VAT Committee has clearly expressed its views on the implications of the *Skandia* judgment, with the preference being for the ‘Swedish VAT group system’ and for regarding reciprocal supplies between the head office and fixed establishment as taxable.<sup>85</sup> As the minutes of the 103rd meeting of the VAT Committee of 20 April 2015 show, however, this is not so easy to achieve. This is because many countries clearly have differing views on the issue

and the Committee is explicitly asked to provide guidelines.<sup>86</sup> Ideally, this issue should be resolved at a global level so as to minimize the chances of non-taxation (from a European perspective). In that respect, the OECD discussions on BEPS provide an interesting point of reference for examining the fixed establishment in a broader perspective.

- Lastly, and regardless of the *Skandia* case, it follows that the judgment in the *FCE Bank* case (reciprocal supplies are not taxable) in principle applies also to situations in which the head office is established outside the EU, while this would appear also to be the prevailing doctrine in the literature.<sup>87</sup> This conclusion would seem to us to apply equally to a situation involving a head office in the EU and a fixed establishment outside the EU. In view of the aspects outlined above and the potential for mismatches, it might have been easier in retrospect if the ECJ had ruled in the *FCE Bank* case that supplies between the head office and the fixed establishment were within the scope of VAT as this would have more closely reflected views prevailing both

## Notes

<sup>82</sup> Two obvious solutions would be to declare all supplies between the head office and fixed establishment – regardless of whether one or both is or are part of the VAT group – to be: (1) taxable, or (2) non-taxable.

<sup>83</sup> In the same sense, see G.J. van Norden, ‘Beleidsregels, rechtszekerheid en kenbaarheid’, *NTR* 2014/2566.

<sup>84</sup> In multiple cases the ECJ limited the temporal effects of its judgments, for example in cases that bear the risk of severe economic repercussions. For a more extended paper about the temporal limitation of ECJ judgements, see M. Lang, *Limitation of the Temporal Effects of Judgements of the ECJ*, *Intertax*, Volume 35, Issue 4.

<sup>85</sup> Issues arising from recent judgments of the Court of Justice of the European Union (VAT Committee, 31 Mar. 2015), *taxud.c.1(2015)747072* – Working paper No. 845.

<sup>86</sup> Minutes of the 103rd meeting (VAT Committee, 16 Jun. 2015), *taxud.c1 (2015)2838199* – Working paper No. 866 final.

<sup>87</sup> Cf. M.M.W.D. Merckx, *De woon- en vestigingsplaats in de btw*, Deventer: Kluwer 2011, p. 425; M. Schrauwen, ‘De FCE-zaak: de vaste inrichting a contrario btw-belast’, *BtwBrief* 2006, 12 (No. 1); A. Meurkes & M. Ultee, ‘Geen prestaties tussen hoofdhuis en in EU gevestigde vaste inrichting?’ *BTW-bulletin* 2006, No. 5.

in VAT systems outside the EU<sup>88</sup> and in the field of corporate income tax.<sup>89</sup>

## 5 RIGHT OF HEAD OFFICE AND FIXED ESTABLISHMENT TO DEDUCT INPUT VAT – LE CRÉDIT LYONNAIS

### 5.1 *Le Crédit Lyonnais*

On 12 September 2013, the ECJ issued its judgment in the case of *Le Crédit Lyonnais (LCL)*,<sup>90</sup> in which it stated that a bank established in France, with most of its transactions liable to VAT, was not allowed to take account of its foreign branches' turnover when calculating its *pro rata* deductible.<sup>91</sup> This judgment was unfavourable for LCL as its US branch generated substantial interest income, for which a deduction was available under Article 169(c) of the VAT Directive.<sup>92</sup> According to the ECJ, the right of deduction should be determined independently for each jurisdiction and not on the basis of a 'worldwide *pro rata*'. For the purposes of calculating the *pro rata* deduction, an enterprise liable for VAT is deemed to be established in the country of the fixed establishment and to be subject to the rules that this Member State applies to the fixed establishment.<sup>93</sup> The arguments given by the ECJ for separately assessing the right to deduct input VAT were:

- (1) Including all turnover generated within the EU: this would seriously jeopardize the rational allocations of

the spheres of application of national VAT legislation and the rational of the applicable proportion.<sup>94</sup>

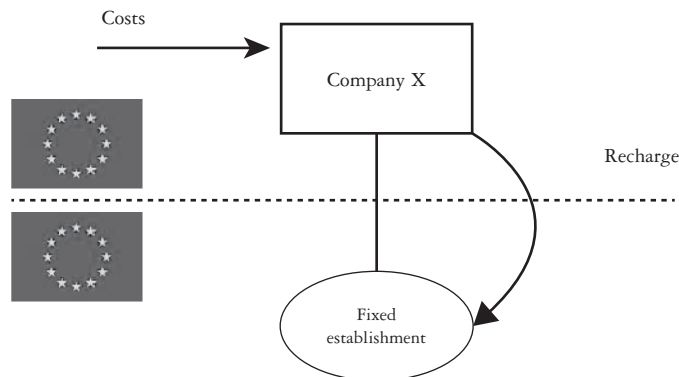
- (2) Including turnover generated outside the EU: neither the preamble to the Sixth Directive nor its substantive provisions support finding that the turnover of fixed establishments may be included to calculate the *pro rata* deduction available to the head office.<sup>95</sup> In short, the basic assumption that the fixed establishment in principle constitutes a single taxable person should be assigned a narrower interpretation with regard to the right to deduct input VAT.

### 5.2 Comments on *Le Crédit Lyonnais*

The *LCL* case raises the question of the extent to which an establishment of a legal entity is entitled to deduct input VAT if that establishment does not itself perform any taxable transactions, whereas the legal entity it is part of does perform such taxable transactions.

- It is common in many sectors, for a legal entity to consist of a head office and a fixed establishment from a VAT perspective, with the only (future) taxable transactions being performed by the fixed establishment. Costs may be incurred by the head office, which are then charged or allocated to the fixed establishment (see the following diagram).

Figure 5 Example of the Right of Input Deduction



## Notes

<sup>88</sup> A. Charlet & D. Koulouri, 'Relations between Head Offices and Permanent Establishments: VAT/GST v. Direct Taxation: The Two Faces of Janus', in: M. Lang *et al.*, *Value Added Tax and Direct Taxation – Similarities and Differences*, Amsterdam: IBFD 2009, p. 715.

<sup>89</sup> Based on the idea of the separate entity approach. See s. 4.1.

<sup>90</sup> ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000.

<sup>91</sup> We assume that this (also) means fixed establishments.

<sup>92</sup> The business model, and therefore LCL's underlying reasons for applying the world *pro rata*, was examined by Fournier during a seminar arranged by the Foundation for European Fiscal Studies; see M.L. Schippers, 'Verbondenheid in het douanerecht en BTW pro rata problematiek', *WFR* 2014/352.

<sup>93</sup> ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000., paras 33–34.

<sup>94</sup> ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000, para. 35.

<sup>95</sup> ECJ EU 12 Sep. 2013, C-388/11, ECLI:EU:C:2013:541 (*Le Crédit Lyonnais*), *European Court Reports* 2013-00000, para. 43.

- A strict interpretation of the *LCL* case could result in the head office having no entitlement whatsoever to deduct input VAT as the revenue generated by the foreign fixed establishment would be unable to be included in calculating the amount eligible for deduction by the head office. From a perspective, however, of neutrality and the purpose of VAT itself – taxation of consumption – we would not expect this to be the intended result.<sup>96</sup> It would also seem to follow from Article 169(a) of the VAT Directive that the right to deduct input VAT should be available in the head office's country of establishment, even if costs are incurred by the head office for activities performed outside that country. No distinction would appear to be made, in this respect, between activities carried out by the head office itself and those carried out by a fixed establishment of the legal entity; reference is made solely to the 'taxable person'. It also follows from the *FCE Bank* case that the head office and the fixed establishment constitute a single taxable person.
- The question of whether there is a right of deduction and, if so, how this is effected also arises in situations in which costs are incurred by a passive fixed establishment. If the only costs incurred by a passive fixed establishment are local costs, on which the establishment is charged VAT, it would seem to us to follow from the joined cases of *Daimler* and *Widex* that the right to reclaim input VAT would arise under the VAT refund directives.<sup>97</sup> However, the situation would be different, in our opinion, if the passive fixed establishment had to report reverse charged VAT. In that case, the passive fixed establishment would seem to have to be registered locally for VAT, with input VAT being reclaimed through a local VAT return. As we see it, the arguments for allowing the right of deduction to a passive fixed establishment are the same as in the above scenario, in which the head office itself does not carry out any taxable transactions.
- The judgment in the *Skandia* case may actually prove favourable for a head office or passive fixed establishment in a situation as outlined above. This is because if only the other establishment, to which 'internal' supplies are made, is part of a VAT group, the transactions between the head office and the (passive) fixed establishment should be within the scope of VAT

(depending on the interpretation applied by the specific Member States) and so also 'visible' for determining the right to deduct input VAT. In such a situation, a passive fixed establishment could thus be 'transformed' into an active fixed establishment as, in that case, supplies would be made to third parties, as discussed in section 4.

## 6 CONCLUSION

As outlined above, the Implementing Regulation and the *Welmory*, *Skandia* and *Le Crédit Lyonnais* cases have provided new insight into the concept of the fixed establishment. However, this new insight has not served to clarify the position to any significant degree. What is more, the fixed establishment for VAT purposes is now subject to more discussion than ever before. Given that many aspects still remain to be clarified (What, for example, is a fixed establishment? Are transactions between a head office and a fixed establishment taxable or not? And how should account be taken of the head office and the fixed establishment when determining the right of deduction?), this discussion seems set to continue over the coming years. The task now facing national governments, in anticipation of future case law on the subject, is to set out more detailed policy, at a European or ideally global level, on how to avoid the mismatches between countries that can result in double or non-taxation. As well as developments in the fixed establishment from a VAT perspective, any harmonization in this respect also needs to take account of European and global developments regarding the permanent establishment in the field of corporate income tax. Against this background, it is interesting to consider the OECD's public consultations on BEPS (Action 7) on preventing artificial avoidance of the status of the permanent establishment.<sup>98</sup> These consultations also refer to the convergence of the permanent establishment in corporate income tax and the fixed establishment in VAT when seeking to prevent double taxation and non-taxation, as well as to the high administrative burden that can arise in the event of inconsistent and non-uniform application of these concepts. It will take many years, however, to achieve uniform application. As a result, the mysteries surrounding the fixed establishment in VAT look set to continue for the foreseeable future.

### Notes

<sup>96</sup> Schrauwen and Theunissen draw the same conclusion in: M.C. Schrauwen & K.A.M.M. Theunissen, 'Gevolgen Le Crédit Lyonnais-zaak voor de Nederlandse praktijk', *BruBrief* 2013/113.

<sup>97</sup> See the previously mentioned Directive 2008/9/EC and Thirteenth Directive 86/560/EEC.

<sup>98</sup> OECD (2015), Comments received on public discussion draft, BEPS Action 7: Prevent the Artificial Avoidance of PE Status, *OECD Publishing*, p. 20 & 122. An update was published on 15 May 2015: OECD (2015), BEPS Action 7: Preventing the Artificial Avoidance of PE Status, *OECD Publishing*.



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