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Subsidiary as a Fixed Establishment[2]

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Abstract

Fixed establishment (FE) is one of the institutions of the EU value added tax system; its structure is essential to correctly determine the right tax jurisdiction of an EU Member State for the purpose of VAT settlement in situations of cross-border provision of services. However, the legal structure of a FE adopted by the EU legislator (and, consequently, adapted to national legislation of the Member States) causes uncertainty when it comes to its interpretation. In the absence of unambiguously defined conditions in EU law to consider a specific presence and activity of an enterprise to be a FE, interpretation rules contained in judicial decisions issued by the Court of Justice of the EU play an important role. Among attempts made by the CJEU to clarify the 'blur areas' resulting from the dynamics of modern business processes, one of the most interesting ones is the possibility of considering a subsidiary to be a fixed establishment for a parent company. The purpose of this paper is to analyse legal and economic factors, the fulfilment of which may constitute a condition for considering a subsidiary to be a fixed establishment for a parent company, with particular emphasis on the ruling of the Court of Justice of 7 May 2020 in the Dong Yang case (C-547/18).

Keywords: VAT, fixed establishment, place of supply of services, subsidiary, economic reality.

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Spółka zależna jako stałe miejsce prowadzenia działalności gospodarczej[3]

Streszczenie

Stałe miejsce prowadzenia działalności gospodarczej (FE) stanowi jedną z instytucji unijnego systemu podatku od wartości dodanej, której konstrukcja ma zasadnicze znaczenie dla prawidłowego ustalenia właściwej jurysdykcji podatkowej państwa członkowskiego UE dla celów rozliczenia podatku VAT w sytuacjach świadczenia usług o transgranicznym charakterze. Jednakże przyjęta przez prawodawcę unijnego (a w rezultacie adaptowana do legislacji krajowych państw członkowskich) konstrukcja prawna FE budzi liczne wątpliwości interpretacyjne. Wobec braku jednoznacznie sformułowanych w prawie UE warunków uznania określonej obecności i aktywności przedsiębiorstwa za konstytuujące FE istotną rolę odgrywają reguły interpretacyjne zawarte w orzeczeniach Trybunału Sprawiedliwości UE. Wśród podejmowanych przez TSUE prób doprecyzowania „obszarów nieostrości" wynikających z dynamiki współczesnych procesów biznesowych jednym z najbardziej interesujących jest kwestia możliwości uznania spółki zależnej za stałe miejsce prowadzenia działalności gospodarczej spółki dominującej. Celem niniejszego artykułu jest analiza uwarunkowań prawnych i ekonomicznych, których spełnienie może stanowić przesłankę uznania spółki zależnej za FE spółki dominującej, ze szczególnym uwzględnieniem rozstrzygnięcia TS z dnia 7 maja 2020 r. w sprawie Dong Yang (C-547/18).

Słowa kluczowe: VAT, stałe miejsce prowadzenia działalności gospodarczej, miejsce świadczenia usług, spółka zależna, rzeczywistość gospodarcza.

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The Fixed Establishment Concept in EU Regulations

The concept of a fixed establishment was introduced into EU law in the provisions of the Sixth 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. This Directive was replaced by Directive 2006/112/EC of the Council of 28 November 2006 on the Common System of Value Added Tax[4] (hereinafter referred to as the VAT Directive), which also includes the provisions concerning a FE.

According to the current wording of Article 44 of the VAT Directive, 'the place of supply of services to a taxable person acting as such shall be the place where that person has established his business. However, if those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located.'[5] Article 44 of the VAT Directive 'sets as general B2B rule, which in practice is the fall-back or default rule, i.e. when no specific rules apply.'[6]

One of the primary reasons for the implementation of the FE concept in the EU VAT regulations is a demand for neutrality – the purpose of these regulations is to provide a company that is subject to VAT and is a resident of one Member State and a company subject to VAT and residing in another Member State with equal tax treatment when services are rendered in the same Member State.[7]

Bearing in mind the VAT settlement mechanisms adopted in EU regulations, the FE structure mentioned in Article 44 of the VAT Directive is of key importance to identify a place where it is assumed (for VAT purposes) that a service is provided; therefore, it is possible to determine a Member State where cross-border services will be settled in terms of VAT. The existence of a fixed establishment is also important

4 Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax (Official Journal of the European Union L 347, 11 December 2006, pp. 1–118).

5 Article 45 of the VAT Directive contains rules for identifying the place of supply of a service for VAT purposes in a situation where the customer is a non-taxable person.

6 B. Terra, J. Kajus, *Introduction to European VAT*, IBFD 2019, Online Books IBFD.

7 M.L. Schippers, J.M.B. Boender, *VAT and Fixed Establishments: Mysteries Solved?*, "Intertax" 2015, 11, p. 710.

for the purposes of input tax refund within the meaning of Article 171 of the VAT Directive or the application of the reverse charge mechanism.[8]

Despite the key importance of a FE in relation to cross-border services, for several dozen years of its presence in the EU legal transactions, it was not legally defined, and its understanding was based on the interpretation developed in the CJEU judicial practice. The legal definition of a FE was not adopted until 1 July 2011 by Regulation 282/201.[9] According to Article 11(1) of Regulation 282/2011, for the purposes of applying Article 44 of the VAT Directive, a 'fixed establishment shall be any establishment – other than the place of establishment of a business – characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs.' The definition of a FE in Article 11(1) of Regulation 282/2011 refers to B2B transactions and emphasises the possibility of purchasing and using services by such a fixed establishment (ability to consume).[10] This FE category is described as a 'Passive Fixed Establishment.'[11]

In turn, Article 11(2) of Regulation 282/2011 contains the definition of FE categorised as 'active' – for the application of Article 45 of the VAT Directive[12] in particular, a 'fixed establishment' shall be any establishment, other than the place of establishment of a business, characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to provide its services.

The definition of FE adopted in Regulation 282/2011 largely refers to the understanding of this institution shaped in the previous judicial practice of the CJEU, hence the widespread use of interpretative guidelines contained in the Court's judgements, also those given before the adoption of this legal act.

The FE structure adopted in Regulation 282/2011, due to vague terms used and the lack of an unambiguously quantifiable threshold, the exceeding of which would

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8 J. Sarnowski, P. Selera, A. Bartosiak, *Stałe miejsce prowadzenia działalności gospodarczej na gruncie niemieckiego podatku VAT i niemieckiej praktyki podatkowej*, „Kwartalnik Prawa Podatkowego" 2018, 3, p. 27.

9 Council Implementing Regulation (EU) No. 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the Common System of Value Added Tax (Official Journal of the European Union L 77, 23 March 2011, pp. 1–22).

10 The Active Fixed Establishment construction included in the content of Article 11(2) of the Regulation is also used for the purposes of applying Article 56(2)(2), Article 58 and Article 192(a) of the VAT Directive.

11 M.L. Schippers, J.M.B. Boender, op. cit., pp. 713, 715.

12 In accordance with Article 45 of the VAT Directive, 'the place of supply of services to a non-taxable person shall be the place where the supplier has established his business. However, if those services are provided from a fixed establishment of the supplier located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located.'

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result in the establishment of a FE for EU VAT purposes, gives one a lot of room for interpretation. This allows the presence and activity of an enterprise in a country other than the one where the business is established to be assessed. Unfortunately, the CJEU judicial practice does not provide strong hints as to the interpretation of terms and phrases used by the EU legislator, but it delivers some guidelines on how to understand certain criteria, especially the criterion of human and technical resources or the criterion of permanence.

One of the first decisions concerning a FE was the judgement of 4 July 1985 in the Gunter Berkholz case (C-168/84), in which the Court of Justice of the European Union decided that a fixed establishment is a place that entails a certain minimum of stability resulting from permanent presence of both the human and technical resources.[13] The Court also stressed that the purpose of Article 9(1) of the Sixth Directive applicable at that time was to avoid conflicts of jurisdiction between Member States.

In turn, in the ARO Lease judgement (C-190/95), the Court stated that when a taxpayer neither hires their own employees in a given state, nor do they have an organisational structure that is permanent enough to ensure 'a framework in which agreements may be drawn up or management decisions taken,' there is no fixed establishment.[14] In the Planzer Luxembourg case (C-73/06), the Court confirmed that the FE existence requires a minimum of permanence through the gathering of permanent human and technical resources necessary for the provision of certain services; this permanence implies a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to provide certain services independently.[15]

Referring to these guidelines of the CJEU, the Voivodship Administrative Court in Warsaw stated that a 'sufficient degree of permanence' should be assessed each time from the perspective of a specific case. A different degree of permanence will be sufficient, for instance, when purchasing services to run an office (whether a branch or an agency), while another will be required, for instance, when providing gas or fuel trading services. The Court in Warsaw emphasised that the CJEU has not yet clarified whether it is time or intention of an entity assessed in terms

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13 CJUE, 4 July 1985, Case C-168/84, Gunter Berkholz v. Finanzamt Hamburg-Mitte-Altstadt, ECLI:EU:C:1985:299, para. 18.

14 CJUE, 17 July 1997, Case C-190/95, ARO Lease BV v. Inspecteur van de Belastingdienst Grote Ondernemingen te Amsterdam, ECLI:EU:C:1997:374, para. 19.

15 CJUE, 28 June 2007, Case C-73/06, Planzer Luxembourg Sàrl v. Bundeszentralamt für Steuern, ECLI:EU:C:2007:397, paras. 51–52; 'A fixed installation used by the undertaking only for preparatory or auxiliary activities, such as recruitment of staff or purchase of the technical means needed for carrying out the undertaking's tasks, does not constitute a fixed establishment' (para. 56).

of a permanent place of business that should be a decisive criterion as far as the permanence is concerned; therefore, the question of what is sufficiently permanent: an establishment (structure) operating for a certain period of time or rather a structure that was established not for temporary needs, but *permanently*,[16] remains open.

The permanence of the place of business should not be identified with 'intensity and frequency of actions undertaken as part of business activity, as well as with management decisions that will not be taken by a person present in a given country.'[17] The key factors to recognise that a company has a fixed establishment in a given Member State include (1) professional staff necessary to deliver goods and (2) minimum technical resources necessary to conduct business in that country.[18]

The general nature of interpretative guidelines resulting from the CJEU judicial practice does not help to understand the FE concept in the tax practice of Member States unambiguously. For instance, a German court in the FG Münster judgement (judgement of 5 September 2013, 5 K 1768/10 32) stated that despite the fact that **human resources are an important criterion for determining whether a fixed establishment exists, this does not mean that the criteria for human and technical resources must be met equally**. Above-average technical resources can make up small human resources, and in exceptional cases, even lack thereof.[19] On the other hand, the Polish Voivodship Administrative Court in Gliwice decided that in order to determine whether or not an entity has a fixed establishment in a given state, it is not necessary for this entity to own technical means (constituting the technical infrastructure). It is important, however, for such an entity to have actual control over them so that it can use them appropriately when purchasing and using (consuming) services or providing them.[20]

Hopes were high that the meaning of FE can be defined in connection with the Welmory case examined by the Court of Justice, also due to the fact that it was the first case concerned with the construction of Article 44 of the VAT Directive and the provisions of Regulation 282/2011. In the judgement in this case, the CJEU decided that a taxpayer that is established in one Member State and uses the services provided by another taxpayer established in another EU country should be considered an owner of a FE in that other Member State within the meaning of Article 44 of the VAT Directive: 'if that establishment is characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical

16 See Judgement of the VAC in Warsaw of 26 April 2019, III SA/Wa 2197/18.

17 See Judgement of the SAC of 26 February 2020, I FSK 1313/17.

18 Ibidem.

19 J. Sarnowski, P. Selera, A. Bartosiak, op. cit., p. 36.

20 See Judgement of the VAC in Gliwice of 17 March 2020, I SA/Gl 1707/19.

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resources to enable it to receive the services supplied to it and use them for its business, which is for the referring court to ascertain.'[21] Therefore, the Court shifted the entire interpretative burden to national courts, giving them a lot of room for liberal interpretation of the provision in question and allowing them to independently assess whether the human and technical resources characteristic of a given case are sufficient to identify a fixed establishment in a given country.[22]

Unlike the CJEU, the Advocate General in the Welmory case explicitly stated that in order to acknowledge that an entity has a fixed establishment in a given country, it is not necessary for such an entity to hire staff and its own technical resources. It is, however, required that the control over the human and technical resources be comparable to the control that a taxpayer exercises over their own technical and human resources.[23]

The EU legislator tries to narrow down the broad interpretation resulting from the definition of a FE from Article 11(1) of Regulation 282/2011 through the guidelines from Article 22(1) of the same Regulation. This guideline can be considered an 'auxiliary FE test' and its use should help a service provider determine whether the place of business of a customer to whom the provider renders its services can be considered a FE. The test was divided into two main stages. At the first stage, regarding the factual aspects, a service provider should analyse 'the nature and use of the service provided.' If its nature and use do not allow the provider to determine a fixed establishment to which a service is provided, the provider should move to the second stage to check whether:

a) a contract, an order and a VAT identification number attributed to a customer by a Member State and communicated to a service provider identifies its fixed establishment as the place of the service receipt,
b) a fixed establishment is the same as an entity paying for the service.

Where the FE test provided for in Article 22(1) of Regulation 282/2011 does not give a positive result or when services covered by Article 44 of Directive 2006/112 are provided to a taxpayer under a contract covering at least one non-identifiable and non-quantifiable service, a service provider has the right to state that services are provided to the place where a customer has established its business. Unfortunately, the FE test nature described in Article 22(1) of Regulation 282/2011 does

21 CJUE, 16 October 2014, Case C-605/12, Welmory sp. z o.o. v. Dyrektor Izby Skarbowej w Gdańsku, ECLI:EU:C:2014:2298, para. 65.

22 J. Sarnowski, P. Selera, A. Bartosiak, op. cit., p. 32.

23 Opinion of Advocate General Kokott, 15 May 2014, Case C-605/12, Welmory sp. z o.o. v. Dyrektor Izby Skarbowej w Gdańsku, ECLI:EU:C:2014:340, para. 48.

not provide a satisfactory level of clarification of terms and phrases of key importance to assess whether or not a taxpayer has a FE in another Member State. What is more, a service provider may have difficulties in determining what kind of entity will actually use a given service. According to the auxiliary FE test, an entity that pays for a service is also be an entity using it, but in business reality, it is not always the case as it is quite common that a service provider is frequently required to specify an entity using a service in an invoice, and the payment will most often be made at a later date.[24]

There are many problematic issues related to the FE structure adopted in EU law; particular attention should be paid to one of them, namely the possibility of qualifying a subsidiary as a FE of a parent company. The level of uncertainty for the interpretation in this matter has increased as a result of recent judgement of the CJEU of 7 May 2020 in the Dong Yang case (C-547/18).[25]

Possibility of Considering a Subsidiary to Be a Fixed Establishment – General Interpretation Rule

The analysis of the FE normative structure leads to the conclusion that it was not the intention of the EU legislator to qualify a subsidiary as a FE of the parent entity. This conclusion results both from the purpose of the provisions of the VAT Directive defining the place of supply of services for VAT purposes, and from the legal and organisational nature of the relationship between a parent company and a subsidiary.

The FE concept is intended to guarantee 'fair allocation' of a company's specific presence and economic activity to the tax jurisdiction of Member States for the purposes of VAT settlement. It is about preventing situations where a company that is a VAT payer in one EU country creates a significant economic (business) structure but does not establish a subsidiary or a branch in such a country. This, in turn, would create favourable conditions for manipulation of the structure of services purchased on the EU market in such a way that the VAT burden included in the price of a service purchased in those EU countries where VAT rates are high is avoided. A VAT taxpayer providing the said service to a taxpayer registered in

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24 A. Rutkowska-Brdulak, *Stałe miejsce prowadzenia działalności w VAT a podmiotowość prawnopodatkowa. Dylematy, konsekwencje, ryzyka*, LEX 2018.

25 CJUE, 7 May 2020, Case C-547/18, Dong Yang Electronics Sp. z o.o. v. Dyrektor Izby Administracji Skarbowej we Wrocławiu, ECLI:EU:C:2020:350.

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another EU country qualifies it as the so-called export of services; as a consequence, VAT is settled in a Member State where a service buyer (a VAT registered payer) has their registered office. Therefore, the purpose of a fixed establishment is to contribute to the creation of conditions ensuring equal competition on the internal market, irrespective of where buyers of services are registered.

On the other hand, the interpretation of tax law (Article 44 of the VAT Directive) clearly shows that the qualification of the place of service provision concerns the same VAT payer. The EU legislator uses the phrase 'if those services are provided to a fixed establishment of the taxable person.' This means that an actual structure of presence and activity of **one taxpayer** that meets certain requirements may be classified as their FE. The VAT Directive (except in the case of the creation of a VAT group) does not contain regulations providing for (i) 'individual suspension' of a VAT taxpayer status of a properly registered company, which remains a separate legal and tax entity even if it is economically dependent on an owner. Neither does the Regulation provide for the assumption that for VAT purposes it is de facto only an economic structure and, as such, it may 'belong' to another taxpayer tax-wise. As Giorgio Beretta figuratively put it, in such a situation a subsidiary may be considered a FE 'in disguise,'[26] which contradicts the view aptly expressed in literature that 'in principle, a head office and fixed establishment constitute part of the same legal entity.'[27]

Based on the CJEU modest judicial practice in the presented matter, one may conclude that the Court favours a general interpretation rule according to which a subsidiary should not be classified per se as a FE of a parent company. It is worth emphasising, however, that the CJEU does not treat this rule unconditionally and formulates it as an *a contrario* conclusion.

The issue of qualifying a subsidiary as a parent company's FE was analysed by the CJEU for the first time in the DFDS judgement (396/02). The Court then allowed for such a possibility, but it did so because of the special kind of business relations between the parent company and its subsidiary. The Court chose a functional approach towards a legal situation: a company registered in a Member State (UK), formally constituting a separate legal entity, in fact, 'merely acts as an auxiliary authority of its parent.'[28] Thus, in this judgement, the Court stated that the

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26 G. Beretta, *Dong Yang Electronics (Case C-547/18): Oh Yes, a Subsidiary Can (also) Be a Fixed Establishment under EU VAT, but Information Asymmetries May Save You!*, "Kluwer International Tax Blog" 15.06.2020, http://kluwertaxblog.com/2020/06/15/dong-yang-electronics-case-c-547-18-oh-yes-a-subsidiary-can-also-be-a-fixed-establishment-under-eu-vat-but-information-asymmetries-may-save-you/ (access: 05.11.2020).

27 M.L. Schippers, J.M.B. Boender, op. cit., p. 716.

28 CJUE, 16 September 2004, Case C-396/02, DFDS BV v. Inspecteur der Belastingdienst – Douanedistrict Rotterdam, ECLI:EU:C:2004:536, para. 26.

fundamental condition for the existence of a fixed establishment was the complete lack of economic independence of the subsidiary of the parent company (also in terms of business decisions). M.L. Schippers and J.M.B. Boender rightly notice that '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.'[29]

The actual state in the DFDS case – where the parent company established in one Member State (Denmark) conducts business activity (shipping, travel and general transport) through a subsidiary registered in another EU country (UK) and the subsidiary acts as a general and principal agent booking office – is considered very rare in business practice. Therefore, the judgement in the DFDS case should be read as a general (but not absolute) exclusion of the possibility of qualifying a subsidiary as a FE.

The Court distanced itself from the possibility of considering a subsidiary to be a FE of a parent company in the Daimler case judgement. In that judgement, the Court stated that a VAT payer that is established in a Member State and conducts only technical tests or performs research in another Member State, excluding taxable transactions, cannot be considered an owner of a FE in that other state where economic transactions are carried out.[30] According to the Court, such an assessment – made in the course of the FE interpretation – is not undermined by the fact that a taxpayer has a subsidiary in a given Member State, this taxpayer is their sole owner and their business activity consists almost exclusively in providing a taxpayer with various services related to technical tests.[31] The Court emphasised the subsidiary tax status resulting from legal nature of the relationship between a parent company and a subsidiary: 'a wholly owned subsidiary is a legal person with an independent liability for tax.'[32] On the other hand, with reference to the previous ruling in the DFDS case, the Court emphasised that in that case, the statutory independence of the subsidiary was disregarded in favour of commercial relations only to establish which of the companies, a parent or a subsidiary, actually provided taxable services and, consequently, in which Member State they were taxed.[33]

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29 M.L. Schippers, J.M.B. Boender, op. cit., p. 717.

30 CJUE, 25 October 2012, Joined Cases C-318/11 and C-319/11, Daimler AG and Widex A/S v. Skatteverket, ECLI:EU:C:2012:666, para. 44.

31 Ibidem, para 51.

32 Ibidem, para. 48.

33 Ibidem, para. 49.

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Since the Daimler judgement, the possibility of qualifying a subsidiary as a FE has not been the subject of the Court's decision for several years. However, the CJEU recent judgement in the C-547/18 Dong Yang Electronics case seems to reopen the discussion on this subject. The Court ruled that Article 44 of the VAT Directive and Articles 11(1) and 22(1) of Regulation 282/2011 should be interpreted in such a way that a service provider cannot infer the existence of a fixed establishment of a company based in a third country in a Member State **from the mere fact** (emphasis by the author) that this company has a subsidiary in that Member State. Moreover, the Court stated that this service provider is not required to analyse contractual relations between these two entities to make such an assessment.

Admittedly, the Court emphasised that the FE formation 'cannot depend solely on legal status of the entity concerned,' but at the same time, the CJEU stated that it does not mean questioning the possibility of establishing a FE as a consequence of certain manifestations of business activity of a subsidiary of a foreign entity. The assessment of the tax status of a subsidiary in terms of its possible qualification as a FE of a parent company, should be carried out on the basis of conditions laid down in Regulation 282/2011, particularly in Article 11. According to the Court, such a status 'must be assessed in the light of economic and commercial realities.'[34]

As the Advocate General emphasised in her opinion in the C-547/18 case, the VAT Directive clearly says that a subsidiary – as a separate legal entity – cannot be considered a fixed establishment of business of a parent company. Article 44 of the VAT Directive refers to a taxpayer who has its registered office in one place and a fixed establishment in another; 'however, a parent company and a subsidiary are not one taxable person, but two.'[35] It is possible to depart from this model only by creating a VAT group between affiliated entities on terms provided for in the VAT Directive. If it were possible to qualify a subsidiary as a FE of a parent company for VAT purposes, it would be in contradiction to provisions on imposing an obligation to pay VAT on another entity (Article 196 of the VAT Directive) and also on the so-called VAT group (Article 11 of the VAT Directive).[36]

As far as Article 11(1) of the regulation is concerned, the Advocate General emphasized that it does not contain any guidelines as to whether the infrastructure of one taxpayer (i.e. their registered office) may also constitute a fixed establishment

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34 CJUE, 16 Oct. 2014, Case C-605/12, Welmory sp. z o.o. v. Dyrektor Izby Skarbowej w Gdańsku, ECLI:EU:C:2014:2298, paras. 31–32.

35 Opinion of Advocate General Kokott, 14 Nov. 2019, Case C-547/18, Dong Yang Electronics Sp. z o.o. v. Dyrektor Izby Administracji Skarbowej we Wrocławiu, ECLI:EU:C:2019:976, para. 29.

36 Ibidem, para. 39.

of another taxpayer.[37] As G. Beretta, aptly notices, the Advocate General adopted a very narrow interpretation of a situation where a subsidiary could be considered a FE and 'an ex-post recharacterization of a subsidiary as a FE of a foreign company undermines legal certainty, in so far as the other party to a transaction must know whether the subsidiary or the parent company is in fact liable for VAT.'[38]

Despite the significance of reservations as to the possibility of qualifying a separate legal entity and, consequently, a separate VAT taxpayer (a subsidiary in relation to a parent company) as a fixed establishment, the CJEU in the Dong Yang judgement allowed for such a possibility, combining it with an undefined criterion for assessment of 'economic and commercial realities.'

'Economic and Commercial Realities' as a Criterion for Qualifying a Subsidiary as a Fixed Establishment

The criterion for an analysis of the actual economic conditions in the process of applying provisions of the EU VAT system has been present in the CJEU judicial practice for many years. Despite the key importance of the 'economic reality' paradigm, emphasised in the Court's judicial practice,[39] it was not formally reflected in the provisions of the EU VAT system. It should be emphasised that unambiguous decoding of the meaning that the CJEU gives to this paradigm is not an easy task. Interpretation problems are exacerbated by non-homogeneous terminology used by the Court in this matter. J. Bijl aptly notices that the CJEU uses the concept of 'economic reality', but also 'economic and commercial reality', 'commercial reality', the 'actual economic situation' or 'economic perspective'.[40] So far, the Court has not presented a coherent and comprehensive understanding of the concept of 'economic reality', understood as an instrument of interpretation of the provisions of the EU VAT system. Instead, the Court either refers to it 'mechanically' with

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37 Ibidem, para. 33.

38 G. Beretta, *Dong Yang Electronics (Case C-547/18): Can a Subsidiary Be (also) a Fixed Establishment under EU VAT?*, "Kluwer International Tax Blog" 22.11.2019, http://kluwertaxblog.com/2019/11/22/dong-yang-electronics-case-c-547-18-can-a-subsidiary-be-also-a-fixedestablishment- under-eu-vat/ (access: 5.11.2020).

39 See for example, CJUE, 2 May 2019, Case C-224/18, Budimex S.A. v. Minister Finansów, EU:C:2019:347; CJUE, 22 November 2018, Case C-295/17, *MEO* – Serviços de Comunicações e Multimédia SA v. Autoridade Tributária e Aduaneira, ECLI:EU:C:2018:942; CJUE, 20 June 2013, Case C-653/11, Her Majesty's Commissioners of Revenue and Customs v. Paul Newey, ECLI:EU:C:2013:409.

40 J. Bijl, *The EU VAT treatment of vouchers in the context of promotional activities*, Tilburg (2019), https://research.tilburguniversity.edu/en/publications/the-eu-vat-treatment-of-vouchers-in-the-context-of-promotional-ac (access: 6.11.2020).

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a vague emphasis on its importance and meaning, or it understands this concept in a fragmentary (casuistic) way in relation to a specific factual and legal situation. This causes fundamental difficulties in reconstructing the universal meaning of this concept.

An interesting proposal for understanding the concept of 'economic reality' in EU VAT regulations was presented by A.J. van Doesum and F.J.G. Nellen, according to whom it is 'a judicial perception of an existing state of affairs that defines the economic relations between two or more parties.'[41] Thus, defined economic reality should, in their opinion, apply not only to actions of parties involved in a transaction, but also to all circumstances related to the transaction, such as common commercial practice, the parties' intentions and their contractual arrangements.[42] These authors emphasise that the concept of 'economic reality' in the CJEU judicial practice is used as 'a benchmark of normality inherent to the doctrine of abuse of law' or as 'a benchmark of "VAT reality" to realize a purposeful application of VAT.'[43]

If one assumes that this classification is justified, it can be concluded that in the Dong Yang case, the CJEU applied the second proposed model to classify a subsidiary as a FE of a parent company through a general reminder that 'consideration of economic and commercial realities form a fundamental criterion for the application of the common system of VAT.'[44] Unfortunately, the Court – even though it made the criterion of 'economic and commercial realities' essential to recognise (or not) a subsidiary as a FE in the given circumstances – did not attempt to be more specific. The Court only referred to its earlier judicial practice, which does not provide clear indications as to the limits of this criterion meaning.

The possibility of considering a subsidiary to be a FE of its parent company was based on the Court's questioning the model of qualifying a given place as a FE based solely on legal status of an analysed entity (the Dong Yang case). According to the Court, 'such treatment depends on the substantive conditions set out in Implementing Regulation No 282/2011, in particular in Article 11 thereof, which must be assessed in the light of economic and commercial realities.'[45] The fact that the Court refers in this specific case to the need to consider the economic perspective in the application of EU VAT provisions is treated as a guideline according to

41 A. van Doesum, F. Nellen, *Economic Reality in EU VAT*, "EC Tax Review" 2020, 5, p. 214.

42 Ibidem.

43 Ibidem.

44 CJUE, 7 May 2020, Case C-547/18, Dong Yang Electronics Sp. z o.o. v. Dyrektor Izby Administracji Skarbowej we Wrocławiu, ECLI:EU:C:2020:350, para. 31.

45 Ibidem, para. 32.

which 'civil law cannot be decisive for VAT.'[46] One should agree that national provisions of civil (commercial) law cannot prevail over substantive EU law in the field of VAT; it does not, however, mean that they can be ignored. This also applies to the assessment (for VAT purposes) of the nature of the relationship between entities that are parties to a transaction, which 'must be considered both from the perspective of the economic and legal ties binding the two parties, and with a view to the place of establishment of each party.'[47]

The use of an interpretation instrument by the CJEU through an analysis of 'economic and commercial realities' cannot lead to the Court's freely creating an 'alternative economic reality' to decode a transaction or relationship for the purposes of applying the provisions of common VAT system (A.J. van Doesum and F.J.G. Nellen define it as the 'VAT reality'). Despite the autonomy of tax law in relation to other branches of law (particularly civil and commercial law), which is generally accepted at the national level, and the need to apply EU VAT provisions independently of differently shaped civil (commercial) law regulations of individual Member States, the interpretation of tax law cannot justify the shaping of an image of a given situation or economic relationship through the prism of its possible consequences in terms of VAT.

In the Dong Yang case, the CJEU systemically accepted the possibility for national authorities to qualify a commercial company that has a legal personality and thus legal autonomy to act independently in trade as a FE of a foreign parent company; thereby, the Court consents to creating an 'alternative economic reality' for the purposes of applying Article 44 of the VAT Directive. In this case, 'alternative' means (i) helping to define 'commercial and economic reality,' disregarding legal status (the existence and operating of an independent legal entity in the form of a company where a foreign entity holds shares) and (ii) allowing tax authorities to modify the actual business motives behind the specific role of a subsidiary in achieving the goals of the entire group of related entities.

The Court did not accept the proposal of the Advocate General presented in the opinion to the Dong Yang case to clearly narrow the possibility of considering a subsidiary to be a FE down to cases of abusive practices, using the *Community acquis* of the CJEU in this matter, in particular the Halifax judgement (255/02). In this judgement, the Court stated that in order to establish the existence of an abuse, it is required that given transactions – even though they meet formal conditions laid down by the relevant VAT regulations – result in pecuniary advantages. Giving

46 A. van Doesum and F. Nellen, op. cit., p. 215.

47 S. Heydari, *When One Becomes Two: The Forlorn Future of the Fixed Establishment*, "Derivatives & Financial Instruments" 2014, 3, p. 149.

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such advantages would be contrary to the purpose of those provisions, and all objective factors should show that the purpose of disputed transactions is to gain a tax advantage; 'the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.'[48] Where an abuse is found, transactions that had been carried out may therefore be redefined in such a way as to recreate a situation that would have existed had the abusive transaction not taken place. In order to assess whether the purpose of the disputed transactions was to gain tax advantages, their actual content and significance should be established, and the redefinition should not go beyond what is necessary to ensure the correct collection of VAT and avoid fraud.[49]

Surprisingly, the Tribunal in the Dong Yang case extended the possibility of such reclassification also to non-abusive cases, which calls for a negative assessment. As much as it is justified to reclassify a business transaction (in particular contracts) for the purposes of proper application of VAT regulations in order to identify 'a wholly artificial arrangement which does not reflect economic reality and is set up with the sole aim of obtaining a tax advantage,'[50] the reclassification of legal and tax status of a legal entity (subsidiary) operating in accordance with the law for the purposes of individual application of VAT regulations should be considered a breach of the certainty of law principle. Certainty of the law should primarily protect service providers in the context of (the lack of) the necessity to levy VAT on a service provided to a foreign entity. As far as providing services to another domestic entity – including a subsidiary of a foreign entity – is concerned, a service provider basically identifies it as a domestic transaction, being aware of an obligation to settle VAT for its performance. The uncertainty as to the VAT status of a service buyer (independent domestic VAT payer vs. FE of a foreign VAT payer) noticeably disturbs the 'jurisdictional compromise' adopted in the VAT Directive to a mechanism for identifying the place of supply of services for VAT purposes. This uncertainty is a result of the CJEU decision to allow tax authorities to reclassify the VAT status of a foreign entity's subsidiary.

In addition, it may cause the so-called the attraction effect: once tax authorities of the Member States have a general assessment tool in the form of 'economic and commercial realities', they can widely define which facts and circumstances fall

48 CJUE, 21 February 2006, Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise, ECLI:EU:C:2006:121, paras. 74–75.

49 See Judgement of the VAC in Gdańsk of 11 February 2020, I SA/Gd 2102/19.

50 CJUE, 27 October 2011, Case C-504/10, Tanoarch s.r.o. v. Daňové riaditeľstvo Slovenskej republiky, EU:C:2011:707, para. 51.

within these realities and which can be ignored for the reconstruction of 'objective economic reality', from which tax consequences will then be deduced. In the case of companies controlled by foreign entities, this may give rise to the temptation to classify them by tax authorities as foreign establishments of a foreign parent company and thus 'shifting' an obligation to settle VAT from the country where a service buyer is established to the country of VAT registration of a subsidiary.

Conclusions

The purpose of a fixed establishment operating within the EU VAT system is to fairly impose the VAT settlement obligation on individual Member States in cross--border situations. In other words, a state where the presence and activity (in the provision or purchase of services) of an enterprise being a VAT taxpayer registered in another EU country is significant, both in the objective and functional dimension, should be able to apply its own national VAT regime to transactions made on its territory. However, when exercising this competence, tax authorities of EU countries cannot create an 'alternative economic reality' limited by EU VAT regulations, to which the interpretation of facts and circumstances in a given case is 'adjusted'. The CJEU judgement in the Dong Yang case opens up such a possibility as a result of the Court's systemically recognising (for VAT purposes) a subsidiary (registered and operating as a separate and independent VAT payer) as a fixed establishment of a parent company. What is particularly surprising is the adoption by the CJEU of an undefined category of 'economic and commercial realities' as a key instrument for assessing the VAT status of a subsidiary. It may result in an increase in tax risk of entities operating cross-border in the European Union, which seems to be contrary to the idea of the internal market.

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