Permanent Establishments in Indirect Taxation

RITA DE LA FERIA∗

Similarly to the significant of the concept of permanent establishment (PE) for the purpose of income taxes rules, the relevance of the concept of fixed establishment (FE) for the VAT rules can hardly be overestimated. The term plays a central role, and is consistently relied upon by the legislator, for both determining the place of supply of services in VAT, and to establish the right to VAT refund, where tax is incurred in a country other than that where the business is established. Yet, despite its significance, the term is far from clear, and in recent years the debate over its definition and scope, primarily in the context of new, globalised, economic realities, and the development of the digital economy, has intensified. The aim of this chapter is to shed light over the meaning and significance of the concept of FE for VAT purposes. It will focus first on the meaning and significance of the concept from the perspective of European VAT legislation and the jurisprudence of the Court of Justice of the European Union (CJEU). It will then discuss current challenges to the current law posed by new economic realities, discrepant application of the FE criterion at national level, and its links to the PE concept. It is argued that the case law of the CJEU highlights the challenges posed by both globalisation, and digitalisation of the world economy, and that whilst it provides short-term relief to these challenges, dealing with them on a longer term basis will require re-assessment of established jurisprudence. It considers some of the key decisions on FE by national courts, concluding that whilst a unified concept of secondary establishment for the purposes of income tax and VAT is desirable, at present equating PE to FE would likely give rise to double taxation within VAT.

I. Preliminary Considerations on Place of Supply Rules in VAT

VAT is a tax on consumption, and as such taxation is meant to take place when and where consumption occurs. Whilst this principle is usually unproblematic in a national context, it raises difficulties in cross-border situations, and rules are required to determine where transactions have taken place for VAT purposes, i.e. the territoriality of the transaction. Whilst a few countries, primarily in African and Asian developing countries rely on a general rule, on the principle of taxation where consumption takes place, most countries have a set of detailed rules.

∗ Professor of Tax Law, University of Leeds, UK. Sections of this Chapter were presented at conferences in Munich (2013), Basel (2015), and Warsaw (2015); I am grateful to the organisers, and for comments received therein. I am also grateful to Luke Tattersall for helpful research assistance.
For these countries that do have them, these detailed rules, known in Europe as place of supply rules,\(^1\) are not dissimilar to international allocation rules in income taxes;\(^2\) they determine which country is entitled to determine to tax a specific transaction, just as international allocation rules determine which country is entitled to tax a specific income; both types of rules aim to avoid situations of double taxation, and of non-taxation.

The EU place of supply system is not only extremely complex, but increasingly so.\(^3\) Whilst place of supply rules remained almost unaltered until the introduction of the transitional VAT system in 1992,\(^4\) the last two decades have witnessed an almost complex revamp of the European VAT place of supply system: the first wave of amendments dealt with specific types of services, such as telecommunication services,\(^5\) radio, television broadcasting, and electronically supplied services,\(^6\) and electricity and gas;\(^7\) the most significant amendments came in the wake of approval in February 2008, of the so-called VAT package,\(^8\) whose latest elements have only entered into force in 2015, and which included changes to the general place of supply rules, as well as to those specifically applicable to e-commerce.\(^9\)

The ultimate aim of all place of supply rules is to act as proxies for one basic rule: tax should be charged at the place of consumption of the goods or services. The complexity, therefore, resulting from the myriad of legal proxies used to determine the place of supply of each transaction, is the product of a mixture of external pressures, and internal weaknesses. External, uncontrolled, pressure arises from the emergence of new global economic realities,
primarily the new digital economy, making cross-border transactions, lacking in any territorial or physical element, become the new normal. The EU response to this new reality has been slow and cumbersome, openly displaying the weaknesses of the EU legislative tax procedure: with all decisions having to be taken by unanimity voting of now 28 Member States, not only it is difficult to see any new legislation approved, but even when approved, new legislation is by nature a compromise, often patchy, and purposively vague.

The factors augmenting the complexity of the place of supply system are also at play when considering the role of FE in the EU VAT system. In the presence of similar external pressures, internal difficulties in approving new VAT legislation, has resulted in the CJEU taking the lead on clarification of the concept and role of FE; yet, as discussed below, consideration of the jurisprudence of the Court in the last decade demonstrates that the Court too, has struggled in adapting a system primarily thought for a national, physical, economy, to a globalised, digital, one.

II. FE in EU VAT law

The concept of FE plays a central role in the EU VAT system; crucial for both determining the place of supply (of services) in VAT, and to establishing the right to VAT refund, where tax is incurred in a country other than that where the business is established. Table 1 provides an overview of all EU VAT rules which rely on the concept of FE. Yet, the use of the concept gives rise to various difficulties, which can be converted into three questions, as follows:

(1) What can be regarded as a FE?

(2) When are services said to be supplied from the FE?

(3) When should the FE criterion be used?

TABLE 1: EU VAT rules which rely on the concept of FE

<table>
<thead>
<tr>
<th>PLACE OF SUPPLY RULES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Supply</strong></td>
</tr>
<tr>
<td>Article 38</td>
</tr>
<tr>
<td>Article 39</td>
</tr>
</tbody>
</table>

**Article 44** Supply of services to taxable persons (VAT Directive 2006/112/EC)  
“the place of supply of those services shall be the place where that fixed establishment is located”  
“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”

**Article 45** Supply of services to non-taxable persons (VAT Directive 2006/112/EC)  
“single service shall be taxable in the Member State in which the travel agent has established his business or has a fixed establishment from which the travel agent has carried out the supply of services”

**Article 307** Special scheme for travel agents (VAT Directive 2006/112/EC)

### VAT REFUND RULES

<table>
<thead>
<tr>
<th>Article</th>
<th>Subject-matter</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 192a</td>
<td>Exercise of right to deduct (VAT Directive 2006/112/EC)</td>
<td>“a taxable person who has a fixed establishment within the territory of the Member State where the tax is due shall be regarded as a taxable person who is not established within that Member State when the following conditions are met: (a) he makes a taxable supply of goods or of services within the territory of that Member State; (b) an establishment which the supplier has within the territory of that Member State does not intervene in that supply”</td>
</tr>
<tr>
<td>Article 3</td>
<td>Right of refund to taxable persons not established in Member State of refund (Directive 2008/9/EC)</td>
<td>“This Directive shall apply to any taxable person not established in the Member State of refund who meets the following conditions: (a) during the refund period, he has not had in the Member State of refund, the seat of his economic activity, or a fixed establishment from which business transactions were effected”</td>
</tr>
<tr>
<td>Article 1</td>
<td>Right of refund to taxable persons not established in EU (Thirteenth VAT Directive 86/560/EEC)</td>
<td>“A taxable person not established in the territory of the Community...shall mean a taxable person who...has had in that territory neither his business nor a fixed establishment from which business transactions are effected”</td>
</tr>
</tbody>
</table>

### OTHER VAT RULES

<table>
<thead>
<tr>
<th>Article</th>
<th>Subject-matter</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 219a</td>
<td>Invoicing (VAT Directive 2006/112/EC)</td>
<td>“invoicing shall be subject to the rules applying in the Member State in which the supplier has established his business or has a fixed establishment from which the supply is made”</td>
</tr>
<tr>
<td>Article 221</td>
<td>Invoicing (VAT Directive 2006/112/EC)</td>
<td>“Member States may impose on taxable persons who have established their business in their territory or who have a fixed establishment in their territory from which the supply is made, an obligation to issue an invoice...in respect of supplies of services exempted under points (a) to (g) of Article 135(1)”</td>
</tr>
</tbody>
</table>
Whilst a definition of FE now exists within EU VAT legislation, it has been broadly left to the Court to provide guidance on to the above questions. Table 2 provides a comprehensive list of CJEU cases on FE. A glance over the cases’ numbers tells its own story, and it is quickly apparent that this jurisprudence can be broadly divided into stages: after the first landmark decision in *Berkholz* on FE in the context of place of supply rules,¹¹ there was an approximate 10 years’ period where the Court elaborated on the guidance provided in *Berkholz*; this was followed by a quiet period where no new cases on the topic were referred to the Court, and then, from 2011 onwards, a new stream of cases, focussing primarily on FE in the context of the refund system.

**TABLE 2: CJEU cases on FE**

<table>
<thead>
<tr>
<th>CJEU CASES ON FE</th>
</tr>
</thead>
<tbody>
<tr>
<td>168/84 Berkholz</td>
</tr>
<tr>
<td>C-231/94 Faaborg-Gelting Linien</td>
</tr>
<tr>
<td>C-190/95 ARO Lease</td>
</tr>
<tr>
<td>C-260/95 DFDS</td>
</tr>
<tr>
<td>C-390/96 Lease Plan</td>
</tr>
<tr>
<td>C-453/03 RAL</td>
</tr>
<tr>
<td>C-210/04 FCE Bank</td>
</tr>
<tr>
<td>C-73/06 Planzer Luxembourg</td>
</tr>
<tr>
<td>C-318-319/11 Daimler and Widex</td>
</tr>
<tr>
<td>C-323/12 E. ON Global Commodities</td>
</tr>
<tr>
<td>C-605/12 Welmory</td>
</tr>
</tbody>
</table>

The quiet period between the early 2000s and 2011, seemed to have given EU institutions, taxpayers, and other stakeholders alike, a false sense of security. The Court’s jurisprudence in relation to FE had been the object of several criticisms in the preceding years, namely that it created more questions than it resolved, that it showed the Court to be result-driven, siding with tax authorities in all but one case (*DFDS*),¹² and that it was susceptible to manipulation.¹³ However, by 2003 the European Commission expressed the view that the Court’s jurisprudence had successfully clarified the meaning of FE, and thus extra legislative clarification was

---

unnecessary.\textsuperscript{14} Their view had also been confirmed by the results of the public consultation, which it had undertaken prior to presenting the proposal.\textsuperscript{15} The matter seemed, on the surface at least, settled; until the new wave of cases started arriving to the CJEU, and it was clear that the development of new economic realities represented a real challenge to the role of the FE concept in the EU VAT system. Answers to the above questions were not as clear as it was once thought.

\textit{What can be regarded as a FE?}

Remarkably,\textsuperscript{16} until recently there was no definition of FE in EU VAT legislation. Since 2011, FE is defined – albeit only for place of supply purposes – in Article 11 of the Council Implementing Regulation (EU) No 282/2011,\textsuperscript{17} as follows:

```
1. For the application of Article 44 of Directive 2006/112/EC, a ‘fixed establishment’ shall be 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.

2. For the application of the following Articles, a ‘fixed establishment’ shall be 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 which it supplies:
   (a) Article 45 of Directive 2006/112/EC;
   (b) from 1 January 2013, the second subparagraph of Article 56(2) of Directive 2006/112/EC;
   (d) Article 192a of Directive 2006/112/EC.

3. The fact of having a VAT identification number shall not in itself be sufficient to consider that a taxable person has a fixed establishment."
```


\textsuperscript{15} The Commission launched a public consultation on place of supply of services in May 2003, see \textit{VAT – The Place of Supply of Services, Consultation Paper}, TAXUD/C3/2357, May 2003.

\textsuperscript{16} As noted by H. Stensgaard, “Nexus for Taxpayers in Respect of VAT v. Direct Tax Treaties” in M. Lang, P. Melz and E. Kristoffersson (eds.), \textit{Value Added Tax and Direct Taxation – Similarities and Differences} (Amsterdam: IBFD, 2009).

This definition is in essence an attempt at codifying the jurisprudence of the CJEU on the concept of FE up to then, starting with Berkholz, the first – and still regarded as the leading – case on the concept of FE.

Berkholz concerned the installation and operation of gaming machines on board ferries, which travelled regularly between Germany and Denmark. Although these machines were maintained, repaired, and replaced, at regular intervals by Berkholz employees, Berkholz did not maintain a permanent staff on board the ferryboats. The question for the Court was whether the gaming machines should be regarded as a FE for the purposes of what is now Article 44 of the VAT Directive. Whilst the Court did not give a direct answer, it did offer guidelines as to the concept of fixed establishment. In order to be regarded as a FE for the purposes of the Directive an establishment must be "of a certain minimum size and both the human and the technical resources necessary for the provision of the services [must be] permanently present." The Court went on to add that "it does not appear that the installation on board a seagoing ship of gaming machines, which are maintained intermittently, is capable of constituting such an establishment".

Some years later, the Court delivered its judgment in DFDS, which as opposed to Berkholz, did not relate to Article 44, but to Article 307 of the VAT Directive. The judgment established important interpretative guidelines in relation to the interconnection between the FE criterion and the other Article 44 criteria, as well as indicating which activities the FE must perform in order for services to be considered to have been supplied from there; however, it also clarifies the scope of the concept, as set out in Berkholz.

DFDS A/S was a Danish tour operator, which sold package tours to passengers and travel agents in the United Kingdom through a wholly-owned subsidiary, DFDS Ltd, pursuant to an agency agreement. The Court was essentially asked whether DFDS Ltd should be regarded for the purpose of the VAT Directive as a FE of the parent company, or as an intermediary acting for it. It stated that:

"[Article 307 of the CVSD] is to be interpreted as meaning that, where a tour operator established in one Member State provides services to travellers through the intermediary of a company operating as an agent in another Member State, VAT is payable on those services

in the latter State if that company, which acts as a mere auxiliary organ of the tour operator, has the human and technical resources of a fixed establishment.”

The Court’s concluded therefore that, the fact that DFDS Ltd was a separate legal entity from DFDS A/S was not sufficient to conclude that it was an independent agent; where the agent acts as a mere auxiliary organ to the parent company, and where it has the characteristics, in terms of human and technical resources, of a FE it is regarded as such for the purposes of the Directive.

The Court’s next step in delineating the concept of FE was given in ARO Lease. ARO Lease BV was a Dutch company whose business was the leasing of passenger cars; although the majority of its customers were established in the Netherlands, some were established in Belgium. ARO had no offices or premises in Belgium; Belgium-based were customers were mostly introduced to ARO by a self-employed Belgian intermediary (typically car dealers); and leasing agreement were drawn up at ARO’s offices in the Netherlands. Belgium tax authorities took the view that the presence of a fleet of vehicles in Belgium was sufficient in order to infer the presence of a fixed establishment from which the services were being supplied, but the CJEU disagreed: in order for an establishment to be recognised as a FE for the purposes of Article 44 of the Directive, it “must possess a sufficient degree of permanent and a structure adequate, in terms of human and technical resources, to supply the services in question in an independent basis.”

Thus, whilst the reference in Berkholz to human and technical resources on a permanent basis is maintained, the Court introduces in ARO Lease two new requirements: it must have an adequate structure, and supply the services on an independent basis. Soon after, the Court had the opportunity to reiterate its decision. In 1996, even before the Court delivered its judgment in ARO Lease a similar question had reached the Court: Lease Plan involved the lease of passenger cars by a Luxembourg company, Lease Plan Luxembourg, to Belgium customers. The circumstances of the case were similar to the ones described for ARO Lease, and the Court merely repeated its position, expressly alluding to that judgment. The decision proved to be the last one issued by the Court on the concept of FE for several years.

Just when it appeared that the concept of FE had been dealt with by the Court in a definitive manner, RAL arrived to the CJEU. Similarly to Berkholz, the case concerned the exploitation of gaming machines. Until 2000, the RAL Group supplied gaming machines’ services from its

---

23 Id at last paragraph.
24 Thus enlarging the concept of FE, see B. Terra, n. 12 above, at 139.
26 Id at paragraph 16.
28 Case C-452/03, [2005] ECR I-3947.
"amusements arcades" located in the UK; on that year, however, the RAL Group – following advice from their external tax advisers – set a restructuring scheme, the principal purpose of which was to ensure that the place of supply of the gaming machines services would be deemed to be Guernsey, i.e., outside the territory of the EU for VAT purposes.\textsuperscript{29} It is evident from the description of RAL Group’s new structure that the scheme was constructed around the Court’s jurisprudence regarding the concept of FE: avoiding any physical presence in the UK (apart from the actual gaming machines), RAL failed to fulfil the criteria established by the Court in \textit{Berkholz} and \textit{ARO Lease}.\textsuperscript{30}

This was not, however, the Opinion of the Advocate General Maduro, who considered that in \textit{Berkholz} and \textit{ARO Lease}, the Court only required the presence of a minimum size of establishment: “no more and no less than the resources necessary for the provision of services of a permanent nature”. He took the view that the Court “did not make the permanent presence of all possible human and technical resources, possessed by the supplier himself, in a certain place, a precondition for concluding that the supplier has a fixed establishment there”, and his opinion, RAL Group’s amusement arcades in the UK satisfied this the “minimum-requirements test” for existence of an FE.\textsuperscript{31} This position came as somewhat surprising at the time, in light of the Court’s previous reluctance to accept the existence of FE;\textsuperscript{32} unfortunately, however, the Court opted not to deal with this issue in the judgment. Instead, in another surprising twist, it chose to apply what is now Article 5\textsuperscript{3} of the VAT Directive, concluding that the gaming services supplied by RAL should be regarded as “entertainment and similar activities” for the purposes of the first indent of that provision,\textsuperscript{33} failing to comment on the concept of FE. This decision in itself, as well as the Opinion of Advocate General Poiares Maduro regarding the concept of FE, however, raise cause for concern for the apparent willingness to abandon previously set guidelines, where they lead to an outcome that is not favoured by the Court.

The next time the CJEU had the opportunity to discuss the concept of FE was in the controversial \textit{FCE Bank} case.\textsuperscript{34} The case concerned supplies of services by FCE Bank, established

\textsuperscript{29} It was accepted by the VAT Tribunal that the purpose of the restructuring was to avoid VAT, see \textit{RAL (Channel Islands) Ltd, RAL Ltd, RAL Services Ltd, RAL Machines Ltd v Customs & Excise Commissioners} (2002) VAT Decision 17914, paragraph 199.

\textsuperscript{30} This reasoning is confirmed by a letter from RAL Group’s external tax advisers addressed to the RAL Group, see ibid, at paragraph 27.

\textsuperscript{31} Case C-452/03, [2005] ECR I-3947, at paragraph 41.

\textsuperscript{32} See \textit{Berkholz}, \textit{ARO Lease}, and \textit{Lease Plan} mentioned above, as well as case C-231/94, \textit{Faaborg-Gelting Linien}, [1996] ECR I-2395; the sole exception to this approach being DFDS.

\textsuperscript{33} The decision was controversial, not least because the possible application of Article 53 was never addressed in \textit{Berkholz}, even thought the services supplied by Berkholz were similar to those supplied by the RAL Group. For an analysis of the Court’s apparent inconsistency in this matter, and the possible reasons behind it, see R. de la Feria, “GAME OVER for Aggressive VAT Planning?: \textit{RAL v Commissioner of Customs & Excise}” (2005) British Tax Review 4, 394–401.

\textsuperscript{34} Case C-210/04, [2006] ECR I-2803.
in the United Kingdom, to one of its permanent establishments in Italy, and whether these transactions should be subject to VAT. Insofar as FE was concerned, the Court was asked whether a FE, which is not a distinct legal entity distinct from the company of which it forms part, established in another Member State, and to which the company supplies services, must be treated as a taxable person. It concluded that even where a branch constitutes a FE, because it is not a legal entity distinct from the company of which it forms part, it cannot be treated as a taxable person for the purposes of Article 2 of the Directive. Although the Court did not provide any extra guidance as regards the definition itself of FE, it is interesting to note that, in his Opinion, Advocate General Leger does appear to go back to the accepted definition of FE prior to RAL.35

Soon after FCE Bank, the Court had the opportunity to go back to the concept of FE in a case that, like RAL, seemed to involve a tax avoidance scheme: Planzer Luxembourg.36 The case concerned the refusal by the German tax authorities to grant a refund of VAT incurred by Planzer Luxembourg, a company incorporated in Luxembourg, on fuel supplies in Germany. Planzer Luxembourg was wholly owned by a Swiss company, and had limited human resources in Luxembourg; the German tax authorities, therefore, took the view that the applicant’s business was managed in Switzerland rather than in Luxembourg. The Court was asked first whether the certificate under the Eighth Directive constituted irrefutable proof that the taxable person was established in the issuing Member State; and second, what constitutes a business or a FE from which business is carried out, for the purposes of the Thirteenth VAT Directive. The Court's decision confirmed the possibility to refuse requests for VAT refunds where there the FE is a mere fictitious presence.

Moving away from abuse of law concerns, the most recent wave of cases on the FE criterion demonstrates not the risks of manipulation, but rather the challenges presented by new economic realities. The first in this new wave of cases were Daimler and Widex,37 followed by E. ON Global Commodities,38 but it is in Welmory that the Court has had to significantly revisit the concept of FE.39

In E. ON Global Commodities the Court was asked to consider the conditions for VAT refund under what was then the Eighth VAT Directive. E. ON Global Commodities was a company established in Germany, who carried out supplies of electricity in Romania; whilst it had no physical presence in Romania, it had designated a tax representative identified for VAT

---

35 See Opinion of the Advocate General, at paragraph 26.
36 Case C-73/06, [2007] ECR I-5655.
37 Joint cases C-318-319/11, ECLI:EU:C:2012:666. See below on significance of this decision.
38 Case C-323/12, ECLI:EU:C:2014:53.
39 Case C-605/12, ECLI:EU:C:2014:2298.
purposes therein. The question for the CJEU was essentially whether the presence of a tax representative was sufficient to prevent E. ON Global Commodities from relying in the Eighth Directive procedure to obtain a refund of input VAT incurred in Romania. The Court concluded that “the mere designation of a tax representative does not suffice to permit the taxable person concerned to be regarded as having available a structure possessing a sufficient degree of permanence and his own staff who are responsible for the management of his economic activities”.

*Welmory* concerned a company established in Cyprus which organised sales by auction on an online sales platform. The company concluded a cooperation agreement with a Polish company, under which customers purchased a number of ‘bids’ from the Cypriot company on an online sales site; those ‘bids’ then give the customer the right to take part in the sale of the goods offered for auction by the Polish company on that site and to make an offer to purchase one of the items. The Cypriot company later acquired the Polish company, and the question for the Court was essentially whether the Polish company, an independent taxable person, could be regarded as a FE of the Cypriot company, for the purposes of Article 44 of the VAT Directive. The key element that differentiates this case from previous cases on the concept of FE is that this case concerns the status of the *acquirer* of services, rather than the *supplier* of those services. As the Court points out:

> “The main proceedings relate to the interpretation of Article 44 of the VAT Directive, which states that the place of supply of services to a taxable person is no longer determined by reference to the taxable person supplying the services but by reference to the taxable person receiving them.

> The question therefore arises whether the Court’s case-law ... is still relevant, having regard to the changes made by Article 44 of the VAT Directive.”

Having concluded that the relevant case-law applies *mutatis mutandis* to the new wording of Article 44, the Court goes on to assess the concept of FE where the business is by its nature virtual. It stated that the fact that such a business can be carried on without requiring an effective human and material structure is not determinative; since, despite its particular character, it still required an appropriate structure such as computer equipment, servers and

---

40 Case C-323/12, ECLI:EU:C:2014:53, at para 47.
42 Case C-605/12, ECLI:EU:C:2014:2298, at paras. 39-40.
software, which can qualify as a FE. How much of this “appropriate structure” is necessary remains unclear.43

Table 3 below summarises the above CJEU case-law as regards the concept of FE.

**TABLE 3: Summary of CJEU cases on concept of FE**

<table>
<thead>
<tr>
<th>WHAT CAN BE REGARDED AS A FE?</th>
<th></th>
</tr>
</thead>
</table>
| **Berkholz (168/84)**       | — an establishment must be of a certain minimum size; and  
                              — both the human and the technical resources necessary for the provision of the services must be permanently present |
| **DFDS (C-260/95)**         | — a separate legal entity can be regarded as a FE where it acts as a mere auxiliary organ to the parent company, and has the human and technical resources of a FE |
| **ARO Lease (C-190/95) and Lease Plan (C-390/96)** | — it must have an adequate structure, and supply the services on an independent basis |
| **RAL (C-453/03)**          | — the permanent presence of all possible human and technical resources, possessed by the supplier himself, is not a precondition for concluding that the supplier has a FE (Opinion AG Maduro) |
| **FCE Bank (C-210/04)**     | — a FE, such as a branch, which is not a separate legal entity, cannot be regarded as a taxable person |
| **Planzer Luxembourg (C-73/06)** | — a fictitious presence, such as that of a ‘letter box’ or ‘brass plate’ company, cannot be described as a place of business for the purposes of VAT refund |
| **E. ON Global Commodities (C-323/12)** | — the mere presence of a tax representative does not amount to a FE |
| **Welmory (C-605/12)**      | — the concept of FE developed for suppliers of services, applies *mutatis mutandis* to acquirers of services  
                              — where businesses can be carried on without requiring an effective human and material structure is not determinative for lack of FE; an appropriate structure, such as computer equipment, servers and software, is sufficient |

*When are services supplied from the FE?*

The recurrent usage by the legislator of the expression “fixed establishment from which services are supplied” or “fixed establishment from which business transactions are effected”, indicates that the application of the FE criterion is dependent, not solely from the existence of a FE, but crucially also on the ability to establish a connection between the FE and the services supplied. In essence, the problem has been to determine which activities the FE has to perform in order for the services to be considered to have been supplied from there.

43 See R. Mikutiene, “The preferred treatment of the fixed establishment in European VAT” (2014) *World Journal of VAT/GST Law* 3(3), 166-190. For further comments on this issue, in the context of the FE structure necessary for the purposes of income tax, see section IV below.
In *DFDS*, the Court concluded the services had been supplied by the FE. Whilst Court did not elaborate on the reasons, and namely what activities would have to be performed by the FE in order to conclude that the services had been supplied from therein, Advocate General La Pergola discussed briefly the issue. In his Opinion, he concluded that the services had been supplied by the FE because the contracts were signed in the United Kingdom, payments were made in British currency, and the FE would deal with eventual complaints. In its judgment, the Court does not make reference to any of these points, but it does refer to the need to take into account “the actual place where the tours are marketed”.44

The place where the contracts were signed was also used in *ARO Lease* as an important element which pointed to the fact that the services had been supplied from ARO in the Netherlands, as opposed as from a FE in Belgium; and the VAT Committee (almost unanimously) considered that performance of subsequent actions, such as after sales services or application of guarantee clauses, is relevant, but not administrative support task, such as accounting, invoicing, or debt-claim collection.45

After *ARO Lease*, however, the topic was not addressed again by the CJEU for a long time, until the recent decision in *Daimler and Widex*.46 This prolonged silence had unforeseen consequences, however, and was particularly relevant in the context of what became known as the force of attraction principle.47 In 2002, Directive 2000/65/EC entered into force, removing the obligation for businesses established within the EU to appoint VAT representatives in other Member States.48 The unintended result was the introduction in some Member States of the force of attraction principle for VAT purposes:49 a phenomenon already present in income tax purposes,50 whereby a FE becomes liable for payment of VAT in the country where it is located, in relating to a transaction in which it is not involved. Essentially, the presence of an FE of a non-resident in the Member State of the customer, would result in the assumption that the FE was involved in the transaction, which would have two potential effects: an output VAT liability would arise in the Member State where the FE was established; and the non-resident main

45 Guidelines Resulting from the 86th Meeting of the VAT Committee, 18-19 March 2009, taxud.d.1(2009)357988 – 614
46 Joint cases C-318-319/11, ECLI:EU:C:2012:666.
49 Although it has been defended that this was in fact the European Commission’s intention, see C. Amand, n. 47 above.
company would no longer be able to exercise the right to deduct VAT through the VAT refund process. The principle was enshrined in the law of some Member States, endorsed by their national courts, and applied in many others.

The practice was deemed unacceptable following the CJEU decision in *FCE Bank*, where the court ruled that an FE, which was not a separate legal entity, could not be regarded as a taxable person, and thus intra-group transactions were to be disregarded for VAT purposes. Whilst there were other relevant aspects to that decision, insofar as the force of attraction principle goes, one wonders whether the Court’s decision was necessary: the use of FE as the connecting fact is dependent on the condition that services/transactions are supplied by the FE, i.e. even if an FE exists, output liability should not arise unless supplies are actually carried out by it. Soon after the decision, Article 192a was inserted in the Directive, with the clear aim of limiting the force of attraction principle; and some years later, in 2014, the European Commission issued an opinion to the VAT Committee where it emphasised this point, namely the need to establish a correlation between the FE and the actual supplies. However, only in *Daimler and Widex* did the Court finally reconsider the matter.

Daimler was a German company with a wholly-owned subsidiary in Sweden, where it carried out winter testing of cars; the Swedish subsidiary provided the premises, test tracks, and services connected with the test activities, but there was no staff permanently in Sweden, and testing staff, together with the advanced technical equipment used, were rather flown in for the test periods. Widex was a Danish-based company that manufactured hearing aids; it owned a research division in Sweden, where it carried out solely audiology research, and no other activity. Neither Daimler, nor Widex, performed any taxable activities in Sweden; and thus, both entities, applied to the Swedish tax authorities for a refund of input VAT incurred in Sweden under the procedure laid out in Directive 2008/9/EC. The Swedish authorities refused the

---

52 Although reportedly not in France, Portugal, Denmark, Ireland, UK, Italy, Greece, Estonia, and Latvia, see C. Amand, n. 47 above.
54 Giving rise to other difficulties, particularly in the context of the digital economy, see below.
56 Although the provision was criticised for introducing the concept of “intervention” in the supply, see P. Schilling and D. Hogan, “Intervention – A problematic new concept of EU VAT Law” (2010) *International VAT Monitor* 3, 187; and M. Merkx, *Establishments in European VAT* (Kluwer Law International, 2013), at 86 et seq.
refund, arguing that both entities had a FE in Sweden, and thus disqualified from the VAT refund procedure.

In both cases, the question for the Court whether a taxable person for VAT established in one Member State and carrying out in another Member State only technical testing or research work, not including taxable transactions, can be regarded as having in that other Member State a “fixed establishment from which business transactions are effected” within the meaning of Article 3(a) of Directive 2008/9/EC. The Court starts by confirming that the expression conveys two cumulative conditions, namely: the existence of a ‘fixed establishment’ and, secondly, that ‘transactions’ be carried out from that establishment. On the case, the Court concluded that since the second condition was not present, there was no need to assess whether the first was fulfilled, as follows:

“For the purposes of exclusion of a right to refund, taxable transactions must actually be carried out by the fixed establishment in the State where the application for refund is made and a mere ability to carry out such transactions does not suffice.

In the main proceedings, it is not in dispute that the undertakings concerned do not carry out output taxable transactions in the Member State where the applications for refund have been made through their technical testing and research departments.

In those circumstances, a right to refund of the input VAT paid must be granted, without it being necessary to examine, moreover, whether the undertakings in question do actually each have a ‘fixed establishment’ within the meaning of the provisions to be interpreted…”58

Whilst this decision cannot be said to be surprising in light of the wording of the provisions, as well as of previous jurisprudence, its consequences are far reaching.59 Table 4 below summarises the above CJEU case-law.

**TABLE 4: Summary of CJEU cases on connection between FE and supplies**

<table>
<thead>
<tr>
<th>WHICH ACTIVITIES NEED TO BE PERFORMED BY THE FE?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DFDS (C-260/95)</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>ARO Lease (C-190/95) and Lease Plan (C-390/96)</strong></td>
</tr>
<tr>
<td><strong>Daimler and Widex (C-</strong></td>
</tr>
</tbody>
</table>

---

59 For a detailed analysis of this case, as well as of its implications see R. de la Feria and A. Carvalho, “Entre Daimler e Welmary: O Conceito de Estabelecimento Estável Para Efeitos de IVA” (2013) Revista de Finanças Públicas e Direito Fiscal 6(2), 193-216.
When should the FE criterion be used?

Answering this question involves two different issues, namely: first, to what extent should the general place of supply rules, which make use of the FE connector, be used, in detriment of other specific place of supply rules; second, even where the general place of supply rule applies, which should prevail, the place of business or the place of FE.

Insofar as the first point is concerned, the application of one single place of supply rule to all services was regarded from the outset as problematic by the European Commission, and as a result, the VAT Directive includes several specific place of supply rules, applied to certain services, such as consultancy, entertainment, advertising, etc. The nature of the interaction between these specific rules, and the general place of supply rules was not explicitly stated by the legislator, however, so questions over that nature soon arose: should the specific rules be regarded as exemptions to the general place of supply rules, and as such, interpreted strictly?

The Court referred for the first time to the relationship between these different rules in Berkholz, when it stated that that the specific rules “set out a number of specific instances of places where certain services are deemed to be supplied”, whilst what is now Article 44 laid down the general rule on the matter. However, it was not until Trans Tirreno that the Court gave more specific guidance as to interconnection between the different rules. The Court stated in that case that:

"[Article 43] by way of derogation from the strict principle of territoriality, lays down the general rule that the service is deemed to be supplied at the place where the supplier has established his business or has a fixed establishment from which the service is supplied. [Other Articles provide] for certain derogations from that general rule for specific services where the fiction that the services are supplied at the supplier's place of business is inappropriate and it lays down other criteria defining the place at which those services are deemed to be supplied."

The characterisation by the CJEU of specific place of supply rules as derogations did not, however, completely clarify matters: the questions of whether the general place of supply rule

---

63 Id at paragraphs 15-16.
took interpretative precedent over specific place of supply rules, or whether those rules were to be interpreted restrictively, remained unanswered. Some years later, the Court delivered its decision in *Hamann*, where it started by reiterating the position already expressed in *Trans Tirreno*, but then seemed to conclude that specific place of supply rules constitute exceptions to the main rule, and as such should be interpreted strictly. This reading was not without controversy, and Advocate General Fennelly later defended that the decision in *Hamann* provided “no intimation of the priority, as a matter of interpretative principle, of the first paragraph over the second.” The issue was not, nevertheless, settled until the decision in *Dudda*.

The question referred to the CJEU in *Dudda* was whether sound-engineering services should be regarded as “cultural, artistic, entertainment, or similar services” within the meaning of what is now Article 53, or whether they should be deemed to fall within the scope of the general rule. At the hearing, the German government referred to the legislative history of the place of supply rules, as well as to the rulings in *Trans Tirreno* and *Berkholz*, to defend specific place of supply rules constituted derogations to the general rule, and as such should be interpreted strictly. The European Commission took the opposite view, arguing that specific place of supply rules should be seen as providing *lex specialis* in respect of the various specialised services to which they apply, with the general place of supply rule providing for a residual *lex generalis*; a deliberate policy of reading the specific place of supply rules in a restrictive fashion would be a mistake. The Court, following the opinion of Advocate General Fennelly, agreed with the Commission, stating that the general place of supply rules in no way took precedent over specific place of supply rules; and in every situation, the question which arose was whether it was covered by one of the specific rules, and if not, it fell within the scope of the general rule. This approach has been confirmed by the Court in latter cases.

The second point highlighted above stems from the fact that place of supply rules which make reference the FE criterion tend to use similar wording: “the place of supply shall be deemed to be the place where that taxable person has established his business or has a fixed establishment for which the goods / services are supplied”. This wording reflects the use of two different criteria for determining the place of supply: the place where the supplier has established his business, and the place where the supplier has a fixed establishment. The use in the provisions of the word “or” could lead to the assumption that they constitute alternative criteria of equal

---

67 Id at paragraphs 20–22.
value, i.e., that none has primacy over the other. This interpretation was, however, rejected by the CJEU in its early case-law.

In Berkholz, the Court adopted the view that the place where the supplier has established his business is the “primary point of reference” for determining the place of supply of services. Another establishment can only be referred to “if the reference to the place where the supplier has established his business does not lead to a rational result for tax purposes or creates a conflict with another Member State”.69 It resulted from this decision therefore that the FE criterion should only be applied where there was a FE from which supplies were made; and the use of the place where the business is established did not lead to a rational result for tax purposes or created a conflict with another Member State.70

This de facto hierarchy established by the Court in Berkholz amongst place of supply criteria was consistently reiterated by the Court in subsequent cases involving FE claims,71 where the Court had the opportunity to elaborate on the meaning of irrational result. In DFDS, the conditions for being regarded as a FE were fulfilled, so the CJEU had to decide on whether the use of the place where the supplier has established its business criterion would lead to an irrational result for tax purposes, or create a conflict with another Member State.72 The Court, following the Opinion of Advocate General La Pergola, concluded that the use of this criterion would lead to distortions of competition, and thus, to an irrational result for tax purposes:

“Systematic reliance on the place where the supplier has established his business could in fact lead to distortions of competition, in that it might encourage undertakings trading in one Member State to establish their business, in order to avoid taxation, in another Member State which has availed itself of the possibility of maintaining the VAT exemption for the services in question.”73

In ARO Lease, the issue of the rationality of using the place where the supplier has established his business criterion was again raised by Advocate General Fennelly. The Court concluded, however, since a FE was deemed not to exist, it was not necessary to consider the rationality element.74 Some years later, in RAL, the CJEU returned to this element in a slightly different

70 I. Roxan refers to a “double-test for the use of a fixed establishment the place of supply”, in n. 13, at 611.
71 See, for example, case C-231/94, Faaborg-Gelting Linien, [1996] ECR I-2395.
73 Id at paragraph 23.
74 This approach has been questioned by the UK courts in Customs & Excise Commissioners v Chinese Channel (Hong Kong) Ltd, [1998] STC 357 where it was observed that: “the cynic might observe, however, that in every case where the court has emphasised the priority of the main place of business test, the court has also found that no fixed establishment existed. It remains to be seen what the court would decide to be the appropriate test where they find that there was a fixed establishment from which the supply was provided”.

18
context: the “rational result for tax purposes” was extended from a criterion to choose between place of business or place of FE, to a criterion to choose between general and specific place of supply rules.\textsuperscript{75}

Following the above decisions, it was suggested that the lack of consideration by the CJEU of the circumstances, under which the use of the place where the supplier has established its business criterion would lead to a conflict with another Member State, was the main source of uncertainty.\textsuperscript{76} Yet, time has dispelled these concerns; instead the main aspect of the last decade’s case-law on this regard, has been the implicit taking over of rationality considerations, to the detriment of the place of business as the “primary reference”. Indeed, applying rationality has meant that, in practice, the place of business can no longer be regarded as the primary point of reference;\textsuperscript{77} where there is a FE, from which supplies are made, this will be the connecting factor used, by tax authorities, and courts alike. Place of business has de facto become lex generalis; FE from which supplies are made is lex specialis. Table 5 below summarises the above CJEU case-law.

**TABLE 5: Summary of CJEU cases on use of FE criterion**

<table>
<thead>
<tr>
<th>WHEN SHOULD THE FE CRITERION BE USED?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General or specific place of supply rules?</strong></td>
<td><strong>Trans Tirreno</strong> (283/84) — specific place of supply rules constitute derogations to the general rule</td>
</tr>
<tr>
<td></td>
<td><strong>Hamann</strong> (51/88) — specific place of supply rules constitute exceptions to the main rule, and as such should be interpreted strictly</td>
</tr>
<tr>
<td></td>
<td><strong>Dudda</strong> (C-327/94) — specific place of supply rules are lex specialis, and the general rule, lex generalis; — general rule is a residual rule, which will only apply when specific rules do not</td>
</tr>
<tr>
<td></td>
<td><strong>RAL</strong> (C-453/03) — place of supply rule chosen should lead to a rational solution from the point of view of taxation</td>
</tr>
<tr>
<td><strong>Place of business or place of FE?</strong></td>
<td><strong>Berkholz</strong> (168/84) — place of business is the primary point of reference, another establishment can only be referred to if place of business does not lead to a rational result for tax purposes or creates a conflict with another Member State</td>
</tr>
<tr>
<td></td>
<td><strong>DFDS (C-260/95) — systematic creation of distortions to competition constitutes an irrational result for tax purposes</strong></td>
</tr>
</tbody>
</table>

### III. FE in EU VAT Law: Challenges

\textsuperscript{75} Case C-452/03, [2005] ECR I-3947, at para 33. For an analysis of the Court’s reasoning and its consequences, see R. de la Feria, n. 33 above.

\textsuperscript{76} See I. Roxan, n. 13 above, at 626.

\textsuperscript{77} For an opposite view see R. Mikutiene, n. 43 above, at 168.
European law on the application of the FE criterion, as outline above, gives rise to various difficulties. These can be broadly divided into three headings, as follows:

(1) Adapting to new economic realities
(2) FE in domestic law
(3) FE vs. PE

Each of these issues is addressed below.

Adapting to new economic realities

The pressures facing the EU VAT system are neither new, nor circumspect to specific areas of system. Over the last two decades a system that was thought primarily for a national, physical, economy, has had to adapt to a globalised, digital, one. Difficulties have therefore arisen in a multitude of areas, from exemptions to compliance obligations, and place of supply rules are no exception. The above analysis of recent CJEU cases highlights the significant challenges arising in the context of the FE criterion:

— _Welmory_ highlights the challenges presented to the FE concept, as it had been developed by the Court, by the digitalisation of the world economy; and,
— _Daimler_ demonstrates the difficulties for the role of the FE criterion within place of supply and refund rules, arising from a globalised world economy.

As recently stated by the OECD, the digital economy is increasingly becoming the economy itself.78 The difficulty resides in the fact that legislation, as well as early CJEU case-law on the concept of FE, has been constructed on the presumption of a physicality, which has been eroded by the progressive digitalisation of the world economy. The problem is not exclusive to VAT, and the same presumption of physically has traditionally been a constitutive element of the concept of PE, which requires a territorial or geographical link to the ground. This element of the PE concept has been consistently challenged in recent years,79 not only because it creates a distortion to competition by treating e-commerce and traditional commerce differently,80 but mostly in the context of the opportunities for profit shifting that it creates. Possible modifications to the definition of PE in the OECD Model Convention are currently being considered, which would significantly broadening the concept,81 although stopping short of

79 For an overview of how the thinking has evolved in the last 15 years, see G. Teijeiro, “Taxation of the digital economy: A moving target”, LinkedIn, 24 October 2015.
81 This is consistent with a worldwide trend for enlargement of the concept at both national and bilateral levels. For recent examples see: L. Ambagtsheer-Pakarinen, “Tax Authorities issue statement on possibility of employee working from home creating PE in Sweden for foreign employer” _IBFD Tax News_
accepting a digital presence as a virtual PE,\textsuperscript{82} despite strong criticism and the apparent willingness of some countries to move in that direction.\textsuperscript{83}

In VAT, the challenges posed by the digital economy to place of supply rules, and in particular to the FE concept, have been known for some time. As far back as the late 1990s, scholars argued that if the CJEU did not drop the human resources element from the FE concept, the tax system would “slowly commit suicide”.\textsuperscript{84} Apart from the enforcement element, there is also a significant risk of manipulation: on one hand, the easiness in which digital items can be transferred between different companies within a group, creates a strong incentive to route the acquisition of these intangibles through FEs located in low tax jurisdictions;\textsuperscript{85} and on the other hand, avoiding the existence of an FE is also relatively easy in the digital era, namely by removing the presence human and technical resources, or placing them in another country.

\begin{footnotesize}

83 A recent decision of the Central Tax Court in Spain has expanded the territorial nexus, by establishment the existence of a Spanish PE on the basis of a website directed at the Spanish market, even though the server was located in another country, see G. D. Sprague, “Spanish Court Imposes Tax Nexus by Finding a ’Virtual PE’” (2013) \textit{Tax Management International Journal} 42, 48. See also M. Gianni, “The OECD’s Flawed and Dated Approach to Computer Servers Creating Permanent Establishments” (2014) \textit{Vanderbilt Journal of Entertainment & Technology Law} 17(1), 1-38; and H. Fuchs, “Israel – Taxation of foreign digital services – draft circular released for public comments” \textit{IBFD Tax News Service}, 9 April 2015.


85 See R. Mikutiene, n. 43 above; J. Swinkels, n. 10 above; and J. Englisch, n. 31 above.
\end{footnotesize}
In this context, the preliminary reference to the CJEU in Welmory was unsurprising, and the decision eagerly waited.\(^{86}\) The key question was whether the Court would depart from previous case-law, and endorse the possibility of a virtual FE. Either a positive or a negative answer would have had significant ramifications for the FE criterion; the Court’s decision was somewhere in between. There is a clear departure from previous case-law, namely the requirement which goes back to the decision in Bekholz of the presence of human and technical resources – the Court now accepts that the existence of an FE is not dependent on the existence of those resources. However, it did stop short of removing the physicality nexus in the concept of FE, by stating that “an appropriate structure, such as computer equipment, servers and software” was still necessary. The decision represented a step forward towards acknowledgement of new economic realities, but does raise some, possibly contradictory, concerns: on one hand, the lack of support for a virtual FE means that some of the manipulation risks mentioned above, are still present; on the other hand, in some situations, as it is further demonstrated in the Daimler case, establishing the existence of an FE will put into question fundamental principles of the EU VAT system.

Daimler highlights the challenges to the FE criterion arising from new corporate structures which reflect globalisation: the various activities, which form part of a production chain, are no longer circumscribed to one country, or even a few countries, but are not carried out in many different countries. As the OECD comments “world trade and production are increasingly structured around global value chains”.\(^{87}\) This geographical fragmentation of production processes according to the comparative advantages of each location, has increased efficiency and competitiveness, but also poses significant challenges.\(^{88}\) One of these challenges is allocation of taxing rights, both for CIT, and for VAT purposes: in CIT this reality has created the problem known as profit splitting; in VAT, however, where no splitting is possible,\(^{89}\) the difficult has been to identify which country in abstract has the strongest claim to taxing a specific transaction. The problem is (unwillingly) further aggravated by the Court’s case-law on other areas of the VAT system, as Daimler demonstrates.

In this context, and like Welmory, the preliminary reference to the CJEU in Daimler came as no surprise.\(^{90}\) Predictably also the Court reiterated the need for taxable supplies to be carried out by the FE in order to the criterion to be used, thus confirming the cumulative nature of the FE

\(^{86}\) Case C-605/12, ECLI:EU:C:2014:2298.  
\(^{88}\) Ibid.  
\(^{89}\) Although it has been - rather unwisely - suggested that transfer pricing guidelines are used to determine which establishment should account for VAT, see A. Charlet and D. Holmes, “Determining the Place of Taxation of Transactions under VAT/GST: Can Transfer Pricing Principles Help?” (2010) International VAT Monitor 6, 434–436.  
\(^{90}\) Joint cases C-318-319/11, ECLI:EU:C:2012:666.
nexus: the establishment has to fulfil the conditions for an FE, and carry out taxable supplies. The decision was the right one, both in light of the wording of the place of supply and refund provisions, and of the principles of the EU VAT system; on the contrary, a decision in favour of the Swedish tax authorities would have had the potential to significantly compromise the principle of the right to deduct.

Under existing rules the right to deduct for a company operating in Member States, other than the one where it is headquartered, can be exercised via one of two routes: where there is a FE, the right to deduct can be exercised through a VAT return; where no FE is present, the right to deduct can be exercised via the refund system. In the case of Daimler, however, the position adopted by the Swedish tax authorities of regarding Daimler's establishment as an FE would ultimately have resulted in it being unable to exercise its right to deduct input VAT: the right to deduct via the refund system would have been obviously denied on the basis of the existence of an FE; but crucially, however, even if Daimler had registered its establishment in Sweden, it would have been unable to deduct input VAT in that country, since it performed no output supplies therein.

Since Daimler's business was fully taxable, there can be no doubt as to the company's right to deduct VAT. The right to deduct is a fundamental principle of the EU VAT system, corollary of both the principle of fiscal neutrality, and the principle of VAT as tax on consumption. Its centrality to the functioning of VAT means that, as the Court has consistently reiterated over the last three decades, the right cannot be limited unless expressly provided for in the Directive, and applies even to preparatory activities where output transactions were never ultimately carried out. The question, therefore, cannot be whether the right to deduct can be denied in respect of activities which will ultimately lead to taxable outputs; but rather how can it be exercised. By deciding in favour of the taxpayer, the Court ensured that the right to deduct could be exercised via the refund procedure. There was of course an alternative, but it would have been considerably riskier in the immediate term, since it would have implied a radical departure from the Court's previous case-law: ensuring that Daimler could exercise the right to deduct via VAT returns submitted in Sweden, even though it made no output supplies in that country; thus departing from established case-law on the concept of economic activity.

The pernicious link between the concept of taxable person (Article 9), and taxable supplies (Article 2), was established in the early 1990s in the Polysar case. On the face of it, it was a

---

91 See R. de la Feria and A. Carvalho, n. 59 above, at 210 et seq.
94 Case C-60/90, [1991] ECR I-3111.
short, apparently unremarkable case,\textsuperscript{95} which had nevertheless massive consequences for the overall functioning of the EU VAT system.\textsuperscript{96} The decision to exclude businesses that did not perform taxable output activities from the scope of VAT was neither inevitable in light of the wording of the Directive, nor is it the international norm. In the so-called modern VATs the test for right to deduct input VAT is whether that tax is related to carrying out the person’s enterprise, rather than whether they are directly used to make taxable supplies; an entity with employees, making acquisitions for business purposes, would therefore be treated as a taxable person, regardless of whether it does taxable supplies.\textsuperscript{97}

Returning to \textit{Daimler}, the position adopted by the Court of ensuring the exercise of the right to deduct via the refund system, does provide short-term relief, but it can only be seen as a temporary solution. Ultimately, the reality of geographical fragmentation of production, as well as the evolving nature of secondary establishments demonstrated in \textit{Welmory}, will need to be addressed. Like other areas of the VAT system, such as the treatment of holdings, or that of financial instruments, the functioning of place of supply rules is being hampered by the Court’s reluctance to depart from its own judicial construct of economic activity.

\textit{FE in domestic law}

At present, national practices as regards the FE criterion differ significantly;\textsuperscript{98} not solely as regards what can be regarded as a FE, but also as regards the elements which will determine whether supplies are deemed to have been carried out by the FE.

What can be regarded as a FE? It might have been expected that the codification of CJEU case-law as regards the definition of FE, included in the Implementing Regulation (EU) No 282/2011,\textsuperscript{99} would have the effect of harmonising its application throughout the EU. Unfortunately this turned out not to be the case; not only as a result of different reactions to evolving economic realities, but also because the definition of FE included in the Regulation

\textsuperscript{95} As P. Farmer put it, the judgment that at the time ‘seemed innocuous enough in itself’, see “Taxable persons and the ‘Private Life’ of Companies” (1997) 2 EC Tax Journal 41–48, at 42.


\textsuperscript{98} On the difficulties arising from these discrepancies, see M. Merkx, n. 18 above.

\textsuperscript{99} See section II above.
itself has reportedly been interpreted differently by individual Member States, said to be under the illusion that they have a wide discretion on the application of the concept.

The decision in Philip Morris by the Italian Courte Suprema di Cassazione, where the Italian Supreme Court determines the existence of an FE by reference to the concept of PE, for example, precedes the Regulation, but it has been consistently reiterated by the Italian courts ever since. Yet, in other countries a connection between the two concepts is expressly rejected: this is the case, for example, under Polish law, where courts, as well as tax authorities, reportedly follow closely CJEU jurisprudence, with no connection made between the two.

When are services said to be supplied from the FE? One of main points of disparity of treatment between Member States relates to the situations when more than one establishment – secondary or not – is involved in the supply of one single service, by performing different activities. In Belgium and France, tax authorities take the view that the service is supplied by the FE where it took part in the negotiation of the contract between the supplier and the customer; whilst in the UK, and in Germany, the supply is deemed to have been made by the establishment most closely connected to the supply, irrespectively of contractual negotiations.

<table>
<thead>
<tr>
<th>TABLE 6: Summary of key UK case-law on FE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK KEY CASE-LAW ON FE</strong></td>
</tr>
<tr>
<td>What can be regarded as a FE?</td>
</tr>
<tr>
<td><strong>Astral Marina Services</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Muster Inns</strong></td>
</tr>
</tbody>
</table>

---

100 I. Lejeune et al, n. 18 above, at 146.
101 R. Mikutiene, n 43 above.
103 Courte Suprema de Cassazione, No. 6799/04 of 6 April 2004; Courte Suprema de Cassazione, No. 17206/06; Courte Suprema de Cassazione, No. 3889/08 of 15 February 2008. For a brief comment on this last case see G. Chiese, “Italian Supreme Court ruling on treatment of Italian subsidiary of Swiss parent as permanent (fixed) establishment for VAT purposes”, IBFD Tax News Service, 2013.
105 P. Schilling and D. Hogan, n. 56 above.
106 See Table 6 below.
107 R. Mikutiene, n. 43 above.
109 Muster Inns Ltd v Commissioners for Her Majesty’s Revenue & Customs, [2014] UK FTT 563.
<table>
<thead>
<tr>
<th>When are services said to be supplied from the FE?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chinese Channel</strong></td>
<td>— where services are supplied by more than one establishment, the determinant element is the importance of the supply, i.e. which establishment supplies most important service</td>
</tr>
<tr>
<td><strong>Zurich Insurance</strong></td>
<td>— place of contracting is not the most significant factor to determine where services are supplied, but rather where the work is done and consumed</td>
</tr>
</tbody>
</table>
| **Omnicon**                                       | — where services are supplied by more than one establishment, the following questions are relevant to determine establishment from which services are supplied:  
  • which establishment has authority to make contracts?  
  • which establishment has authority to take decisions concerning the contracted services?  
  • which establishment prepares or makes other decisions, for example about the artwork or other creative work used in the campaign?  
  • which establishment actually uses the services? |
| **Binder Hamlyn and Vincent Consultants**          | — FE for the purposes of receiving services may still exist, even if no business activities are carried out there, but are carried out from other addresses overseas |

**FE vs. PE**

The discussion over whether FE and PE are – or should be – identical concepts, and whether there should be one single concept of secondary establishment for VAT and corporate income tax (CIT), has been going on for some time. Although the concept of PE had been discussed by the Court in the context of DFDS, in FCE Bank the CJEU quickly dismissed its relevance, noting that the OECD Model Convention, and consequently its Commentary, is irrelevant “since it concerns direct taxation whereas VAT is an indirect tax”. The statement, however, did not settle what, in practice, is a particularly relevant question. The difficulty lays in the fact that some legal factors militate in favour of their similarity, others militate against it.

---

110 Healthcare Leasing Limited v The Commissioners for Her Majesty’s Revenue and Customs, LON/2006/0763.
112 Zurich Insurance Co v Revenue and Customs Commissioners, [2007] STC 1756.
113 Omnicom (UK) PLC (LON/93/2441)/Diversified Agency Services Ltd (CO/2750/94).
114 Binder Hamlyn (EDN 82/55), [1983] VATTR 171.
There is clearly much commonality between the two concepts.\textsuperscript{117} Militating against their similarly however is, first, the terminological discrepancy: the fact that the legislator has consistently, and over a significant time period, used different terms, is indicative of intent to convey different meanings.\textsuperscript{118} Yet, this is terminological discrepancy, so evident and consistent in the English language, is not present in every language. As demonstrated by Table 7 below, within the EU alone, in approximately 1/3 of official languages, the same term is used to identify a secondary establishment for VAT, as for a secondary establishment for corporate income tax purposes.\textsuperscript{119}

**TABLE 7: FE vs PE: linguistic differences within EU\textsuperscript{120}**

<table>
<thead>
<tr>
<th>Language</th>
<th>FE USE SAME TERM FOR FE AND PE?</th>
<th>Irish</th>
<th>Italian</th>
<th>Latvian</th>
<th>Lithuania</th>
<th>Maltese</th>
<th>Polish</th>
<th>Portuguese</th>
<th>Slovak</th>
<th>Slovenian</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgarian</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Croatian</td>
<td>NO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cypriot</td>
<td>NO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Czech</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Danish</td>
<td>NO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dutch</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>English</td>
<td>NO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estonian</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finnish</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>French</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{117} For a comparative description of the common elements, see H. Stensgaard, n. 16 above, at 635 et seq.

\textsuperscript{118} On the historical background to the introduction of the term FE in the Directive, see P. Pistone, n. 20 above.


\textsuperscript{120} The content of this table is based on information provided by numerous tax practitioners across the EU, to whom I am extremely grateful, namely: Maria Vraa Schauw-Peterson, Laura Gradinescu, Rasa Mikutiene, Madalina Stefan, Radu Petrescu, Marjaana Helminen, Yiannis Demetriades, Kim Pedersen, Ethna Kennon, Jaakko Husa, Danielle Cunniffe, Cristina Popa Nistorescu, Janis Taulacs, Dimitrova Dennitsa, Vladimir Marinescu, Daniel Anghel, Vladimir Batarelo, Karina Elgaard, Sarah Aquilina, Giannis Despotidis, Henrik Stensgaard, Azra Begic Milanez, Erki Uustalu, Nikos Dimitrakopoulos, Konstantinos Margaritis, Mateja Babić, Panos Thilveros, Katerina Perrou, Eva Tsika, Daniel Deak, Malcolm Melak, John Vella, Declan Butler, Marja Hokkanen, Sabine Vuskane, Eero Männistö, Kristina Gogić, Eero Viigimäe, Desreee Cassar, Mojca Bartol Lesar, Eleanor Kristoffersson, Antonino Giusto, Alki Kuldekpp, Ljudmilla Kuhto, Iveta Grossova, Mikko Pikkujaemsä, Peter Agoston, Silvio Cilia, Margarita Souanova, Teodosia Kirilova, and Nana Sumrada Slavnic.
<table>
<thead>
<tr>
<th>Language</th>
<th>Germany</th>
<th>Spanish</th>
<th>Sweden</th>
</tr>
</thead>
<tbody>
<tr>
<td>German</td>
<td>NO</td>
<td>Spanish</td>
<td>YES</td>
</tr>
<tr>
<td>Greek</td>
<td>YES</td>
<td>Swedish</td>
<td>NO</td>
</tr>
<tr>
<td>Hungarian</td>
<td>YES</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

It is also said – and that appears to be the ratio behind the Court’s statement in *FCE Bank* – that VAT and CIT are different taxes, and as a result the legislative function of the secondary establishment criterion in each of these taxes is also distinct: its function within VAT is to identify where consumption takes place, whilst for CIT purposes is to identify where income is generated.\(^{121}\) The argument, however, is misleading. Whilst it is certainly true that the object of taxation for these two taxes, i.e. what is being taxed, is dissimilar, the core function of the secondary establishment criterion is not: in both taxes its function remains in essence to allocate the right to tax to a given country.\(^{122}\) As opposed to what is often argued therefore, similarity of function is actually one of the most convincing arguments in support of a unified concept of secondary establishment.

Notwithstanding the above, comparing the PE concept in the OECD Model Convention, with that of FE under CJEU case-law, it is clear that despite the trend towards their expansion,\(^{123}\) as they stand, there are still key differences between the two concepts.\(^{124}\) The two most significant differences are the possibility envisaged by the OECD Model Convention of an agent PE, whilst a similar agency structure would not be sufficient to indicate the presence of an FE;\(^{125}\) and the need for the establishment to carry out taxable transactions for the FE criterion to be applied, whilst no such requirement is present insofar as a PE is concerned. Both differences point towards a clear conclusion, namely that the concept of PE is broader than that of FE, so that an FE will necessarily fulfil the conditions for its characterisation as a PE, but the opposite may not be the case.


\(^{122}\) This position is shared by others, see T. Ecker, *A VAT/GST Model Convention* (Amsterdam: IBFD, 2013), at 155 et seq; and F. Vitale, “Relationship between Head Offices and Permanent Establishments: VAT/GST v. Direct Taxation: Brief thoughts on the characteristics and function of permanent establishments” in M. Lang, P. Melz and E. Kristoffersson (eds.), *Value Added Tax and Direct Taxation – Similarities and Differences* (Amsterdam: IBFD, 2009).

\(^{123}\) See point III above on the impact of the digital economy on the two concepts.


\(^{125}\) For a different view see M. Iavagnilio, n. 101 above, arguing that an agency FE can be defended under the DFDS case. For recent analysis of rules concerning agency PE, see A. Plejsier, “The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?” (2015) *Intertax* 43(2), 147-154.
The above differences are acknowledged even in countries which apply the same term to characterise secondary establishments for CIT and for VAT purposes. In practice, and with a few exceptions,\textsuperscript{126} most tax authorities take the terms to have different meanings depending on the type of tax in question.\textsuperscript{127} In line with the above conclusion on the broader nature of the PE concept, tax authorities will often assume the presence of a PE, where the presence of an FE is established, but will not necessarily assume the presence of an FE, where a PE exists.\textsuperscript{128}

Having established that the two concepts are at present dissimilar, the question is then whether ideally they should be. There is much to support in a unified concept secondary establishment for VAT and CIT: not only would it promote conceptual coherence given the similarity of their function; but there is also an obvious practicality element to it, which would result in decreased compliance and administrative costs, as well as in increased legal certainty. Historical, as well as practical, reasons would dictate that the alignment of concepts would see the PE concept, as outlined in the OECD Model Convention, taking centre stage: PE is a much older concept, dating back to the 19\textsuperscript{th} century German law,\textsuperscript{129} as well as a more widely known and accepted concept worldwide.\textsuperscript{130} Yet, if the FE concept was to be align to that of PE double taxation problems would be likely to arise, either at output level – same transaction deemed taxable in two different countries – or at input level – denial of deductibility of input tax. This double taxation is partially a result of the complexity of place of supply rules, in the case of outputs; and a result of the concept of taxable person, and in particular of economic activity, as it has been interpreted by the Court.\textsuperscript{131} Therefore, whilst a unified concept of secondary establishment is clearly desirable, alignment of the concepts of PE and FE must be preceded by a review of place of supply rules, as well as reconsideration of settled case-law on the concept of economic activity, so as to ensure that situations of double taxation would not occur.

IV. Conclusion

\textsuperscript{126} See above comments on position of Italian tax authorities and courts.
\textsuperscript{127} See for example M. Gorazda and D. Elvira Benito, n. 103 above, as regards Spanish law and practice.
\textsuperscript{128} There are, however, some exceptions: recently the Italian tax authorities issued guidance to the effect that participants in Expo 2015 carrying out activities therein were required to fulfil their tax obligations for both income tax and VAT purposes, see G. Gallo, “Expo 2015 – further clarifications”, \textit{IBFD Tax News Service}, 9 July 2015.
\textsuperscript{130} T. Ecker, n. 121 above, at 161.
\textsuperscript{131} See above.
European VAT is at a cross-road. The steady shift from income to consumption taxes – a global trend for some time – has significantly intensified since 2008, thus increasing reliance on VAT. Yet the EU VAT system is hardly fit for purpose: the assumptions on which it was build, such as territoriality, physically, and public sector monopolies, are crumbling, if not completely gone. With unanimity required for every meaningful legislative amendment, change is difficult to attain. In the last few years, the European Commission has been favouring soft law as an instrument of change, but whilst useful, soft law has many limitations, not least the risk it presents to legal certainty. The other possible agent of change is the CJEU. Judicial activism too has its shortcomings, but it has the comparative advantage of providing more legal certainty than soft law. Whilst the Court has traditionally played a leading role in adapting the EU VAT legislation to evolving economic realities, its reluctance to depart from previous, now old, case-law has hampered further development. Yet, if the challenges posed by the coupling of increased reliance on the EU VAT system, with a new digitalised, globalised, economy, are to be met, depart it must.


133 The publication of the VAT Committee guidelines is a paramount example; see European Commission, Guidelines Resulting From Meetings of the VAT Committee, 20 October 2015.