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VAT EXPERT GROUP

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Sub-Group on the topics for discussion

Draft Opinion on *Welmory sp. z o.o.* (Case C-605/12)

This opinion is issued following discussions in the VAT Expert Group (“**VEG**”) on the decision of the Court of Justice of the European Union (“**CJEU**”) in the case of *Welmory sp.z o.o.*(Case C-605/12) (“**Welmory**”).

Welmory is the first decision of the CJEU concerning the concept of fixed establishment (“**FE**”) following the adoption of the “VAT Package” introduced in 2010 by Directive 2008/8/EC, which entails a paradigm shift towards a destination based taxation system. The CJEU construed articles 43 and 44 of Directive 2006/112/EC (“**the VAT Directive**”) and article 11 of EU Council Regulation 282/2011/EU (“**Regulation**”). Article 44 concerns business to business (“**B2B**”) supplies. The FE concept also applies to business to consumer (“**B2C**”) supplies covered by article 45 of the VAT Directive and various other provisions in the VAT Directive, which are not necessarily covered by article 11 of the Regulation.

In *Welmory*, the CJEU held that the “*case-law on the interpretation of Article 9(1) of the Sixth Directive can in principle be applied mutatis mutandis to the interpretation of Article 44 of the VAT Directive*”. Article 9(1) applied to B2B and B2C supplies. Essentially, the CJEU held that notwithstanding the introduction of the VAT Package, the fundamental principles concerning the FE concept have not changed as summarised below.

Distinct concepts

FE is a concept of European Union VAT law, the interpretation of which cannot be left to the discretion of the Member States. That concept is fundamentally distinct from the concept of a permanent establishment (“**PE**”) that applies for direct tax purposes. The PE concept is defined in article 5 of the OECD Model Tax Convention. Its aims are to avoid double taxation, double non-taxation and to allocate the taxing rights for direct tax purposes between jurisdictions. For VAT purposes, taxing rights are allocated on the basis of the destination principle (place of consumption). This destination principle, as interpreted by the CJEU, is robust and copes well with the challenges of the increasingly globalised world of trade.

The VAT Directive does not define “FE”. The Regulation provides for specific rules designed to bring uniform treatment throughout the Union, which must be applied restrictively (recital (5)). Those rules take account of the case law of the CJEU and seek to provide clear and objective criteria to facilitate the practical application of the concepts (recital 14).

The CJEU in case C-210/04, “*FCE Bank*” stated that with regard to the FE concept:

“39. It should be noted that the OECD Convention is irrelevant since it concerns direct taxation whereas VAT is an indirect tax.”

Nothing in the VAT Directive, the Regulation or *Welmory* changes the force of that declaration. The FE and PE concepts are distinct and must remain so. The existence of a PE does not mean that there also exists an FE, and vice versa.

The tests for establishing whether or not an FE exists are distinct and must be applied separately. They need to give legal certainty and must be easy to apply in practice. As VAT is applied on a transactional basis, economic operators (suppliers and customers) must be in a position to know at the time of each supply, starting with the very first one, if and where VAT is due and whether it is to be charged.

There is increasing evidence that tax authorities incorrectly conclude that an FE exists on the basis of the existence of a PE, and vice versa. This gives rise to legal uncertainty, disputes, increased costs, the imposition of penalties and, in some cases criminal sanctions, even though there is no VAT risk and loss for the tax authorities.

Primary and secondary concepts

The CJEU in *Welmory* stated that “*in accordance with settled case-law of the Court, the object of the provisions determining the point of reference for tax purposes of supplies of services is to avoid, first conflicts of jurisdiction which may result in double taxation and, secondly, non-taxation*” (para. [42]).

The CJEU in *Welmory* also re-stated that the most appropriate and primary point of reference is the place where the taxable person has established its business. Only if that place of business does not lead to a rational result, or creates a conflict with another Member State, that another establishment may come into consideration (para.[53]). The place where a taxable person has established his business is objective, simple, practical and offers great legal certainty, being easier to verify than, for example the existence of a fixed establishment (para.[55]). Advocate General Kokott stated that “*in the case of doubt, the assumption is that no fixed establishment exists*” (para.[45]).

According to the case law of the CJEU, Articles 43 to 45 of the VAT Directive prescribe a hierarchy whereby the place where a taxable person has established its business is the primary point of reference. The FE concept is of secondary importance. Essentially an FE only becomes relevant where the primary point of reference does not give a rational result. The CJEU has established that double taxation or non-taxation anywhere generally do not give a rational result.

Applicable tests

The case law of the CJEU, as reflected in the Regulation, provides that an FE only exists if an operator has sufficient human and technical resources in a state other than that in which its place of establishment is located. These resources must be owned by the operator, or be available to it in a manner that is comparable to being so owned.

An FE must have demonstrable substance. A non-established taxpayer’s VAT registration does not give rise to an FE (see article 11(3) of the Regulation). The VEG considers that the case law of the CJEU and the Regulation support an additional requirement that for an FE to exist it must also make or intend to make supplies.

Article 44 has generated debate whether VAT now recognise a ‘recipient’ FE or what may be viewed as a passive FE. The VEG considers that unless an FE also makes or intends to make supplies (whether or not such supplies are supplies for VAT purposes), VAT law cannot recognise it as an FE. Support for that proposition is found in the use of the expression ‘*receive and use for its own needs*’ in article 11 of the Regulation and in joined cases C-318/11 and C-319/11, *Daimler AG and Widex AS*. In line with that CJEU’s case law, the VEG considers that the expression ‘use for its own needs’ implies that an FE must use (or have the intention of using) such supplies for its own business.

The VEG considers that under the case law of the CJEU there is and should only be a single concept of FE for all VAT purposes. The VEG is concerned that any concept of a ‘recipient’ FE creates significant uncertainty, risks and practical difficulties for economic operators. Such risks are disproportionate, and they hinder the proper functioning of the European VAT system in a single market. Suppliers have to rely on the information provided by the customer and tax authorities must accept that suppliers will rely in good faith on information provided by their customers.

Conclusion

Whether an FE exists or not should be based on the specific facts and circumstances of each case, and in accordance with the case law of the CJEU. The VEG believes that there is only a single concept of FE that should be applied uniformly across the EU. The FE concept is distinct from the PE concept and should remain so. A non-restrictive application of the tests as to whether an FE exists would undermine the principle of legal certainty and give rise to difficulties in practice.

According to the case law of the CJEU, the most appropriate and primary point of reference is the place where the taxable person has established its business. Only if that place does not lead to a rational result, or creates a conflict with another Member State, then another establishment can come into consideration.