VAT NEWS

Fixed establishment and VAT, the story continues (ECJ decision in Dong Yang Electronics, C-547/18)

On 07.05.2020, the ECJ issued its judgment in case C-547/18, Dong Yang Electronics on the topic of the fixed establishment (FE) for VAT purposes.

The concept of FE is of utmost importance in the EU VAT law, provided that it works as a tool for determining the services' place of supply. Moreover, it confirms which jurisdiction is entitled to collect the VAT and ensures the avoidance of conflicts between States that may lead to cases of double taxation or non-taxation.

Article 44 of the VAT Directive sets out the general rule for supplies of services and states that in a situation where the customer is a business, the place of supply is where the customer is established. However, if those services are provided to a fixed establishment of the customer located in a place other than where it is established, then the place of supply of those services shall be where that fixed establishment is located.

Although the concept of FE has been defined in the VAT Implementing Regulation and clarified by several ECJ judgments, it is still surrounded by uncertainty and being interpreted differently across EU Member States.

Below we give you an insight into the facts of this case and the ECJ's reasoning as well as our comments in this regard.

I. Background

This case concerned supplies of services made under a contract by Dong Yang, a company established in Poland, to LG Korea, a company established in South Korea, involving the assembly of circuit boards from certain materials owned by the latter. LG Korea has also two subsidiaries in Poland (LG Poland Production and LG Poland Sales).

The processing and assembly of the products was undertaken jointly by Dong Yang Electronics and LG Poland Production based on a cooperation agreement, with each entity taking care of a specific part of the overall supply to LG Korea. The Polish subsidiary was also tasked with storage facilities and logistic services for the finished products owned by the Korean parent company, which then sold those products to another Polish subsidiary (LG Poland Sales), which finally marketed them across the EU.

Dong Yang did not charge Polish VAT on its services to LG Korea since the latter assured the former that it did not have a fixed establishment in Poland, did not employ staff, own property or have technical equipment in Poland. As such, it treated its supplies of services as taking place outside the EU.

The Polish tax authorities took the view that Dong Yang's supplies should have been subject to Polish VAT as they were made to a FE of LG Korea in Poland in the form of LG Poland Production.

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In addition, the Polish tax authorities stressed that Dong Yang, instead of relying on the statements of LG Korea, should have examined the actual contractual relationship between LG Korea and its subsidiary.

The Polish Courts referred this case to the ECJ for a preliminary ruling.

II. The ECJ Decision

The ECJ confirmed that Article 44 of the VAT Directive and Article 11(1) and Article 22(1) of the VAT Implementing Regulation must be interpreted such that the existence of a FE of a company established in a third State cannot be deduced by a service provider merely because that company has a subsidiary there. On the contrary, such classification shall always be examined in light of the economic and commercial reality (irrespective of legal form), i.e. based on the material conditions laid down in the aforementioned Regulation.

Furthermore, the applicable legislation requires the supplier to exercise a reasonable degree of care in determining the correct place of supply. However, this does not include any obligation for the supplier, i.e. Dong Yang, to seek out and verify inaccessible contractual relationships between its customer, i.e. LG Korea, and the subsidiaries.

III. Comments

The above ECJ judgment is undoubtedly significant since it sheds more light into the long debated concept of FE. Most importantly, the Court insists on the principle of substance over form, namely any qualification of a FE should only rely on the fulfillment of material conditions. Moreover, it clarifies that any duty of investigation on the part of the supplier in this regard, does not go beyond the obligations of a diligent businessman.

This ruling reflects, up to a certain point, the ECJ's reasoning in case DFDS (C-260/95) where the Court had also to examine whether a local subsidiary could be regarded as a FE of a foreign company. Although, the context and the outcome in DFDS were totally different, the principle of substance over form was also applied therein.

However, the ECJ by non-including in its judgment some of the remarks made by the Advocate General (AG) Kokott in her Opinion, lost a great opportunity to surround companies dealing with subsidiaries of non-EU parent companies with even more legal certainty.

In particular, the AG observed that a subsidiary could exceptionally be considered as a FE in case the contractual structure applied by the parties constituted an abusive practice that gave rise to a tax benefit.

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Moreover, the AG pointed out that the supplier may rely on a written statement from its customer that it does not have a fixed establishment in the EU.

If the AG's remarks had been incorporated into the ECJ judgment, then companies dealing with subsidiaries of non-EU parent companies would have had a more precise view of the required degree of care in these cases and national Courts would have been granted an interpretation toolkit more suitable to address such VAT disputes at a wider level.

Nevertheless, despite any weak points, the ECJ's judgment in Dong Yang Electronics paves without any doubt the way for addressing the VAT disputes concerning the alleged presence of FE of foreign subsidiaries across the EU in a more consistent manner.

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