KPMG Meijburg & Co Tax & Legal

CJEU in Dong Yang case: subsidiary could be a fixed establishment for VAT purposes

On May 7, 2020 the Court of Justice of the European Union ('CJEU') rendered judgment in the Dong Yang Electronics case (C-547/18). The case concerned whether a subsidiary may, for VAT purposes, constitute a fixed establishment, and, if so, how the service provider must determine whether it performs its services to the parent company or the fixed establishment.

The CJEU ruled that a close examination of VAT regulations reveals that a subsidiary may, in certain circumstances, be regarded as a fixed establishment for VAT purposes, but that a service provider does not have to examine the contractual relationship between the parent company and the subsidiary when determining whether it provides its services to the parent company or to a possible fixed establishment.

1. Background and points of law

Dong Yang Electronics (Poland, 'Dong Yang') assembles printed circuit boards for LG Display established in Korea ('LG Korea'). This assembly qualifies as a service for VAT purposes, with the right to levy VAT being allocated to the country where the customer is established or has a fixed establishment.

Dong Yang issued invoices to LG Korea for these services without charging Polish VAT. It qualified the Korean head office of LG Korea as the purchaser of its services, because it had concluded a services agreement with LG Korea and LG Korea had assured it that, for VAT purposes, LG Korea did not have a fixed establishment in Poland.

The Polish tax authorities argued however that Dong Yang should have charged Polish VAT to LG Korea. According to the Polish tax authorities, the Polish-resident subsidiary of LG Korea (LG Poland) qualifies for VAT purposes as a fixed establishment of LG Korea and the services of Dong Yang Poland are provided to this fixed establishment. The Polish authorities argued that the personnel and the technical resources of LG Poland are available to LG Korea by virtue of a contractual relationship between LG Korea and LG Poland, so that LG Poland is in fact a fixed establishment of LG Korea.

According to the Polish authorities, Dong Yang should have determined, on the basis of the type of services provided and their use, for which establishment of the customer the service was provided (the head office of LG Korea in Korea or the alleged fixed establishment in Poland). The Polish tax authorities argued that Dong Yang should have concluded that LG Korea had a fixed establishment in Poland and that the services were provided to the fixed establishment and not to the head office in Korea.

The questions for which a preliminary ruling was requested were:

1. Can it be inferred from the mere fact that a company established outside the European Union has a subsidiary in Poland, that this company has a fixed establishment in Poland?

2. If not, is the supplier required to examine the contractual relationships between the customer established outside the European Union and its subsidiary in the European Union in order to determine whether there is a fixed establishment?

2. CJEU judgment

Although the final outcome reached by the CJEU is in accordance with the Opinion rendered by Advocate General ('AG') Kokott on November 14, 2019, the CJEU nevertheless took its own path. According to the Court, it cannot be ruled out that LG Poland must be regarded as a fixed establishment of LG Korea for VAT purposes. At the same time, the CJEU noted that the mere fact that LG Korea has a subsidiary in the EU does not mean that there is indeed a fixed establishment. The CJEU emphasized that the qualification as a fixed establishment does not depend of the legal form, but on the material conditions that must be assessed in the light of economic and commercial reality. Unlike AG Kokott in her Opinion, the CJEU did not take the doctrine of abuse of law into consideration.

In the present case, whether there is a fixed establishment and whether the services of Dong Yang are provided to LG Korea or to the alleged fixed establishment (LG Poland) must be determined by Dong Yang as service provider. In its second question, the referring Polish court wanted to know whether Dong Yang is required to examine the contractual relationships between LG Korea and LG Poland to determine whether LG Korea has such a fixed establishment in Poland and whether the services are provided to this fixed establishment.

The CJEU emphasized that the VAT Implementing Regulation contains criteria that Dong Yang must take into account in order to determine whether it provides its services to a fixed establishment of the customer. Firstly, it must examine the nature and use of the service by the customer. Where the nature and use of the service provided do not enable him to identify the fixed establishment to which the service is provided, Dong Yang, in identifying that fixed establishment, should pay particular attention to whether the contract, the order form and the VAT identification number attributed by the Member State of the customer and communicated to him by the customer identify the fixed establishment as the customer of the service. What must also be taken into account is whether the fixed establishment is the entity paying for the service.

If, based on the above criteria, it is not possible to denote the fixed establishment of the customer as the purchaser of the service, then Dong Yang, as the provider of the service, may legitimately assume that the services are provided to the head office of LG Korea in Korea.

The CJEU concluded that this means that Dong Yang, as the provider of the service, does not have to examine contractual relationships between its customer and their subsidiaries in order to determine whether the subsidiary can be denoted as a fixed establishment for VAT purposes.

3. Impact on Dutch practice

The fact that the CJEU emphasized that a service provider does not have to examine contractual relationships within the customer's group when determining the taxability of its services is a positive outcome, given that the service provider after all generally has no insight into this. The CJEU has thus avoided an unreasonably heavy burden of proof and additional costs for service providers.

In the present case the CJEU did not however fundamentally rule out that a subsidiary may constitute a fixed establishment of a parent company. This is in accordance with the CJEU judgment in the DFDS case (C-260/95), but this basic assumption is rarely applied in the Netherlands. As a general rule, a subsidiary is not regarded as a fixed establishment of a parent company. Bearing in mind the present judgment, we still recommend that you look into whether there is a risk within your organization that a subsidiary in the Netherlands, but especially in other EU Member States, must be regarded as a fixed establishment. We can imagine that various Member States will see this judgment as confirmation that a subsidiary may constitute a fixed establishment and will pay much less attention to the ruling that the service provider could in this case assume that it provided the service to the foreign head office. We often see this issue in the context of discussions about profit allocation to a permanent establishment for direct taxes (such as corporate income tax). In such cases, foreign tax authorities also argue that a subsidiary is a fixed establishment for VAT purposes of a foreign parent company.

The term 'fixed establishment' as used for VAT purposes, is rapidly developing. Within the EU, we are increasingly seeing disputes arise about the alleged presence of fixed establishments for VAT purposes (whether or not inspired by the Welmory judgment, C-605/12). For example, an Austrian court also recently sought a preliminary ruling from the CJEU about the term 'fixed establishment' in the Titanium Ltd case (C-931/19). We refer in this respect to our alert. In our experience, EU Member States still differ in their interpretation of the term 'fixed establishment'. This judgment is unlikely to eliminate these differences.

The term 'fixed establishment' does not only play a role in determining the taxability of a service, but is also relevant for international supplies of goods. One of the 'quick fixes' that took effect as of January 1, 2020 is the simplification of the VAT treatment of call-off stock that a taxpayer holds in another EU Member State. However, this simplification does not apply if the supplier has a fixed establishment in the country whether the call-off stock is located. A question that is often raised in practice is whether maintaining a local supply of stocks results in the presence of a fixed establishment, and that question is not always easy to answer. We therefore recommend that you analyze this properly. More information about the VAT quick fixes can be found in our previous alert.

4. What can you do now?

The judgment emphasizes how very important it is to check whether, for VAT purposes, there is a fixed establishment. We recommend that you check whether it is properly determined within your organization whether a customer has a fixed establishment.

Moreover, we recommend that you check whether it is possible that your organization may have fixed establishments outside the Netherlands.

In that respect it is important to keep a close eye on tax developments in the area of fixed establishments and to assess whether these developments apply to your situation, given that the term 'fixed establishment' is rapidly developing. We recommend that you properly document the results of your assessment, just in case the Dutch or foreign tax authorities raise questions about it.

The tax advisors of the Indirect Tax group of Meijburg & Co would be pleased to help you identify the implications of the judgment in the Dong Yang case. Feel free to contact one of them or your regular advisor for more information.

Meijburg & Co
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