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Watch out for the ever-evolving definition of the VAT permanent establishment!

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A significant tax issue in case of installing or expanding activity abroad, the definition of the VAT permanent establishment (which differs from that in Corporate Income Tax), enables localizing services and determining who is liable for VAT.

According to the OECD, the new workplace organization due to the COVID-19 sanitary crisis (i.e. telecommuting) could necessitate the evolution of the definition of the permanent establishment for Corporate Income Tax purposes.

Would new Corporate Income Tax criteria have an impact in VAT?

Presently, to characterize a VAT permanent establishment, a sufficient degree of permanence and a structure apt, from the point of view of human and material resources, are required to either:

- Provide services (supplier permanent establishment).
- Receive services (recipient permanent establishment).

The evolution of the caselaw on the VAT permanent establishment is nevertheless a source of legal insecurity.

Effectively, the question of whether the mere possession of a subsidiary in a Member State constitutes a VAT permanent establishment has never been decided by the EU Court of Justice ("ECJ"), except on very specific facts.

Thus, in the case *DFDS* (20 February 1997) the ECJ held that a subsidiary constituted a VAT supplier permanent establishment since:

- It had a minimal consistence with human and material resources reunited in a permanent manner and,
- Acted as a simple auxiliary, without independence, of its parent company (tour operator) which held the entirety of its capital and imposed numerous contractual obligations upon it.

More recently in the case *Dong Yang Electronics* (7 May 2020), concerning toll-manufacturing services on circuit boards belonging to a Korean company that had a Polish subsidiary, the ECJ held that the Polish subsidiary did not constitute a VAT recipient permanent establishment in Poland considering that, to determine the place of establishment of the recipient of the services provided, the service provider was not bound to examine the contractual relationships between the Korean parent company and its Polish subsidiary, but:

- The nature and use of the service rendered and then,
- If the contract, the purchase order, and the VAT number communicated by the recipient lead to analyzing the local establishment as the recipient of the services and,
- If the local establishment pays for the services.

If this is not the case, the service provider can consider that the services are supplied to the foreign parent company.

Accordingly, the presence in a Member State of a permanent establishment of a company established outside the EU cannot be deduced by the service provider from the sole fact that its client possesses a subsidiary in the EU Member State and the supplier, for its determination of who the recipient is, is not bound to inquire into the contractual relationships between the two entities.

Indeed, the essential criteria considered in VAT is the economic and commercial reality.

The ECJ's decision joins that of the French High Administrative Court, the *Conseil d'Etat* in the case *Bayer Cropscience* (9 October 2015), which held that the effective beneficiary of a service (i.e. the real client who will use and benefit from the service) is the recipient and not the contracting party (i.e. direct client who signed the contract and to whom the service is invoiced).

Finally, this notion of VAT permanent establishment is not fixed. As proof, a question is currently pending before the ECJ in the case *Titanium Ltd*, C-931/19, in order to determine whether the mere passive rental of a building situated in Austria (i.e. without human resources) characterizes a VAT permanent establishment in Austria.

In this evolving context, our firm is here to help with French, as well as international, VAT permanent establishment analyses to help ensure the security of the VAT rules you apply.

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