

Input VAT newsletter

Dong Yang—The Court of Justice of the European Union provides useful guidelines for service providers to help them determine who the beneficiary of their services is

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In its Dong Yang case (C 547/18, 7 May 2020), the Court provides useful guidelines to help service providers determine who their contracting party is and confirms the predominance of the client's seat of economic activity on its fixed establishment(s). It also confirms that a subsidiary could not be considered as a local fixed establishment of a foreign company except in exceptional circumstances, and that the service provider does not have to perform complex inquiries into the contractual relationship between a subsidiary and its parent company. This decision is an opportunity for concerned businesses to review in light of clear guidelines their arrangements in similar cases, as well as other cases they are faced with in their day-to-day operations.

Background

Dong Yang, a Polish company that is part of a Korean group, and a Korean company, K, that is part of another Korean group, concluded an agreement where Dong Yang would assemble printed circuit boards from materials owned by K. K has a Polish subsidiary, P. This subsidiary, P, was involved in this agreement's execution. Indeed, P provided the materials to Dong Yang, which, in turn, provided P with the process and finished goods after assembly. P provided storage and logistics for the finished products and sold these goods to K's other sales companies.

K had a Polish VAT number and a tax representative but assured Dong Yang that it did not have a fixed establishment, did not employ staff, did not own property, and did not have technical equipment in Poland.

Dong Yang invoiced K without Polish VAT for its assembly services. The invoices showed that K was the beneficiary of the services and paid them.

The Polish tax authorities claimed Polish VAT from Dong Yang, arguing that P, the Polish subsidiary of K, is a fixed establishment of K and that Dong Yang provided the services to this fixed establishment and not to the economic seat of K in Korea. The Polish tax authorities considered that K has "exploited the economic potential" of its Polish

subsidiary, P, by way of agreements and that P, as mentioned above, was involved in the value chain.

Dong Yang challenged the Polish VAT authorities' position at the Polish Tribunals, and the Polish Supreme Court referred the case to the Court of Justice of the European Union.

We should note that should Dong Yang have charged Polish VAT, this VAT would be recoverable by P, which performs activities in the scope of VAT.

Questions referred to the Court of Justice of the European Union

The first question referred to the Court was whether an EU subsidiary could be considered as a fixed establishment of its non-EU parent company. If yes, the second question was whether a third party (such as the supplier in this case) is required to examine the contractual relationships between the two companies to determine if the EU subsidiary constitutes a fixed establishment for VAT purposes of its non-EU parent company.

Court decision

Seat of the economic activity and fixed establishment

The Court first reminds us that under EU VAT principles, the most useful rule to determine the place of the supply of services is the taxable person's seat of economic activity. Considering a fixed establishment is a derogation that should only be used if some conditions are met. The Court also reminds us that the concept of fixed establishment includes any establishment, other than the seat of economic activity, which has a sufficient degree of permanence and an appropriate structure with human and technical means that enable it to receive services and utilize the services provided to it for its own needs.

Could a subsidiary be a fixed establishment?

The Court accepts that a subsidiary may constitute a fixed establishment and reminds that the economic and commercial reality is a fundamental criterion for the application of VAT. The sole existence of a subsidiary is not sufficient to conclude that a fixed establishment exists.

Duties of the service provider when determining the beneficiary of its services

Regarding the question as to whether a service provider must examine the relationship between a company and its subsidiary, the Court rules that it must exercise a reasonable degree of care in determining the correct place of supply. This includes an examination of the nature and use of the service provided. If this does not allow the beneficiary to be identified, it should take into account the purchase order and the VAT identification number provided to determine the fixed establishment that is the beneficiary of the service, and if this establishment pays for the service. If this criterion is not sufficient to identify a fixed establishment, the service provider may legitimately consider that the services are provided at the place of the economic seat of its client and not at the place of one of its fixed establishment(s).

The service provider must exercise a reasonable degree of care in determining the correct place of supply. However, this does not include seeking out and verifying inaccessible contractual relationships between its contracting partner and the subsidiaries thereof.

Therefore, the Court rules that a service provider cannot infer from the sole existence, on the territory of a Member State, of a fixed establishment of a company and that the service provider is not obliged to inquire, for such an assessment, of the contractual relationship between the two entities.

Comments

Some may regret that the Court's decision did not include the long and interesting developments of the Advocate General in her opinion, while others would say these comments are rather theoretical.

From a merely practical viewpoint, we could consider the decision of the Court reassuring because it clearly confirms the predominance of the criterion of the economic seat of the taxable person on its fixed establishment(s); that a subsidiary is, in principle, not a fixed establishment of its parent company. In addition, the Court confirms that a service provider does not have to perform complex inquiries regarding the contractual relationship between a subsidiary and its parent company.

It also provides useful criteria for any service provider to determine who its contractor is (nature and use of the service provided, purchase order and VAT identification number provided) in cases similar to those at stake, as well as other cases businesses are faced with in their day-to-day operations. It also confirms that, if these criteria are not sufficient to identify that a fixed establishment is the beneficiary of the service, the supplier may legitimately consider that the services are provided at the place of its client's economic seat.

This decision is an opportunity for concerned businesses to review their arrangements in the light of these clear guidelines.

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