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**Fixed establishment for VAT – Focus on toll manufacturer structures**

In the last years, we noted that the Romanian tax authority increased its scrutiny on the fixed establishment (“FE”) topic. The cases encountered by us referred to companies operating in a multitude of industries, such as pharma, automotive or retail. The tax authority’s argumentation for the FE assessments was generally based on certain interdependencies between the foreign company and its local subsidiary, with the latter intervening in the supplies performed by the foreign entity.

At the current moment, it appears the tax authority’s focus is on **toll manufacturer structures** (where the principal is a non-resident entity) having targeted actions in this area – as detailed in the next section.

On a corresponding note, it seems that the EU’s interpretation of the FE criteria has also broadened – as per the working papers of the VAT Committee of the European Commission issued last year in the context of the 2020 VAT ‘quick fixes’ rules.
Fixed establishment for VAT – Focus on toll manufacturer structures

The FE definition

As per Regulation 282/2001 for implementing the VAT Directive (‘VAT Implementing Regulation’), the FE is defined as any establishment, other than the place of establishment of a business [...], characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources:

- to enable it to receive and use the services supplied to it for its own needs, and
- to enable it to provide the services which it supplies, respectively.

While the VAT Implementing Regulation’s definition relates solely to acquisitions/supplies of services, the Romanian definition is broader in the sense that it also includes the supply of goods, namely: a taxable person having the place of business outside Romania is deemed to be established in Romania provided that it has a fixed establishment in Romania, respectively it has sufficient technical and human resources to perform taxable supplies of goods and/or services on a regular basis.

The Romanian law is broader also with respect to the cases where the FE is considered to be intervening in the supply adding, apart from the taking part in the supply prior or during such transactions (as per the VAT Implementing Regulation), also the post-sale support (e.g. warranty obligations).

Practical assessment of the Romanian tax authority

Based on the above, as well as on the permanent establishment criteria (which although represents separate legislation, it is sometimes used by the tax authority to argument – incorrectly – the creation of an FE), we have seen an increase in the number of FE assessments in Romania.

As mentioned in the summary, the current focus on FE seems to be on toll manufacturing structures (or a combination of a toll manufacturer for one business line and producer / distribution on other business lines) where the parties are affiliates.

Based on the cases encountered by us, the most important aspects the tax inspectors are focusing on are the ‘processes’ which normally do not fall under the responsibility of a toll manufacturer, such as:

- purchase/order of raw materials performed by employees of the Romanian toll manufacturer on behalf of the principal;
- quality control processes of raw materials or finished goods;
- logistics of finished goods (e.g. if delivery of finished goods is performed/arranged by an employee of a Romanian toll manufacturer on behalf of the principal etc.), or
- production / claim handling (e.g. if the Romanian employee discusses directly with the end client, prioritizing production, handling directly the minor production quality issues in front of end clients). In brief, they are trying to prove that actually no processes are driven/performed from the country of establishment of the principal (e.g. negotiation of a group deal/contract for acquisitions of raw materials is not considered sufficient).

In brief, the inspectors are trying to prove that:

- actually no/few processes are driven or performed from the country of establishment of the principal (e.g. negotiation of a group deal/contract for acquisitions of raw materials is not considered sufficient) and
- the tasks performed in Romania by the resident are sufficient in order to ‘operate’ the business – through a fixed establishment created with (part) of the resident’s resources.

In such cases, the result would be that all services received by the principal should be taxable (with 19%) in Romania as well as any other services rendered by other parties to the ‘FE’– e.g. transport services.

Thus, the impact may be significant for the resident/other Romanian service suppliers in case of a 5 years audit (statute of limitation).

In case you have similar structures in place / similar functions undertaken by the resident for the principal, we recommend performing a thorough analysis on the actual reality of your group business
model (which may differ from what was initially contractually set-up) corroborated with a technical analysis of the case.

**Changes of optics also at EU level – VAT Committee guidelines**

The above-named recommendation is also given in the context where we there exists also a (rather unexpected) change of interpretation of the VAT Committee with respect to the FE criteria.

More precisely, in 2015 (working paper 857), the VAT Committee was asked whether the concept of “fixed establishment” also applies to the supply/acquisition of goods (since the aforementioned definition of the VAT Implementing Regulation refers solely to services). On this occasion, the VAT Committee concluded that a taxable person cannot create a FE if it solely supplies goods, without supplying services. Moreover, the VAT Committee clearly mentioned that the *mere existence of a warehouse in a Member State does not allow in itself to characterize this as a fixed establishment in that jurisdiction.*

While this was the approach in 2015, in June 2019, the VAT Committee in the context of the 2020 VAT quick fixes (i.e. short-term improvements for intracommunity trade) changed its opinion stating that, a foreign company who supplies goods based on a call-of-stock arrangement and owns or runs (directly or indirectly) the storage, is deemed to have a FE in that member state.

This is somewhat contradictory with the opinion of 2015 and shows the change in approach through time of the VAT Committee (note: we consider that this change is also due to the BEPS Action 7 Permanent Establishment status).

Although the opinions of VAT Committee are not legally binding, they are generally taken into account as additional guidance in the area of VAT (aiming to offer a uniform interpretation of the VAT law for all member states).

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*Considering all the arguments exposed above, group companies operating in Romania should analyse their business models in order to mitigate any VAT risks.*

*Should you wish, we would be more than happy to assist you in analysing your business set-up and in assessing the corresponding VAT risks.*

For further questions regarding the aspects mentioned in this alert, please contact us.

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Fixed establishment for VAT

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