

Fixed establishment for VAT - New trends

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Summary:

The Romanian tax authority increased its scrutiny on the fixed establishment ("FE") topic. As a result, based on our practical experience, the number of FE assessments has increased significantly.

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.

Apart from the Romanian tax authority's recent appetite for FE creation, it seems that the EU is in a similar register. We refer here to Working Paper no. 968, issued in May by the VAT Committee of the European Commission, which clearly states that, in their view, a supplier under a call of stock regime who owns and/or runs the warehouse in a Member State is considered to have an FE in the concerned Member State. 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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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).

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 argue – incorrectly – the creation of an FE), we have seen an increase in the number of FE assessments in Romania.

As previously mentioned, the FE assessments were made in a variety of industries – with a recent focus on production/distribution companies (rather than service suppliers).

Factually, the tax authority considered on one hand that the foreign entity has comparable control over the resources of the local entity as it would over its own employees and, on the other hand, that the tasks undertaken contributed/facilitated the supplies made by the foreign entity (i.e. warehousing and logistic services, quality control, claim handling or purchasing services).

In our view, based on the jurisprudence of the European Court of Justice, there are certain key criteria for assessing a FE, namely:

- having a structure with a sufficient degree of permanence to provide a framework in which agreements may be drawn up or management decisions taken, thus enabling for supplies to be made on an independent basis;
- the existence of the human and technical resources do not have to necessarily belong to the foreign entity, but the company must have comparable control over these (e.g. employees acting solely/directly at the requirements of the foreign entity; the foreign entity having immediate and constant access to the human and technical resources);
- assuming a financial risk from not performing the services undertaken contractually in a satisfactory manner.

Based on the above-mentioned criteria, group companies having toll manufacturers in Romania or other entities in charge with the logistic of the finished goods, face the risk, upon a tax audit that their services would be considered supplied in Romania (towards the FE of their foreign client). The impact may be significant for the Romanian entity in case of a 5 years audit (statute of limitation), consisting in an additional assessment of 19% VAT applied to the value of the supplied services.

As such, we recommend all companies working under the above-mentioned structures to perform a thorough analysis on their business model (based on the reality of the facts) corroborated with the law provisions.

The above-named recommendation is also given in the context where we currently noted a change in the approach 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 intra-community 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).

Considering all the arguments exposed above, 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.



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