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FIXED ESTABLISHMENTS IN EUROPEAN VAT: BEPS's SIDE EFFECTS?

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ABSTRACT

The focus in the reports of the OECD in its Base Erosion and Profit Shifting (BEPS) project is direct taxation. Still, the effects BEPS will have on indirect taxes must not be underestimated. In this article the author addresses the effects that the BEPS reports and developments will have on the concept of fixed establishment for indirect taxes. On the one hand she discusses the changes in the concept of permanent establishment (PE) and how they might affect the interpretation of the concept of fixed establishment (FE) for VAT purposes. On the other hand she discusses whether or not the issues addressed in BEPS for PEs may be required to address for European VAT in a similar manner for FEs.

1. INTRODUCTION

In October 2015, the OECD presented its final reports in its Base Erosion and Profit Shifting project (also and mostly known under the name BEPS²). The focus in these reports is on direct taxation. Indirect taxes are only addressed in action 1 'Addressing the Tax Challenges of the Digital Economy'.³ Still, the effects BEPS will have on indirect taxes should not be underestimated. The BEPS reports will result in concrete actions at EU and national level, and will also bring about changes in the way multinational business will have to address their tax position towards stakeholders (e.g. country-by-country-reporting is a development in the latter area). The effect that these changes will have on indirect taxes can be seen as the BEPS's side effects. This article focusses on only one of these side effects, the effects that the changes of the concept of permanent establishment (PE) for (corporate) income tax at an OECD level will have on fixed establishments (FEs) in European VAT.

The approach of this article is to first compare the concepts of FE in European VAT and PE in the OECD Model Convention, establishing similarities as well as differences (section 2). Then all of the changes proposed to revise the concept of PE at OECD level are examined individually and their possible side effects for European VAT are discussed. The author also addresses the changes in PEs in BEPS that may

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² All BEPS reports mentioned in this article can be found on the OECD's website <http://www.oecd.org/tax/beps/beps-actions.htm>

³ Action 1 Addressing the Tax Challenges of the Digital Economy to be found on the OECD-website, http://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en.

be required for European VAT in a similar manner for FEs (section 3). Section 4 includes a number of concluding remarks.

2. PE IN THE OECD MODEL CONVENTION VERSUS FE IN EU VAT

Before addressing the changes that are proposed in the BEPS action plan on PEs, it is important to briefly compare the similarities and differences in the concept of PE in the OECD Model Convention and the concept of FE in European VAT. It is important to keep in mind that the PE and FE concepts are autonomous and changes to one of these concepts do not automatically alter the other.

The commentary on the OECD Model Convention is clear about the purpose of the concept of PE for direct taxation: the main use of the concept of a PE is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State.⁴ The European VAT Directive and VAT Implementing Regulation do not define such a clear purpose for the concept of FE. Still, it also takes an important role in distributing taxing powers between Member States and Member States and third countries, both in the situation where FEs provide and receive services, arts. 44 and 45 VAT Directive.⁵

As regards the situation where the concept of FE is used to tax the services provided by the respective FEs, it is important to note that direct taxes are assessed on the entrepreneur's profit, while the objective of VAT is to tax consumption at the level of the final consumer. When FEs are on the receiving end of the transaction, it is important to note that most of the time they will be able to deduct the VAT charged to them, so no taxation effectively takes place.

Both in European VAT and under the OECD Model Convention, certain services or types of profits can be taxed without the presence of a FE or a PE, respectively. For European VAT this concerns services that fall within the scope of a specific place of supply rule, e.g. services related to immovable property (art. 47 VAT Directive) or passenger transport services (art. 48 VAT Directive). Under the OECD Model Convention this concerns specific types of income, e.g. income derived from immovable property (art. 6 OECD Model Convention), dividends (art. 10 OECD Model Convention), interests (Art. 11 OECD Model Convention) or royalties (art. 12 OECD Model Convention).

Compared with the concept of PE in the OECD Model Convention, the concept of FE in European VAT is somewhat underdeveloped. This may be due to the fact that the PE concept is developed by amendments to the commentary on the OECD Model Convention which are very detailed, while the FE concept in European VAT has mostly been developed by national courts and the Court of Justice of the European Union. Therefore, the latter largely depends on the cases that have been brought before these courts. Because the FE concept is underdeveloped, taxpayers and tax authorities may in practice rely on the PE concept from the OECD Model Convention to establish whether or not a taxable person has a FE for VAT. Still, these are treacherous waters. The FE concept for European VAT is an

⁴ Para. 1 of the commentary on art. 5 OECD Model Convention.

⁵ M.L. Schippers and J.M.B. Boender, 'VAT and FEs: mysteries solved?', *Intertax* 2015, no 11, p.710 see the purpose of the FE as a concession to the neutrality principle. Its purpose is to ensure that enterprises liable to VAT and resident in one Member State and enterprises liable to VAT and resident in another Member State are treated equally when supplying goods or services in the same Member State.

autonomous concept that has its own interpretation. A PE for the purpose of direct taxes should therefore not automatically lead to a FE for indirect taxes or vice versa.⁶

The concept of PE and FE have some main similarities regarding the requirements that an entrepreneur should have human and technical resources and that there should be a place of business with a certain degree of permanence. Furthermore when comparing the Commentary on the OECD Model Convention on the concept of PE with the CJEU case law on FE, it is obvious that more or less the same issues raise doubts as to whether or not there is a PE/FE: e.g. the treatment of gaming and vending machines,⁷ the treatment of an establishment carrying out preparatory and auxiliary activities⁸, whether a subsidiary can be a PE/FE of the parent company,⁹ and the PE/FE status in the case of a server, computer equipment, a website, etc.¹⁰ in a State while no personnel is present.

There are also some important differences between the PE concept in the OECD Model Convention and the FE concept for European VAT. The main differences are set out below:

- The requirement that the establishment has to be fixed in the sense that it has a sufficient degree of permanence for the PE in the OECD Model Convention relates to both the element of time¹¹ (the establishment not being of a temporary nature) and place (a link between the place of business and a specific geographical point or area).¹² For VAT purposes it seems to relate to the element of time only, since the CJEU had the opportunity in both the Berkholz and the Faaborg-Gelting Linien case¹³ to explicitly state that a moving object (in this case ferry boats operated between Germany and Denmark) is not fixed and as a consequence cannot be considered a FE, but it did not do so.
- Even though the CJEU has ruled in the Planzer Luxembourg case that preparatory or auxiliary activities cannot lead to a FE as mentioned in the Eight Directive for the refund of VAT (currently governed by Directive 2008/9/EC), art. 11 (1) VAT Implementing Regulation seems to create the possibility for establishments carrying out preparatory or auxiliary activities to qualify as a FE for the B2B main rule for the place of supply of services of art. 44 VAT Directive only.¹⁴ There cannot be a PE in the case of preparatory or auxiliary activities.
- European VAT does not provide for the concept of an agency FE. This may be explained because of the purpose of the FE status for VAT, which is to tax the supply of goods and

⁶ See Gert-Jan van Norden and Philippe Stephany, 'Don't Underestimate BEPS' Impact on Indirect Tax', Tax Planning International: Indirect Taxes 07/16, p. 13 who describe Member States that do not accept that in the case of a PE there may not be a FE for VAT.

⁷ Compare para. 10 of the commentary on art. 5 OECD Model Convention with CJEU 4 July 1985, 168/84, ECLI:EU:C:1985:299 (Berkholz).

⁸ Compare art. 5 (4) OECD Model Convention with CJEU 28 June 2007, C-73/06, ECLI:EU:C:2007:397 (Planzer Luxembourg)

⁹ Compare art. 5 (7) OECD Model Convention with CJEU 20 February 1997, C-260/95, ECLI:EU:C:1997:77 (DFDS).

¹⁰ Compare paras. 42.2-42.6 of the commentary on art. 5 OECD Model Convention with CJEU 16 October 2014, C-605/12, ECLI:EU:C:2014:2298.

¹¹ See para. 6 of the commentary on art. 5 OECD Model Convention.

¹² See para. 5 of the commentary on art. 5 OECD Model Convention.

¹³ CJEU 2 May 1996, C-231/94, ECLI:EU:C:1996:184.

¹⁴ See also Nebojsa Jovanovic and Madeleine Merx, 'Welmory – a Recipe for VAT avoidance?', (2015) 24 EC Tax Review, Issue 4, pp. 202–209.

services in the Member State of consumption, by among other things taxing services in the country where the supplier has its place of business or FE under the main rule for the place of supply of B2C-services, art. 45 VAT Directive. The mere fact that a foreign business has a person that can act for it by concluding contracts with consumers does not necessarily mean that that foreign business also has a structure (technical and human resources) to provide the services in question.

- European VAT has no provision for building sites or construction or installation projects like art. 5 (3) OECD Model Convention. Most of the supplies carried out in relation to these sites and projects will be covered by art. 47 VAT Directive (services related to immovable property) or art. 36 VAT Directive (installation supplies) with the result that they are already VAT taxable in the country where the site is located or the project is carried out. Therefore, such a provision seems not necessary for VAT purposes.

3. THE PROPOSED BEPS CHANGES IN RELATION TO PE

3.1 INTRODUCTION

The major part of the proposed changes in the concept of PE can be found in action 7 of the BEPS Project. There are two main focus areas in action 7:

1. Amendments to the OECD Model Convention and Commentary to prevent the use of certain common tax avoidance strategies that are used to circumvent the existing PE definition, such as arrangements through which taxpayers replace subsidiaries that traditionally acted as distributors by commissionaire arrangements with the result of shifting profits out of the country where the sales took place without a substantive change in the functions performed in that country.
2. Amendments to the OECD Model Convention and Commentary to prevent the exploitation of the specific exceptions to the PE definition currently provided for by art. 5 (4) of the OECD Model Tax Convention, i.e. the exception for preparatory and auxiliary activities.¹⁵

Action 1 stresses that the fact that in many digital economy business models, a non-resident company may interact with customers in a country remotely through a website or other digital means without maintaining a physical presence in the country, may provide issues as regards taxation of profits realized by selling products to those customers and expresses concerns whether the existing definition of PE remains consistent with the underlying principles on which it was based.¹⁶ However the initial ideas in the draft version of Action 1 on a significant digital presence PE or a virtual PE were dropped. Action 1 now refers to the fact that the issue goes beyond the question of PE under tax treaties. Even in the absence of the limitations imposed by tax treaties it appears that many jurisdictions would not in

¹⁵ Action 7 Preventing the Artificial Avoidance of PE Status, p. 9.

¹⁶ Action 1 Addressing the tax challenges of the digital economy, point 184, 185, 253, 254 and 256.

any case consider a nexus to exist under their domestic laws.¹⁷ There are therefore no concrete changes in the PE definition in relation to Action 1.

Action 7 also refers to action 6 as regards the principal purpose test for PEs under art. 5 (3) OECD Model Convention. This test implies that if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provision of the treaty.¹⁸ Since I have established in section 2 that this type of PE plays no significant role in EU VAT, I will not address this issue further in this article. The focus in this article will therefore be on Action 7 only. In respect of Action 7, the Public Discussion Draft on Additional Guidance on the Attribution of Profits to PEs – which was released in 2016 – will not be addressed. This discussion draft elaborates on the attribution of profits to PEs only. This is not an issue of interest from a VAT perspective because as a main rule transactions between head office and FE are not taxable supplies¹⁹ and the taxable amount for VAT is the price actually paid, not an arm's length remuneration.²⁰

3.2 DISTRIBUTOR MODEL TO COMMISSIONAIRE ARRANGEMENT

3.2.1 EFFECT OF BEPS

By replacing subsidiaries that traditionally acted as distributors by a commissionaire arrangement, where the subsidiary acts in its own name, but on behalf of a foreign enterprise, a foreign enterprise is able to sell its products in a State without technically having a PE to which the sales might be attributed. The subsidiary that concludes the contracts does not own the products that it sells and therefore cannot be taxed on the profits derived from the sale of the products. Taxation is limited to its commission. Due to the fact that the subsidiary acts as a commissionaire instead of a distributor the commission is lower than the profit made by selling the goods due to the fact that the risks are more limited for a commissionaire than for a distributor.²¹

The undesired model uses the fact that art. 5 (5) OECD Model Convention relies on the formal conclusion of contracts in the name of the foreign enterprise. It is therefore possible to avoid a PE by changing the terms of the contract. Likewise it is possible to avoid a PE by negotiating contracts substantially in a state, but finalize or authorize them abroad.²²

The proposed changes of art. 5 (5) and (6) OECD Model Convention address this BEPS concern by changing the definition of an agency PE to a certain extent.

¹⁷ Action 1 Addressing the tax challenges of the digital economy, point 261.

¹⁸ Action 6 Preventing the granting of treaty benefits in inappropriate circumstances, p. 9.

¹⁹ CJEU 23 March 2006, C-210/04, ECLI:EU:C:2006:196 (FCE Bank).

²⁰ See art. 73 VAT Directive

²¹ Lee Burns, 'Multinational Anti-Avoidance Law: Australia's Response to BEPS Action 7', Asia-Pacific Tax Bulletin, 2016 (Volume 22), No 1 para. 2.1.1.

²² Action 7, p. 10.

1. There will be an agency PE also when the agent plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, but the agent does not formally conclude contracts.²³
2. There will be a PE also when contracts are not concluded in the name of the foreign enterprise when contracts are concluded for the transfer of the ownership of the foreign enterprise or for the granting of the right to use property owned by the foreign enterprise or property that the foreign enterprise has the right to use or when contracts are concluded for the provision of services by the foreign enterprise.²⁴
3. There will be a PE also when a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related. That person shall not be considered as being independent. A person is closely related to an enterprise if one has control of the other or both are under the control of the same persons or enterprises. In any case a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or in the case of a company, more than 50 per cent of the aggregated vote and value of the company's shares or the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest, or in the case of a company, more than 50 per cent of the aggregated vote and value of the company's shares or the beneficial equity interest in the company) in the person and the enterprise.²⁵

3.2.2 BEPS SIDE EFFECTS FOR EUROPEAN VAT?

As described in section 2 EU VAT is not familiar with the concept of an agency PE. The proposed changes will therefore have the effect that the concepts of PE and FE are drifting further apart.²⁶

Still, because of the proposed changes businesses may consider changing their current model. When considering this they must also take account of the consequences for VAT and other indirect taxes. In this respect it is important to note that in European VAT the type of role that a group company plays in the business model will affect the VAT consequences. In this respect, four types of roles can be distinguished that are relevant for VAT purposes:

1. A (limited risk) distributor that takes ownership of the goods
2. A commissionaire that acts in its own name but for the account of the foreign company
3. An agent that acts in the name of and for the account of the foreign company
4. A different type of role where the group company provides another type of service for VAT

²³ Action 7, p. 16.

²⁴ Action 7, p. 16.

²⁵ Action 7, p. 16-17.

²⁶ See also Gert-Jan van Norden and Philippe Stephany, p. 13 and Ine Lejeune, Bram Markey, Evy Peters and Amandine Baltus, 'Fixed Establishments and Permanent Establishments: The VAT and Direct Tax Concepts Are Drifting Further Apart', IVM September/October 2016, p. 303-315.

For VAT purposes there will be no major differences between the first and the second role. By fiction the commissionaire is considered to receive and supply the goods or services in question, art. 14 (2) (c) and 28 VAT Directive. There may be differences for the taxable amount when the remuneration received differs due to the status as commissionaire or distributor. In the case of an agent role, the agent will provide an intermediary service to its principal and it will be the principal that supplies the goods or services to the customer directly. If the activities go beyond intermediary service the service will qualify as a different type of services for VAT.

Furthermore, a change of model may have consequences for reporting and invoicing obligations. If the subsidiary acts as an agent, the foreign company/principal will have to account for the VAT on the supply to the customer. For the supply of goods this may affect which one of the parties needs to report an intracommunity supply or export, i.e. if the subsidiary acts as an agent this will always be the foreign company. When the subsidiary acts as a commissionaire this may also be the subsidiary. Reporting and invoicing obligations may also change in case the customer is not a taxable person. In the situation where the subsidiary acts as an agent there will be no intracommunity supply to report at all, while there may be an intracommunity supply to report if the subsidiary acts as a commissionaire, i.e. in the link of the supply chain between the foreign company and its subsidiary.

Example 1

Foreign company A established in France has a subsidiary B in Germany. In scenario 1 B acts as a commissionaire. In scenario 2 B acts as an agent. The goods are supplied to customer C (entrepreneur) in Germany. All parties involved have a full right to deduct VAT.

- *Scenario 1*

There are two supplies of goods, one from A to B and one from B to C. Only one of these supplies can be regarded as an intracommunity supply.²⁷ If this is the supply from A to B, A will need to report and account for the VAT on the intracommunity supply in France. B will need to report an intracommunity acquisition in Germany and report and account for the VAT on the subsequent supply to C, which is subject to VAT in Germany. If the supply between B and C is the intracommunity supply, the supply from A to B will be a local supply in France. A will need to report and account for the VAT on this supply in France. B will need to report and account for the VAT on the intracommunity supply in France and can deduct the VAT that A has charged to it. C will need to report an intracommunity acquisition in Germany.

- *Scenario 2*

A supplies goods directly to C. A must report and account for the VAT on the intracommunity supply in France. C will need to report an intracommunity acquisition in Germany. B provides an intermediary service to A that is subject to VAT in France. The VAT on this service is reverse charged. A must report this VAT in its VAT return and can deduct this VAT in the same VAT return.

The choice of model may also affect the place of supply in case the customer is not a taxable person. When the subsidiary acts as an agent there will be a supply of goods directly from the foreign company

²⁷ CJEU 6 April 2006, C-245/04, ECLI:EU:C:2006:232 (EMAG) Parties will need to establish this based on the criteria provided in the Eurotrey case (CJEU 16 December 2010, C-430/09, ECLI:EU:C:2010:786).

to the end consumer which is subject to VAT in the country where the transport starts, most likely the country where the foreign company is established, unless the provision for distance selling applies. In case the subsidiary qualifies as a commissionaire, the foreign company may need to report an intracommunity supply in its own Member State and the subsidiary an intracommunity acquisition in the Member State of the customer. The supply to the customer will then be a local supply of goods subject to VAT in the Member State of the customer. In case goods are imported in relation to this transaction there may likewise be consequences for import duties and import VAT.

Example 2

Foreign company A established in France has a subsidiary B in Germany. In scenario 1 B acts as a commissionaire.. In scenario 2 B acts as an agent. The goods are supplied to customer C (consumer) in Germany. A and B have a full right to deduct VAT

- *Scenario 1*

There are two supplies of goods, one from A to B and one from B to C. The supply between A and B can either be an intracommunity supply or a local supply in France.²⁸ If the supply from A to B is an intracommunity supply A will need to report and account for the VAT on the intracommunity supply in France. B will need to report an intracommunity acquisition in Germany and report and account for the VAT on the subsequent supply to C which is subject to VAT in Germany. If the supply between A and B is a local supply, A will need to report and account for the VAT on this supply in France. The supply between B and C will then automatically be a local supply also, so B needs to report and account for this VAT in France as well.

Scenario 2

A supplies goods directly to C. This supply is subject to VAT in the Member State where the transport starts, unless the rules for distance sales apply. A must report and account for this VAT in France. B provides an intermediary service to A that is subject to VAT in France. The VAT on this service is reverse charged. A must report this VAT in its VAT return and can deduct this VAT in the same VAT return.

For services a choice of model can affect where VAT needs to be paid as well. If the subsidiary qualifies as a commissionaire, VAT on the first supply between the foreign company/principal and the subsidiary will most likely be subject to VAT in the Member State of the subsidiary, where it will be required to report this VAT under the reverse charge rule since the foreign company itself is not established in the Member State of the subsidiary. The second supply, between the subsidiary and the customer, may either be subject to VAT in the Member State of the customer (if the customer is a taxable person for VAT or is qualified as such for the place of supply rules for services under art. 43 VAT Directive), or in the Member State of the subsidiary if the customer is an end consumer.²⁹ In case the subsidiary qualifies as an agent it will provide a service to the foreign company that is subject to VAT in the state of the foreign company, where the VAT will be reverse charged to the foreign company. It is then the foreign company/principal that supplies the service directly to the customer. If that customer is a taxable person (or a person that is qualified as such for the place of supply rules under art. 43 VAT Directive)

²⁸ Again parties should decide this based on the criteria provided in the Eurotyre case.

²⁹ There might also be special rules applicable for the place of supply of services (see section 2).

there will be no difference as regards the place of supply of the service to the customer. However, in case the customer is an end consumer under the agent model the supply will be subject to VAT in the state of the foreign company instead of the subsidiary, unless a special provision for the place of supply of services applies.

To summarize the above when changing the business model for VAT, the following points need to be taken into account:

- Taxable amount
- Reporting and invoicing obligations
- Place of supply changes in case the customer is an end consumer
- Import duties and import VAT

As discussed above the place of supply for B2C-services can be changed by switching from a distributor arrangement (where the subsidiary sells services in its own name and for its own account) or a commissionaire arrangement to an agent model. This concept was used in the DFDS case³⁰ to shift the place of supply from the UK to Sweden for tour operator services to benefit from the Swedish exemption for these type of services. The CJEU, however, regarded the UK subsidiary of DFDS Sweden as a FE of the Swedish company. The CJEU's judgment in the DFDS case seems to have been dictated by EU competition law in general and the rules on sole distributorship of (un)disclosed agents in particular.³¹ It also seemed to have played a role that without assuming a FE in the UK the services from DFDS would escape taxation altogether.³² The DFDS case and the example show that there may be need to consider some type of agency FE for VAT. However in order for an agent to qualify as FE, it should be involved in providing the service as well. As described in section 2, VAT aims to tax consumption by taxing goods and services provided to consumers. Like the proposed changes in Action 7 the formal contract should not be leading. If that where the case a FE can be easily avoided by letting the foreign company formally carry out the service by putting the contract in its name as was done in the DFDS case.

Looking at the future the commissionaire arrangement in relation to B2Cservices should be looked upon as well. In our digital era, platforms where suppliers and customers meet play an important role. Platforms can be operated at a great distance from the consumer, i.e. the entrepreneur operating the platform does not need to be established in the same country as the consumer. If the platform acts as a commissionaire, the commissionaire provision will shift the place of taxation under the main rule for B2C-services from the place where the taxable person actually providing the service is established to the place where the commissionaire is established, thereby shifting the place to a location that may be very distant from the consumer.

Solutions for this problem can be found in:

1. Shifting the place of taxation to the place where the customer is located.
2. Requiring the commissionaire to account for VAT in the Member State of the principal.

³⁰ CJEU 20 February 1997, C-260/95, ECLI:EU:C:1997:77.

³¹ Publication of the European Commission on sole distributorships of (un)disclosed agents, OJ 1962, 139, 2921-2922. No official English translation available. This becomes clear from the Opinion of Advocate-general La Pergola, Opinion of Advocate-General La Pergola of 16 Jan. 1997, C-260/95, ECLI:EU:C:1997:20.

³² Andrea Parolini and Andrea Rottoli, 'The role of the 'Rationality Test' in attributing supplies of service to FEs – A critical approach to Case C-605/12 (Welmory)', *World Journal of VAT/GST Law* 2016, nr. 1, pp. 1-8.

European VAT adopted the first solution as regards telecommunications, broadcasting, and electronically supplies services (tbe-services) in 2015.³³ Both options have an issue as regards compliance, because VAT will need to be paid in a Member State other than where the commissionaire is established. For tbe-services the Mini One Stop Shop (MOSS) is used to address this issue. Under MOSS the taxable person accounts for and pays VAT in its Member State of establishment (or in the case of a non-EU taxable person, in a Member State of choice) for tbe-services taxable in other Member States (or in the case of a non-EU taxable person, in all Member States). It is, however, yet unclear whether the MOSS-system functions properly. It therefore remains to be seen what will be the best option in the future.

3.3 PREPARATORY AND AUXILLIARY ACTIVITIES

3.3.1 EFFECT OF BEPS

The second issue addressed in Action 7 relates to the exceptions of art. 5 (4) OECD Model Convention. Under art. 5 (4) OECD Model Convention there is no PE if one of the activities mentioned in this paragraph is carried out. The provision is meant to exclude activities that are of a preparatory or auxiliary nature from the PE definition. However, art. 5 (4) OECD Model Convention does not explicitly state that the activities mentioned therein must be of a preparatory or auxiliary nature. Some States also have concerns as regards the fragmentation of activities between closely related parties with the purpose of not exceeding the threshold for preparatory or auxiliary activities.³⁴ Therefore two amendments of art. 5 (4) OECD Model Convention are proposed:

1. An addition to art. 5 (4) OECD Model Convention stating that the activities mentioned under a-f must be of a preparatory or auxiliary character.³⁵
2. An amendment of the anti-fragmentation rule so that it includes situations where closely related enterprises together have a PE. This includes the situation where a closely related enterprise already has a PE in a State and the situation where both do not have a PE in a State when considered individually. The anti-fragmentation rule applies only when the business activities carried on by the two enterprises constitute complementary functions that are part of a cohesive business operation.³⁶

3.3.2 BEPS's SIDE EFFECTS FOR EUROPEAN VAT?

For VAT purposes it is important to establish that there may be two types of FE. The first type is the 'classical' type of FE, which is relevant for the main B2C-rule for the place of supply of services. Under this rule services are subject to VAT in the State where the supplier is established, art. 45 VAT Directive. Art. 11 (2) VAT Implementing Regulation defines such a FE as: any establishment, other than the place of establishment of a business, characterized by a sufficient degree of permanence and a suitable

³³ Art. 58 VAT Directive.

³⁴ Action 7, p. 28.

³⁵ Action 7, p. 28 ad 29.

³⁶ Action 7, p. 39

structure in terms of human and technical resources to enable it to provide the services which it supplies. This definition shows that it is required that a person possesses technical means and people to provide services. Therefore, establishments that only carry out activities of a preparatory or auxiliary nature internally (only for the entity of which they are part) will not qualify as a FE for VAT under art. 11 (2) VAT Directive. The second type of FE results from application of a different definition of FE for the main place of supply rule for B2B-services. We can find this definition in art. 11 (1) VAT Implementing Regulation. This provision defines the FE 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. This definition does not require a taxable person to provide services, only to receive and use services that are purchased. This definition therefore might include establishments that are of a preparatory or auxiliary nature.

What is also worth mentioning is that the CJEU ruled in the *Planzer Luxembourg* case³⁷ (and later in the joined *Widex* and *Daimler* cases³⁸) that there is no FE in the case of preparatory or auxiliary activities. These cases, however, were referred to the CJEU for an explanation of the FE concept in the so called Eight Directive (currently covered by Directive 2008/9/EC) under which a taxable person established in a Member State can get a VAT refund of foreign VAT in another Member State. In the *Welmory* case,³⁹ the CJEU did in my opinion not connect these cases to the definition of FE given under art. 11 (1) VAT Implementing Regulation.⁴⁰ Therefore, the question as to whether or not an establishment carrying out preparatory or auxiliary activities qualifies as a FE under art. 11 (1) VAT Implementing Regulation remains open.

With the proposed amendment of art. 5 (4) OECD Model Convention we will have more discussions in practice on whether or not activities have a preparatory or auxiliary nature. This may trigger the debate on whether activities of a preparatory or auxiliary nature may lead to a FE under art. 11 (1) VAT Implementing Regulation. It is in my opinion important to trigger this debate because of the uncertainty for taxable persons in the current situation. I argue there are several reasons to exclude establishments that only carry out preparatory or auxiliary activities internally from the FE concept:

1. Alignment with the concept of FE under the Refund Directive.⁴¹ If the FE concepts are not aligned there can be situations where a taxable person is considered not to have an FE in Member State A under the Refund Directive. It may therefore file a VAT refund request under the VAT Refund Directive in its own Member State to get the VAT refunded in Member State A, while at the same time it is considered to have a FE in Member State A when purchasing services. If this VAT is reverse charged to that FE, it will be required to file regular VAT returns.
2. Most taxable persons have a full right to deduct VAT. Taxing services in the country of an establishment that performs preparatory or auxiliary activities therefore does not result in a

³⁷ CJEU 28 Jun 2007, C-73/06, ECLI:EU:C:2007:397.

³⁸ CJEU 25 October 2012, C-318/11 and C-319/11, ECLI:EU:C:2012:666.

³⁹ CJEU 16 October 2014, C-605/12, ECLI:EU:C:2014:2298.

⁴⁰ See also Nebojsa Jovanovic and Madeleine Merx, 'Welmory – a Recipe for VAT avoidance?', (2015) 24 EC Tax Review, Issue 4, pp. 202–209.

⁴¹ Directive 2008/9/EC, previously the Eight Directive.

VAT flow to that state. This is different for taxable persons that perform exempt supplies, because they normally do not have a right to deduct VAT. However, even if it is considered necessary to see a FE here because of the wish to tax the services purchased for exempt activities in the country where they are used by the establishment that carries out preparatory or auxiliary activities, that rule has a huge overkill due to the number of taxable persons with a full right to deduct VAT that are confronted with this. This must also be considered in relation to the reason mentioned under 3.

3. It is unclear whether the staff present at an establishment that carries out preparatory or auxiliary activities is capable to deal with VAT obligations in that state. The establishment may be of a minimum size, e.g. one might argue that a representative of the business with a car and computer owned by the business may qualify as a FE under art. 11 (1) VAT Implementing Regulation. It is also uncertain whether the foreign company as such is able to deal with those VAT obligations in the state of the FE.⁴²

Looking at the exceptions of art. 5 (4) OECD Model Convention, given the current wording there will be no FE under art. 11 (2) VAT Directive, because with all these exceptions there are no taxable supplies towards third parties for VAT. With the proposed change the scope of these exceptions will be limited to cases where the activities are of a preparatory or auxiliary nature. This is irrelevant for VAT. What is important for VAT is that the establishment provides taxable supplies (goods or services) to third parties. When an establishment carries out activities for third parties it will also be a PE for direct taxes.⁴³ There will also be a PE if the purpose of the establishment in question is identical to the general purpose of the whole enterprise.⁴⁴ If this PE, however, does not perform taxable supplies to third parties there will be no FE under art. 11 (2) VAT Implementing Regulation. Therefore, the proposed changes will – like the proposed change to deal with commissionaire arrangements – also cause the PE and FE concepts to drift further apart.

As regards the anti-fragmentation rule, there is no such rule for VAT. In the ARO Lease case⁴⁵ the European Commission proposed an approach of the concept of FE for VAT that included all places in a Member State where a taxable person possesses staff and/or technical means. The CJEU did not get to this approach, because it concluded that the independent agents that worked for ARO Lease could not be considered ARO Lease's personnel. The idea was explicitly rejected by Advocate-general Fennelly who stated:

31 Even if, contrary to the view which I have just expressed, the notion of 'human and technical resources' employed in the Court's case-law may be interpreted expansively to include resources provided by third parties and subject to separate VAT treatment under the Sixth Directive, I would not be convinced that the service of leasing cars at issue in this case could realistically be regarded as having been provided from a FE in Belgium, since such an

⁴² A Tax Survey issued by the European Commission in 2004 shows that companies without a FE in the classical sense or subsidiary abroad have the highest VAT compliance costs. 'European Tax Survey', European Commission Directorate-General Taxation & Customs Union, taxation papers, working paper no 3/2004. The author is unfamiliar with any other surveys of a more recent date.

⁴³ Para. 26 of the Commentary on art. 5 OECD Model Conventions. By third parties I mean any other enterprise or customer. This can be a group company.

⁴⁴ Para 24 of the Commentary on art. 5 OECD Model Convention.

⁴⁵ CJEU 17 July 1997, C-190/95, ECLI:EU:C:1997:374.

establishment would have to be composed of the various Belgian places of business of the numerous agents who provided pre- and post-leasing services on behalf of ARO. The essence of the services provided by ARO comprises the conclusion of the leasing agreements, which clearly occurred in the Netherlands and which undoubtedly involved the use there by ARO of both human and technical resources; contracts cannot be concluded and financial arrangements put in place without the use of considerable resources. Consequently, the Netherlands is the rational place of supply in accordance with the broad scope to be attributed to the notion of 'the place where the supplier has established his business'.⁴⁶

In our modern society where it is more and more possible to work together at a distance, I think an anti-fragmentation rule is important for VAT as well. Why treat a foreign enterprise that has all its technical means and people in one place differently than an enterprise that has its technical means and people spread out across the territory of one country, but provides the same goods or services?

Under the proposed changes the anti-fragmentation rule will apply to connected enterprises also. If European VAT adopts an anti-fragmentation rule the question is whether it should also be extended to connected enterprises. Connected enterprises can under conditions be considered a VAT group and thus one taxable person. However, in order to regard them as a VAT group each of them will need to have a FE in a Member State (art. 11 VAT Directive). Under the anti-fragmentation rule as it is drawn up in Action 7, only one or none of the connected enterprises has a PE taken individually. In case none or only one of the connected enterprises has a FE, they cannot be part of the same VAT group. What is more, not all Member States have implemented VAT grouping. So it is important to see whether a similar approach of the anti-fragmentation rule for VAT is necessary. In that respect there could be situations where an anti-fragmentation rule for connected enterprises may be relevant for VAT, see example 3.

Example 3

Foreign enterprise A has an agent employed in Member State 1 working from an office there that exclusively concludes contracts for this foreign enterprise. The goods are supplied by a connected foreign enterprise B that has a warehouse in Member State 1 in the name of foreign enterprise A.

One might argue that under current legislation neither of those foreign companies has a FE in Member State 1. This is because none of the foreign companies is supplying goods to the customer from that Member State. Company A only concludes contracts and, as described in section 2, this is insufficient to consider a FE present. Company B is not the one that supplies the goods to the customer and therefore also does not have a FE. When adopting the anti-fragmentation rule in European VAT, it is therefore important to extend it to connected parties, too.

⁴⁶ Opinion of Advocate-general Fennelly of 12 December 1996, C-190/95, ECLI:EU:C:1996:494.

4. CONCLUDING REMARKS

In this article I have concluded that the changes proposed to the concept of PE in art. 5 OECD Model Convention will cause the concept of FE under European VAT and the concept of PE under the OECD Model Convention to drift further apart.

When considering changes in the supply chain because of the proposed amendments to deal with commissionaire arrangements, VAT consequences should be considered also. There may be consequences for the taxable amount, reporting and invoicing obligations, place of supply and import duties and import VAT. The DFDS case in my opinion shows that we need a type of agency FE for European VAT. We should also consider changing the place of supply when a commissionaire is involved and services are provided through this commissionaire's digital platform.

The amendments to art. 5 (4) OECD Model Convention that intend to limit the scope of this provision to activities of a preparatory or auxiliary nature only, may trigger the debate on the interpretation of art. 11 (1) VAT Implementing Regulation. In my opinion, it is desirable to consider only an active FE, a FE that supplies goods or services to third parties, as a FE under art. 11 (1) VAT Implementing Regulation. We should also consider an anti-fragmentation rule in European VAT that includes the position of connected parties as well.