VAT focus

A tale of two companies in two cities: the CJEU's ruling on fixed establishment in *Berlin Chemie*

Speed read

Building on earlier cases on fixed establishment (FE), the CJEU has decided, in the case of *Berlin Chemie A Menarini Sarl* (C-333/20), that Berlin Chemie (BC), a German company, does not have a FE in Romania. Although BC has permanent access to human and technical resources in Romania that are owned by its local subsidiary, Berlin Chemie A Menarini (BCAM), the CJEU did not think BC could dispose of those resources as though they were its own; so, while third party owned resources can create a FE for the user, these ones did not. Also, the CJEU was clear that the same resources cannot, at the same time, be used by BCAM to provide services to BC and also create a FE for BC. As it would appear from the documents submitted to the CJEU that they are so used by the subsidiary, it follows they have not also created a FE for BC.

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Those of you who have read my previous articles know I love a theme on which to hang any VAT analysis. When I came to write this article, I was torn, as Natalie Imbruglia might say, as there are so many possibilities to choose from.

The CJEU case of *Berlin Chemie A. Menarini SRL v Administrația Fiscală pentru Contribuabili Mijlocii București – Direcția Generală Regională a Finanțelor Publice București* (Case C-333/20) is a rollicking place of supply mystery (less a whodunnit than a where is it) with all the required ingredients for a great story: huge sums of money being demanded, human (and technical) resources playing dual roles like all the best double agents, and of course a setting in both Eastern Europe and Berlin – which is a city inextricably linked in popular culture with the spy novels of Len Deighton and John le Carre and the Kitkat Club of Cabaret fame. And there is a happy, or should I say Smiley, ending (for the taxpayer anyway), plus the CJEU has shed some useful guidance on when local borrowed resources do and (more importantly do not) create a fixed establishment (FE) for the overseas based borrower. What more could you ask for?

Of course, the real story is rather more prosaic than the above paragraph might suggest (it is VAT after all), and it has nothing to do with spies, double agents, the Cold War, the musical Cabaret or indeed the French Revolution; rather, it is all about a Romanian company acting as the local representative in Romania of a German pharma company that controlled it. But the large sums of money (which does of course make the world go around) and the happy ending are true, and with luck I have now piqued your interest and you will stay with me to learn about the useful guidance.

Setting the scene: Berlin and Bucharest

Imagine, if you will, two companies. One, Berlin Chemie (BC), is established in Germany but as it sells pharma products in Romania, it is VAT registered there so as to account for Romanian VAT on those sales of goods. The other (Berlin Chemie A Menarini (BCAM) – the appellant in this case) is established in Romania and the majority of its shares are owned by BC. BCAM promotes the Romanian business of BC and ensures BC is compliant with local regulations, so its representative office services may mean BC sells more in Romania; however, it cannot bind BC and has no involvement in the sale of the goods by BC. For its advertising marketing and other services, BCAM is paid a cost plus fee by BC, who is its only customer and only source of income. Thinking that BC has no place of belonging in Romania (as the Romanian VAT registration on its own is not enough to create one), BCAM does not charge VAT on the fee. The Romanian authorities disagree and assess it for several million euros, including penalties and interest, arguing that BC has permanent access to BCAM's staff and other resources in Romania and that creates a fixed establishment for BC in Romania that has received these services, meaning Romanian VAT is due. The case is referred to the CJEU. Fade to black, end of part one.

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Where do I belong?

So the question was fairly simple: did BC have a Romanian FE through its access to the Romanian human and technical resources owned by BCAM (a company that BC controlled)? The answer was perhaps less so. We have seen many FE cases both on where the supplier belongs (though less so recently as so many services are now taxed where the customer, rather than the supplier, belongs) (see *Berkholz* (Case C-168/84), DFDS (Case C-260/95), *Chinese C&E Commrs v Channel (Hong Kong) Ltd* [1998] STC 347 and *ARO Lease* (Case C-190/95)), and as here, where services are received (*Dong Yang Electronics* (Case C-547/18) and *Hastings Insurance Services* [2018] UKFTT 27 (TC)).

We already know that a FE can be created by resources that the entity does not own (*Welmory* (Case C-605/12)). Indeed, if that was not the case, avoiding a FE would be ridiculously easy: an entity could just use seconded staff (rather than employees) and lease (rather than buy) equipment and property.

Although *Titanium* (Case C-931/19) says that an overseas taxable person that does not have its 'own staff' in a member state cannot have a FE in that member state either, this is a fact specific case about whether a property managed by an independent agent created a FE for the property owner and the point here surely is the meaning of 'own staff', which is not wholly synonymous with employee.

However, the key point here is that if these resources it does not own are to create a FE for BC, BC must be able to use and dispose of these resources as though it did own them – and the CJEU did not think this was the case here. As stated above,

the CJEU considered it was likely that the staff and equipment would also be used by BCAM to supply its services to BC as well as being used by BC to facilitate its sales of goods in Romania.

And this is where the decision gets really interesting and where it has perhaps added to what earlier FE cases tell us (note, of course, that CJEU cases are no longer binding on the UK post-Brexit but UK tribunals are likely to take account of them). Because the CJEU has said very clearly that the same resources cannot be used both by BCAM to provide services to BC and also to create the FE of BC that receives those same services.

So, cue the aforementioned happy ending for the taxpayer, assuming the referring court establishes the facts the CJEU has used to come to its conclusion are correct. BC has no FE in Romania: it does not receive the services provided to it by BCAM in Romania but instead receives them in Germany where it has its head office. Romanian VAT is not due on the supply.

Epilogue

We understand that Romania may not be the only member state that has been keen to use resources owned by a third party to create a local FE for overseas companies. This type of arrangement is not uncommon especially in toll manufacturer situations. As this case shows, the amounts of VAT due, if a local FE has been created, can be substantial. It is not that these services by BCAM were escaping VAT: BC was declaring German VAT under the reverse charge, and presumably if Romanian VAT had been due, it would have been deductible in full by BC, but the assessment also included a large penalty and interest charges so the benefit to the authorities was more than mere cashflow. Any supplier in similar discussions with local tax authorities, or who has been recently assessed based on a similar fact pattern to the one in this case might want to revisit the position, time limits permitting.

The sting in the tail?

Of course, even a taxpayer win is not necessarily wholly good news across the board. Here the taxpayer needed to show its customer did not have an FE in Romania, so that the VAT penalty and interest assessment the Romanian authorities had issued would be withdrawn. And the taxpayer has got the support of the CJEU. But sometimes a taxpayer may be fighting to show it does have a FE in a country (where a branch of an overseas company wants to join a local VAT group for example) and this decision may make it harder to show that is the case, if the creation of the FE relies on the use of third-party resources. Then again, it does seem to be a logical decision by the CJEU. If nothing else, it does confirm the old proverb that you cannot ride two horses at once – not even in the 'VAT fiscal theme park', as Lord Justice Sedley so eloquently described it (*Royal & Sun Alliance Insurance Group plc v C&E Commrs* [2001] STC 1476 (CA) at para 54). However, FE uncertainty still remains and case law, while helpful, is no substitute for a full review of the extent of the resources in a country and the permitted use of them by all parties.

There is one question that is often asked about FEs which seems to divide opinion and which was not covered by this case: if one entity creates a FE for another through the dependent agency provisions (an admittedly rare situation), can that entity also make supplies to that FE on which VAT is due? In other words, is the FE separate in VAT terms from the supplier, even though the supplier is also the FE (i.e. the supplier wears two hats). Or is that transaction between agent and the FE of its principal it has created basically a supply to itself, which *FCE Bank* (Case C-210/04) tells us must be disregarded? That is a question that could have come straight out of the film *Inception*... ■

VAT and fixed establishments: key EU cases

***DFDS* (Case C-260/95)**
A Danish company which operated a travel business established a UK subsidiary company to act as its commercial agent selling tour packages. If the UK subsidiary created a fixed establishment for the Danish parent, this would result in UK VAT being due under the tour operator's margin scheme on package tours marketed by the subsidiary. A combination of the fact that the subsidiary was wholly owned by the Danish parent and the various contractual obligations imposed on it by its parent led the court to conclude the subsidiary was acting as an 'auxiliary organ' of its parent and therefore created a fixed establishment.

***Welmory* (Case C-605/12)**
A Polish company operated an on-line auction of goods. Bidders were required to purchase 'bids' (i.e. the right to bid) before taking part in the auction. The seller of the bids was a Cypriot company which also managed the operation of the auction using resources provided (and charged for) by the Polish company. The central question was whether the human and technical resources of the Polish company created a fixed establishment for the Cypriot company in Poland. The court held (without answering the question definitively) that a fixed establishment must be characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive the services supplied to it for its own needs.

***Titanium* (Case C-931/19)**
A Jersey company owned a property in Austria but engaged a local property management company to undertake the day-to-day operations whilst retaining control over important decisions such as entering and terminating leases. None of the company's activities required it to have a presence in Austria and the absence of human and technical resources led the court to conclude that it was not established in Austria for VAT purposes.

***Dong Yang Electronics* (Case C-547/18)**
A business established in Poland had a contract with a Korean company to assemble printed circuit boards. The Korean company had no human or technical resources in Poland. However, it did have a legally separate Polish subsidiary. This subsidiary provided materials to the Polish company and, following assembly, was provided with the printed circuit boards. The court held that it was not possible to infer from the mere existence of a subsidiary that the parent had a fixed establishment.

Tolley

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- Cases: *Berlin Chemie A. Menarini SRL* (14.4.22)
- *Dong Yang*: CJEU rules on VAT fixed establishment (T Velling, 26.5.20)
- *Hastings*: when does a fixed establishment exist? (R Woolich & A Bradley, 19.4.18)