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The Evolution of the Concept of Fixed Establishment (“FE”) and the Digital Economy³

Abstract

The article aims to cover the issue of foreign entities having a “fixed establishment” in a given country. A phenomenon discussed at length in recent months, but one that entities conducting digital business seem to have not really explored in great detail in the context of determination of the principles of taxation of VAT transactions. In this article, we will attempt to analyse the definition of FE on the basis of both binding legal regulations and the existing Polish and EU judicial decisions. At the same time, we will try to answer the question about the impact of the practice of tax authorities pursued in the area of interpretation of the conditions for a FE to be established on the stability of tax settlements of taxpayers operating in the digital industry. In addition to that, the authors will also try to arrive at a balance among the current views on FE, which depict Poland from the tax administration perspective as a country with highly unstable tax practices, detached from logical arguments and unaware of the nature of business.

Keywords: VAT, digitalization, taxes, digital economy, taxation, FE

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Introduction

The advancing digitalisation of economy is not a vision of the future. It has become a fact, a reality that entrepreneurs have to face each and every day. Modern technologies employed in business breed both business-technological and tax-related challenges. But we can see more and more doubts about whether tax regulations – generally considered rather unsuitable for the dynamic business environment – offer taxpayers a sense of comfort when it comes to settlements connected with modern technologies. While digital economy is in full bloom, tax law regulations are not exactly able to keep up with the changes taking place. And there is no doubt that a tax regulation is not able to address each and every activity of a taxpayer, especially when such an activity is innovative and creative by nature and definition. This calls for prudent interpretation of the existing solutions. A thought that crosses the minds of entrepreneurs more and more often – especially of those running their business in Poland – is far from optimistic. No clear mechanisms combined with the pro-fiscal approach of tax authorities leads to uncertainty as to whether the tax settlement models practised for years are not going to be questioned by the Treasury, and not just because of some amendments to the existing regulations but simply because of a different interpretation that that adopted and followed so far.

One of the areas that seem to have been recently drawing an increased interest of tax authorities is the issue of the highly elusive, indefinable, and unclear⁴ concept of FE, connected mainly with international services trade in business to business relationships. Although VAT should be a tax that is neutral for companies,⁵ the will to make a quick, even one-off profit seems to be dominating the practice of tax authorities, leading to questioning of the principles of settling VAT as followed for years by entrepreneurs in conducting their business. Importantly enough, the issue does not pertain to situations where a taxpayer would attempt to abuse the VAT

⁴ M.L. Schippers, J.M.B. Boender, *VAT and Fixed Establishments: mysteries solved?*, "Intertax" 2015, 11, p. 709.

⁵ Cf. judgement of the Court of Justice of the European Union of 14 February 1985 passed in case of D.A. Rompelman and E.A. Rompelman-Van Deelen, C-268/83: "the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of value-added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way."

system (being e.g. a financial institution with a limited right to tax deduction). The issue is a challenge to service providers and customers whose only intention is to settle VAT charged on services, according to known and binding legal regulations and common interpretation.⁶

In the context of digital services, their dynamic development combined with availability of international teams shows that FE – given the present extreme approach of tax authorities – may appear to be an obstacle which innovative enterprises providing their services abroad or purchasing cross-border services will have to deal with at some point. At the same time, despite the existence of the principle of neutrality constituting the VAT system within the framework of EU law, making a mistake in determining the existence of a FE in a given country may appear to be costly and difficult to correct by administrative means in practice.

The basis of the concept of FE

The concept of FE – equated in the past with a “permanent establishment” in the context of income taxes⁷ – is not defined in VAT regulations or in interpretational practice, although a discussion on the matter began already in the 1980s.⁸

The EU VAT regulations provide for a so-called territoriality principle,⁹ according to which in a given country, VAT is levied e.g. on paid provision of services, but only in a situation when the place of provision of such services is the territory of the country in question. In practice, the actual place where a given activity is carried out is not always the place of provision of a given service and – consequently – the place of taxation. The EU legislator has decided to adopt regulations aiming at

⁶ Out of regard for the existing neutrality of VAT and the scope of transactions questioned so far in the area of FE as known to the authors of the article, the authors do not agree with the line of argument offered in the publication named below regarding the motivation of taxpayers in structuring business models causing currently doubts about FE: A. Rutkowska-Brdulak, *Wprowadzenie, [in:] Stale miejsce prowadzenia działalności w VAT a podmiotowość prawnopodatkowa. Dylematy, konsekwencje, ryzyka*, Warszawa 2018, LEX: “the absence of uniform regulations in the area in question and of the lack of transparency in settlements resulting from cross-border provision of services cause – and will continue to cause – tax evasion. To put it differently, entities conducting international business will search for such tax optimisation measures which will reduce their tax obligations under the tax on goods and services or – in broader terms – under the value-added tax.”

⁷ At present, equating the concept of a “permanent establishment” with a “FE” seems to be unfounded – cf. VAT Expert Group’s opinion of 8 September 2016, taxud.c.1(2016)5607910.

⁸ Cf. VAT Committee’s guidelines compiled after meeting no. 15 of 8–9 December 1983, XV/38/83.

⁹ Cf. Art. 5 section 1 item 1 in relation to Art. 2 item 1 of the act of 11 March 2004 on the tax on goods and services (uniform text in the Journal of Laws of the Republic of Poland of 2018, item 2174 as amended; “the VAT Act”).

maintaining the so-called use and enjoyment rule, which guarantees that only those transactions which have actually been consumed (i.e. used and enjoyed) in a given country are taxed in this country, regardless of the place where the service provider has “produced” the provided service.¹⁰

As a result, B2B relationships are based on an assumption that the place of provision of a service is the place where the taxpayer being the customer has their registered business office. But if services are provided to a taxpayer’s FE located elsewhere than this taxpayer’s registered office, the place of provision of services is the FE in question.¹¹ In principle, in order to correctly determine the place of taxation of a service establishing a business relationship between entities from different countries, it is crucial to verify if the services in question are provided to the customer’s registered office, to their FE.

Neither the VAT Act nor the fundamental EU act on the VAT system¹² contain a definition of a “registered office” and a “FE”. Following the many decisions of the Court of Justice of the European Union¹³ striving to allocate services to the “right” country for VAT settlement purposes, the Council Implementing Regulation (EU) No. 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax¹⁴ entered into force on 1 July 2011, introducing a legal definition of both the registered office and the FE into the Polish legal system. It appears, though, that despite the long presence of these regulations, the notions in question are still confusing, and further decisions of the CJEU (including pending cases) shed – and will continue to shed – new light on the concept of FE. Moreover, one can get the impression that the case of FE has become a subject matter discussed on a so far unprecedented scale.¹⁵

While the adopted practice of identifying a taxpayer’s registered office has been to consider the place where a company’s general board works and performs its usual duties – especially the place where important decisions concerning issues regarding the adopted general management policy – as the company’s registered office, with the postal address being not enough for a place to be considered a taxpayer’s regi-

¹⁰ R. Namysłowski, K. Sachs (eds.), *Dyrektywa VAT. Komentarz*, LEX, 2008.

¹¹ Art. 28b sections 1 and 2 of the VAT Act.

¹² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ EU L of 2006 No. 347, p. 1 as amended).

¹³ “CJEU”.

¹⁴ OJ EU L of 2011 No. 77, p. 1 as amended, “Regulation 282/2011”.

¹⁵ M.L. Schippers, J.M.B. Boender, op. cit., p. 723.

stered business office,¹⁶ the problem with FE is much more complicated. There are no clear guidelines on how to define the notion in the first place. According to Regulation 282/2011, a fixed establishment shall be a place characterised 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.

CJEU's decisions prove that establishing a FE will always be a manifestation of a taxpayer's business activity being conducted in a given country. However, this does not mean that every activity pursued abroad will automatically lead to establishing a FE. In order for a FE to be established, several crucial characteristics defined by the CJEU must be met.¹⁷ A FE will be a any place that:

- ❑ is characterised by a sufficient degree of permanence,¹⁸
- ❑ features a suitable structure in terms of human resources (e.g. having employees employed, having delegated employees working in a given country, having other entities' employees obligated to perform activities required by a given taxpayer at the taxpayer's disposal in another country),
- ❑ features a suitable structure in terms of technical resources (e.g. existence of branches in a given country, having devices necessary to conduct business activity independently at one's disposal, having office space or equipment rental agreements concluded or having a legal title to use any such space where

¹⁶ CJEU's judgements of 6 October 2011, case Stoppelkamp, C-421/10, of 28 June 2007, case Planzer Luxembourg, C-73/06.

¹⁷ Interpretation of the Director of the Tax Chamber in Warsaw of 11 March 2016, IPPP3/4512-1074/15-4/JŻ.

¹⁸ Polish tax authorities have analysed the feature of permanence a number of times in their interpretations. In his interpretation dated 25 October 2012, IPPP3/443-784/12-4/KC, the Director of the Tax Chamber in Warsaw argued that "(...) »permanent«, means attached permanently, in a fixed manner to a given place, non-movable, unchangeable. The above means that a fixed business establishment must be characterised by a certain degree of engagement, which makes it possible to acknowledge that the business activity conducted in this place is not temporary or periodic. It is therefore necessary to have some minimum scope of activity to act as an external manifestation that there is some business activity conducted on a permanent basis in a such a place (...)" A similar standpoint was offered by e.g. the Director of the Tax Chamber in Łódź in his interpretation of 23 September 2011, IPTPP2/443-251/11-4/IR: "As the name suggests, »permanent« means attached permanently, in a fixed manner to a given place, non-movable, unchangeable – a fixed business establishment must be characterised by a certain degree of engagement, which makes it possible to acknowledge that the business activity conducted in this place is not temporary or periodic. It is therefore necessary to have some minimum scope of activity to act as an external manifestation that there is some business activity conducted on a permanent basis in a such a place. Thus, to acknowledge that a given place of conducting business is permanent in its nature, it is necessary for this place to feature the relevant technical infrastructure and have the relevant human resources involved in its operation. Such a personal-material structure present in a fixed establishment should be permanent, i.e. appearing in a recurring and non-transient manner."

products are going to be stored – with these products to be modified/shipped to factories or customers according to the owner’s instructions),

- enables it to receive and use the services supplied to it for its own needs.¹⁹

One of the first decisions looking in more depth into the notion of FE can be the CJEU’s judgement of 4 July 1985, passed in case *Gunter Berkholz*, C-168/84. When analysing the circumstances of establishment of a FE, the CJEU argued that if services had been supplied at an establishment other than the place where the supplier had established their business, it was necessary for this establishment to be of a certain minimum size and have both the human and technical resources necessary for the provision of the services in question permanently present in place. The judgement included an analysis of whether business activity involving installing gaming machines on a ferryboat could be considered an act of establishment of a FE. According to the CJEU, such a situation could be considered enabling the establishment of a FE only in the event if the entire staff and the technical facilities required to provide the services in question were present *in situ* all the time. The CJEU found that even a periodic delegation of staff to operate the said gaming machines was not enough to speak of an established FE since the condition of permanence in the human resources aspect was not met.

In a judgement of 17 July 1997, passed in case *ARO Lease BV*, C-190/95, the CJEU found that a FE had to be able to conduct business activity in an independent manner. This means that the CJEU argued that a FE must be capable of making agreements and taking management-related decisions independently. According to the judgement, *ARO Lease BV*’s making cars available to the company’s customers abroad under leasing agreements did not result in the establishment of a FE. The CJUE argued that as the leasing company did not have any separate offices in the country where its cars were made available to its customers, concluding the leasing agreements (drawn up and signed at the company’s main place of business) via agents made the company have no own staff or organisational structure at its disposal, which would let it conduct business activity in the country where its cars were made available to its customers.

¹⁹ According to A. Bartosiewicz, *VAT. Komentarz*, 12th edition, LEX, 2018, the set of components forming a FE should actually use the provided services. Such services are to be really provided for the needs of the structure in question. If it is impossible for a given structure (on account of the human and technical resources available) to “consume” the purchased services, such a structure should not be considered then a FE. At the same time, such a FE should have the means enabling it to provide the services it ‘produces’. Only then – with regard to the performed services – a FE can be established.

In recent months in Poland, there has been a growing trend to identify a Polish FE of foreign companies in the form of any long-term collaboration with a Polish service provider (affiliated or not) acting as an auxiliary in supporting the sales activity pursued by a foreign taxpayer in Poland.²⁰ The considerable subjectivity of the issue results in questioning the settlements of Polish taxpayers who provide comprehensive logistic-warehousing services or toll manufacturing services to foreign entities. Establishing that a company (buyer) has a FE in a given country is important enough that it changes the manner in which VAT is settled in the said country. An activity to which VAT is not applicable (settled by the buyer) becomes an activity subject to VAT taxation at a statutory rate (in Poland, it is 23%).

The current approach (especially that of the tax authorities) seems to be completely incomprehensible – a FE is found to exist virtually in every case of long-term collaboration of a foreign entity with a Polish service provider. At the same time, it is not an approach encountered typically in the European Union, which leads to a natural conflict over the taxation of a given service between tax administration authorities from Poland and from the customer's country.

While it is understandable that Polish tax authorities wish to have as many as taxpayers obligated to pay VAT directly in Poland (and hence they may fail to notice the fact that Polish entities addressing them²¹ with inquiries have FEs located abroad²¹),

²⁰ E.g. p. non-binding judgements of the Provincial Administrative Court in Warsaw dated 7 July 2017, III SA/Wa 2047/16: "without a recommendation of a Country Manager operating in Poland, whose collaboration is not ruled out by the Plaintiff, the Plaintiff's management board may not have the industry insight required to choose business partners individually. The fact that the entire management board of the Plaintiff is based in Malta is insignificant to the case in question. (...) we should consider a scenario where all and any collaborative relationships made with Polish entities, including with the Country Manager, become suddenly broken, i.e. all organisational, technical, and business structures in the country stop carrying out their tasks for the Plaintiff. In such a situation, it would be necessary to find if the Maltese structure of the Plaintiff (according to the description – the management board and the employee receiving the translated orders; there was no mention of a technical infrastructure in Malta in the petition) were capable of taking over the functions of the 'shut down' Polish business modules to maintain continuity of the conducted business activity", dated 20 February 2018, III SA/Wa 942/17: "the activities performed by the employees of the Polish company are not activities independent of the Plaintiff, but activities requiring the Plaintiff's instructions (training). We may not therefore speak of a complete freedom of the Polish company in the performance of strictly specific and specialist activities requiring a set of instructions. (...) the EU judicial decisions and law leave the issue of presence of the technical resources in a »permanent« form and to a »sufficient« degree open to interpretation. (...) since rental on an hourly or daily basis is sufficient to fulfil the needs of the conducted business activity, it should be acknowledged that these needs are fulfilled in a »sufficient« way. (...) although formally the Filing Party does not have technical resources in the form of warehouses or offices located in the country, what matters here is the economic utilisation of human resources and equipment."

²¹ Cf. interpretation of the Director of the National Revenue Information of 15 March 2018, 0111-KDIB3-1.4012.826.2017.2.IK.

but these intensified efforts may lead to the essence of the VAT system becoming warped, distorted. Leaving aside the potential arrears of Polish customers who have not settled their VAT obligations accordingly, when selling “to the country of the buyer’s registered office”, it will be basically possible to deduct the VAT charged as a penalty on the part of the buyer provided that the buyer operates a business (when the transaction is recognised on both parts, there will occur a time shift, interest on the potential arrears, and potential VAT-related sanctions). But the structure formed after an audit will not be financially neutral to the country’s budget (the VAT charged on the seller’s ongoing activity will be deducted by the buyer).

And although one can get the impression that the claim made in Great Britain many years ago, according to which “beyond the everyday world (...) lies the world of VAT; a kind of fiscal theme park in which factual and legal realities are suspended or inverted”²² illustrates the nature of VAT aptly, it is reasonable to call for a search of a “happy medium” in the area of understanding of the concept of FE. A solution that would make it possible to actually settle services in the country where the buyer of such services has an actual business structure and operates their business.

It is important to notice that administrative courts seem to have changed their approach in recent weeks, opting for a more rational interpretation, dampening thus the enthusiasm of tax authorities. For instance, on 7 January 2019, the Provincial Administrative Court in Gdańsk passed a non-binding judgement, III SA/GI 912/18, where it claimed that when a foreign company purchased services in Poland (footwear packaging, customising, and storage) in connection with the pursued activity, but the purchased services were not services the company in question provided itself and were to serve the company’s principal business (manufacture and sale of footwear), it was necessary to acknowledge that the the entire activity was to be conducted in Germany and should be taxed there (i.e. in the country where the company’s registered office was) as well.

We should hope to see administrative courts continue their efforts to stabilise the practice followed with regard to FE to an extent making it possible for foreign taxpayers to purchase services from Poland without fear that such a collaboration would mean that they operate regular business in Poland (which would result not only in a requirement to register for VAT purposes but also – and most likely quite often – in a necessity to remodel the principles of settlement of the handled supplies of goods).

²² Lord Justice Sedley, a ruling passed in case *Royal & Sun Alliance*, 2001.

The digital world and FE

Intangible services seem to be virtually absent from the discussion on the idea of FE. So far, tax authorities have paid little attention to the matter of taxation of digital economy. Since this domain of business activity is quite new, is pursued with the involvement of sophisticated mechanisms, equipment, and – quite frequently – multinational teams (servers located in “cooler” locations, subcontractors from various countries, proficient in a given programming language), tax authorities do not look currently in much detail into the analysis of correctness of settlements and solving problems related thereto. Thus, also the judicial decisions of both national and EU courts existing in this area are limited in number.²³

An exception in this domain – although revolutionary in nature and addressing tangible services as discussed earlier – is the CJEU’s judgement of 16 October 2014 passed in a Polish case of *Welmory sp. z o.o.*, C-605/12, where the CJEU revolutionised the idea of FE, suggesting that a FE can be established despite the lack of own resources in a foreign country (it may be enough to use rented warehouses and take advantage of employees of external service providers to consider a FE being actually established).

In the judgement in question, the CJEU addressed the manner of determining the place of taxation of services provided by *Welmory sp. z o.o.* to a foreign company working closely with the Polish company and conducting its business activity by taking advantage of infrastructure made available to it by the Polish company. Based on an agreement concluded by and between *Welmory* and *Welmory Limited*, the Cypriot company was obligated to run a website with auctions. The website was used by *Welmory* to offer its own products via individual auctions administered by the Cypriot entity, but it was possible to buy any such products only after acquiring the right from *Welmory Limited* to take part in auctions. The Cypriot company hired Polish staff to manage the website and used *Welmory’s* technical infrastructure to this end. *Welmory* did not pay VAT for the services provided to the Cypriot company, claiming that the services in question were subject to taxation in the place of establishment of its customer (i.e. the Cypriot company). The CJUE has made some important points in its judgement:

- a) the main criterion to be first taken into consideration when determining the place of taxation in B2B relationships is the place of establishment of the customer (no rational reason for taxation in the country of establishment should lead to a search for a FE),

²³ Cf. interpretation of the Director of the National Revenue Information of 23 May 2018, 0111-KDIB3-1.4012.121.2018.3.IK, regarding debt handling.

- b) in order for the Cypriot company to be considered having a FE, it should have a structure characterised by a sufficient degree of permanence in terms of the human and technical resources at its disposal (such as IT equipment, servers, relevant software) in Poland, enabling it to receive and use the services supplied to it by the Polish company – meaning the management of a given system of electronic auctions and generation and sale of ‘bids’ – for its own needs.
- c) it is possible to have a FE established in a country where the customer does not have own technical or human resources at their disposal.

Considering the above in the context of digital business, it is important to notice that the CJEU has clearly addressed the issue of location of the infrastructure related to the services purchased in Poland (according to the Polish company, the human and technical resources for the business carried on by the Cypriot company, such as computer servers, software, servicing and the system for concluding contracts with consumers and receiving income from them, are situated outside Polish territory). According to the court, if the said circumstances had turned out to be true, the national court would have had to conclude that the Cypriot company did not have a FE in Poland as it had no relevant infrastructure in Poland.

The question of in which country the obligation to pay the tax arises remains open. Is it the country of establishment of the Cypriot company, or the country where the equipment necessary to run digital activity is located? Unfortunately, neither the Polish nor the EU regulations provide an answer to the said question. How to deal with a situation where the resources used to conduct business activity are distributed across several countries? Is there a FE in each of the said countries? Such an approach seems to be detached from the nature of business, although it is seen in the area of such a common domain as warehousing. In both cases, in the era of the freedom of movement of goods and digitalisation, a seller may take advantage of resources from many countries. Claiming that the equipment essential to one’s business activity and located in a foreign country (e.g. a server making it possible to rent CPU processing power) or subcontractors working on a project basis (a software engineer, a developer, a bitcoin digger) contribute to the establishment of a FE may unreasonably complicate VAT settlements between entrepreneurs. But, following the line of thought of tax authorities, is it not a Polish software engineer who creates a solution sold later on by a foreign company? And if the solution is designed for Polish users? The combined foundations of an activity conducted in Poland and a FE of a foreign company are already taking form, laid by the said software engineer. But the digital world is not that simple. Apart from Polish software engineers there are also software testers, developers, project coordinators or

sales specialists. Each of such subcontractors may be based in a different country. The data storage devices where the “created” solutions are stored may be located in yet another place. How to identify the place where a foreign company purchasing some services makes use of these services? What should determine the ability of identifying a FE? A return to the principle of the customer’s place of establishment seems to be natural and reasonable. But the question is if tax authorities find it just as reasonable when it comes to dealing with the matter in question.

Final remarks

A FE being established is a result of a series of certain specific business operations of a taxpayer. Given such indefinite circumstances governing the notion of FE, running a business based on foreign resources should be meticulously analysed as to its tax-related consequences. Cross-border business models should be secured accordingly (by e.g. an own tax interpretation) if possible. Incorrect taxation is certainly not what entrepreneurs welcome, and the knowledge regarding correct settlements – especially in the area of VAT – makes conducting business comfortable and is, in principle, financially neutral (provided that foreign customers do not give up working with Polish taxpayers who are suggested by the Polish tax authorities to charge VAT on their services).

It is important to bear in mind one more thing. The problems regarding taxation of digital business activity are currently most visible in the domain of income taxes, and there are plans to obligate companies to pay the tax (bearing actually some hallmarks of an indirect consumption tax, like VAT) in the place where “businesses have significant interaction with users through digital channels.” The solution is to be an answer to the problem of global concerns addressing their content to consumers from particular countries of the world actually avoiding paying income tax, but it does show that the issues underlying the increasing digitalisation of business are noticed – although not necessarily in the domain of VAT directly.

How long will VAT in the digital world remain a *terra incognita*? One can hope that the discussion on FE in other sectors of economy stabilises (rationalises) the approach to the matter in question without engaging the entire digital economy sector in an ongoing crossfire of arguments.