The Fixed Establishment and the Welmory Case

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There is still an active debate on which should be the primary proxy in establishing the tax reference point, especially when looking at consumption taxes, such as VAT.

The latest attempt by the European Commission to discuss this matter was in 2010[1]. The common VAT system applicable in the EU exists under the objective to realise an internal market. Yet, there are various theories as to what constitutes a fair distribution of taxing rights, some based on pure philosophical arguments, such as ethical behaviour of the individual (i.e. the individual has a moral duty to pay tax to the state that provides him with general benefits), and others based on state sovereignty arguments (i.e. the state has a right to exist and should therefore levy taxes through a legal framework in order to secure its existence). It is within this basis, that the *Fixed Establishment* (FE) concept arises.

The VAT Directive[2] today makes reference to four types of establishments:

1. the place where the business is established;
2. the FE;
3. the permanent address; and
4. the place of usual residence.

The last two types of establishments are only used in the case where the first two are not found. There are no decisions of the ECJ that discuss these last two types of establishments. The former two however, the business establishment and the FE, are hugely important in determining the reference point of taxation of services.

The FE was only recently defined in law, consolidating the relevant case-law of the European Court of Justice ("ECJ"), in the Implementing Regulation[3]. Therein, the FE requires that:

i. it has permanence; *and*
ii. it has human resources; *and*
iii. it has technical resources; *and*
iv. it either receives and uses services (the *receiving* FE); *and/or*

[1] On 1 December 2010, the European Commission issued its 'Green Paper on the future of VAT. Towards a simpler, more robust and efficient VAT system', prompting a public debate on the future of VAT.
[2] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ 2006, L 347/1
[3] 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 tax, OJ 2011, L 77/1, as amended

v. it supplies services (the *supplying* FE).

The FE concept was a focal point in the fairly recent ECJ case of *Welmory*[4].

Welmory Ltd was a company established in Cyprus ("Welmory") whereas Welmory sp. Z o.o. was a company established in Poland (the "Polish company"). Welmory entered into a collaboration agreement with the Polish company whereby Welmory offered the Polish company a service, being the use of an internet auction site, together with associated ancillary services relating to the leasing of servers needed for the site to function. The Polish company principally sold goods on the site. Welmory however made use of the technical equipment and human resources of the Polish company in running the website.

The selling procedure involved on-line customers firstly having to purchase a number of 'bids' from Welmory directly, which then entitled them to place a bid on an auction, which was organized by the Polish company. Customers firstly acquired the 'right to each bid' by purchasing 'bids' from Welmory. If customers, by placing the highest bid, were then successful in an auction, they would then pay the Polish company to acquire the actual goods, which typically were sold below their market price.

Welmory however would also pay the Polish company a part of the 'bids' that it sold, as part of the cooperation agreement. The Polish company also supplied services to Welmory (advertising, servicing, provision of information and data processing), which it considered followed the basic B2B rule of supply, meaning that no Polish VAT would be charged on the invoice and Welmory would apply reverse charges.

The Polish VAT Authorities considered that Welmory maintained an FE in Poland, to which the Polish company supplied its services, and that the arrangements between the two companies "formed an economic whole". The Polish company challenged this decision, with the Supreme Administrative Court of Poland finally requesting clarifications from the ECJ over the interpretation of Article 44 of the VAT Directive.

The ECJ firstly considered the point of reference for determining the place of supply, for tax purposes. It deemed this an important question. It explained that the purpose of determining the point of reference in general was to avoid conflicts of jurisdiction, which may result in double or non-taxation. It noted, as had Advocate General to the ECJ, Juliane Kokott in her opinion, that Article 44 had a primary point of reference, being the place where the taxable person, as recipient of the service, has established his business.

This serves best the requirement for legal certainty. The court noted that only if that place of business did not lead to a rational result, or if it created a conflict with another Member State, that another establishment should come under consideration.

The court also noted that the place of business was mentioned in the first sentence of Article 44 and therefore constituted the general rule, being objective, simple and practical

[4] ECJ, C-605/12, 16.10.2014, *Welmory sp. z o.o. v Dyrektor Izby Skarbowej w Gdańsku.*

and easier to verify than the existence of an FE. The FE, however, was mentioned in the following sentence, introduced by the adverb 'however', and could only therefore be understood as creating an exception to the general rule.

In addressing the question of the existence of an FE, the ECJ, unsurprisingly concluded that it was irrelevant whether the activities of the two companies formed an economic whole. In order for Welmory to have an FE in Poland, it should have a sufficient degree of permanence, suitable in terms of human and technical resources, to enable it to receive in Poland the services supplied to it by the Polish company and to use them for its business, namely running the electronic auction system in question and issuing and selling 'bids'.

In addressing this, the ECJ clarified that the services supplied and invoiced by the Polish company to Welmory, must be distinguished from those supplied by the Cypriot company to the Polish consumers – they are distinct supplies of services which are subject to different schemes of VAT.

The ECJ noted that it was not in a position to provide a definitive answer to whether Welmory maintained a Polish FE or not. It did however refer to the documents before it, wherein the Polish company maintained that the infrastructure it made available to Welmory, does not enable Welmory to receive and use for its business the services supplied to it by the Polish company. In fact, the Polish company claimed that the human and technical resources for the business carried on by the Cyprus company, including servers, software, servicing and the system for concluding contracts with consumers and receiving income from them, were all situated outside Polish territory.

The ECJ concluded that the national court should examine the FE question, but stated that if the representations made by the Polish company were factually correct, then Welmory could not have an FE in Poland.

This conclusion, although not stated explicitly, potentially implies that the human and technical resources do not need to be owned by Welmory, and could be owned by the supplier, in this case, the Polish company. If this holds, this would have far-reaching implications for *receiving* FEs. It is also unclear whether such a broadening of the FE definition could also apply to a *supplying* FEs.

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About the Author

Alexis Tsielepis is a Fellow of the Institute of Chartered Accountants in England and Wales (ICAEW) and a member of the Institute of Certified Public Accountants of Cyprus (ICPAC).

He sits on various committees charged with VAT and other tax matters and has authored a number of tax syllabuses. He lectures extensively on VAT and Cyprus taxation and has authored a number of related articles on matters pertaining to Cyprus and EU tax.

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