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Dong Yang Electronics (Case C-547/18): Oh Yes, a Subsidiary Can (also) Be a Fixed Establishment under EU VAT, but Information Asymmetries May Save You!

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A subsidiary can (also) be a fixed establishment (FE) of its parent company under European (EU) VAT, after all. This is the most immediate conclusion as it emerges from the much-awaited decision by the Court of Justice of the European Union (CJEU) in *Dong Yang Electronics* (Case C-547/18). With its ruling on 7 May 2020, the CJEU quite unexpectedly revamped its nearly buried case-law in *DFDS* (Case C-260/95), where the Court had found that a subsidiary can indeed constitute a FE of the parent company in so far as the former acts as a "mere auxiliary organ" of the latter.

Thus, the EU judiciary (with all due respect to her) "threw a punch" at Advocate General (AG) Kokott, who, in her conclusions released on 14 November 2019 and that the author had the chance to briefly comment on this blog, has raised a series of "fundamental reservations" (paras 37-46), plus further considerations (paras 47-67), against the possibility to recharacterize, by means of an *ex-post* assessment, a legally separate entity like a subsidiary as a FE "in disguise" of its parent company. It is particularly remarkable that the principle of legal certainty, which AG Kokott had mentioned at every turn in her opinion, has never been recalled by the CJEU in its decision, whose findings instead pay consideration to "economic and commercial realities" as a "fundamental criterion for the application of the common system of VAT" (para. 31).

Beside the one mentioned above, various other interesting findings as well as some (re)open(ed) questions might be traced in the folds of the decision at comment. But let's proceed in due order and briefly expose the facts and questions of the case.

Background

The factual background of the request for a preliminary ruling is that a South Korean company (LG Display Korea) concluded a contract with a third-party Polish company (Dong Yang Electronics) for the supply of services consisting in the assembly of printed circuit boards (PCB) from materials and components owned by LG Display Korea, which were imported from outside the EU and provided to the supplier of PCB assembly services by a Polish (not clear if fully owned) subsidiary of the South Korean parent company (LG Display Poland). The PCB as assembled by Dong Yang Electronics were then supplied back to LG Display Poland, which, after processing them further on the basis of another contract with the parent company LG Display Korea, yielded the products (not

entirely clear if the property thereof was also relinquished by LG Display Korea) to another company part of the LG Display group, i.e. LG Display Germany, which proceeded to marketize them across the EU.

Dong Yang Electronics invoiced the PCB assembly services to LG Display Korea, treating those services as a B2B transaction not subject to EU VAT pursuant to the destination principle as followed in Article 44 of the VAT Directive (VD), being the place of supply in the case at hand outside the jurisdictional reach of EU VAT (i.e. in South Korea, where the business customer LG Display Korea was established).

The Polish tax authorities, however, took an opposite stance. Notwithstanding the parent LG Display Korea and its subsidiary LG Display Poland had separate VAT identification numbers and despite the latter was a legally separate entity and had its own means of production, the Polish tax administration claimed VAT on the relevant transaction, on the ground that Dong Yang Electronics had in fact supplied PCB assembly services in Poland, in as much as the subsidiary LG Display Poland constituted a FE "in disguise" of the parent LG Display Korea. As recalled in both the application file and AG Kokott's conclusions, the Polish tax authorities notably argued that the Korean parent company had created a FE in Poland by "exploiting the economic potential" of its subsidiary thanks to the contractual relationships which it had established. It was not sufficient – this was the Polish tax administration's line of arguments (aside note: essentially, the very same contestation raised by the Polish tax authorities in *Welmory* (Case C-605/12)) – the simple assurance statement made by the customer LG Display Korea to the supplier Dong Yang Electronics that it did not have a FE in Poland as neither staff was employed, nor immovable property and technical resources were possessed therein. Rather, the supplier should have examined the use of its services as required by Article 22 of Implementing Regulation No. 282/2011 (IR); had it done so, it would have concluded that the actual beneficiary of the assembly services provided was, in fact, the structure in Poland where the subsidiary LG Display Poland was based.

The findings of the Polish tax authorities contained in the assessment notice were challenged by the applicant Dong Yang Electronics, which contended that the requirements for the existence of FE were not actually met in the case at hand and that, in any event, as a third party it was impossible for the supplier to have actual knowledge of the cooperation agreements between the parent company and the subsidiary, resulting in the latter being a FE "in disguise" of the former.

This is, in summary, the gist of the subject matter referred to the CJEU.

Fixed Establishment through a Parent-Subsidiary Relationship

As recalled, it is not the first time that the CJEU has to deal with the issue of whether a parent-subsidiary relationship can give rise to a FE establishment in a Member State other than where a legal entity is established. Most extensive considerations in this regard can be found in *DFDS* (Case C-260/95, para. 29), where the Court concluded that a company, which acts a mere auxiliary organ of another, has the human and technical resources of a FE.

Two orders of reasons in particular led the CJEU to overstep the legal personality and, thus, the formal independence of the two companies in that case, namely: 1) the fact that the subsidiary was wholly owned by the parent company, and 2) the consideration of the contractual obligations imposed on the subsidiary by its parent, based on which, *inter alia*, the subsidiary was not

authorized to enter into any contractual arrangements with third parties without the parent company's prior consent (para. 26 of the *DFDS* decision).

Nevertheless, the CJEU's case-law shows a progressive distancing from the *DFDS* decision. Most notably, in *Daimler and Widex* (Joined Cases C-318/11 and C-319/11) the Court annotated that (even) "a wholly-owned subsidiary … is a taxable person on its own account", and the EU judiciary further recalled that, in *DFDS*, the formal independent "status of the subsidiary was disregarded in favour of the commercial reality only to ascertain which of the parent company and the subsidiary had actually carried out the active taxable transactions of supplies and, subsequently, which was the Member State of taxation for those transactions" (respectively, paras 48 and 49 of the *Daimler and Widex* decision).

In *Welmory* (Case C-605/12, para. 36), AG Kokott reasoned that "a legal person with its own legal personality cannot at the same time be the fixed establishment of a different legal person" and, further, that the *DFDS* decision was not "capable of general application" as it concerned the EU VAT's special scheme for tour operators (arts 306-310 VD) – two statements that the same Advocate General eventually reiterated, aside from further considerations, in her conclusions in the case at comment (respectively, paras 37 and 61 of AG Kokott's opinion in *Dong Yang Electronics*).

A qualified opinion against the actual validity and general application of the CJEU's findings in *DFDS* – essentially, recalling the exceptional nature of the facts underlying that case – were also expressed by the VAT Expert Group (VEG) in Working Document No. 48 published in 2015.

Tax scholars have not been silent on this matter either. Terra & Kajus, for instance, consider that "the *DFDS* decision only applies in very specific circumstances" **[1]**, whereas Merkx points her finger to the competition law (mis)guided reasonings apparently adopted by the CJEU in *DFDS* (indeed, competition law principles were expressly referred to by AG La Pergola's opinion in that case) and she recalls that, should the abuse of law doctrine have already been developed at that time, the CJEU "might have decided otherwise" **[2]**. Essentially, the same reasonings are also recalled by Spies, who warns that "the *DFDS* ruling should not be overestimated" **[3]**.

DFDS Is (Surprisingly) Still Alive

Rather than considering *DFDS* as a dead alley, the CJEU in *Dong Yang Electronics* eventually mentioned it and showed to adhere to its reasonings, stipulating that "it is possible that a subsidiary constitutes the fixed establishment of its parent company" (para. 32).

More in detail, the learned judges argued – in *overt* contrast with AG Kokott's opinion on this point (*see*, in particular, para. 29 of AG Kokott's opinion in *Dong Yang Electronics*) – that "the treatment of an establishment as a fixed establishment cannot depend solely on the legal status of the entity concerned", in so far as "consideration of economic and commercial realities form a fundamental criterion for the application of the common system of VAT" (para. 31) **[4]**.

In a nutshell, in the accounts of the CJEU, economic and commercial realities is a criterion that must prevail over legal and formal considerations in the application of EU VAT **[5]**.

The substance-over-form approach taken by the CJEU, however, risks undermining the principle of legal certainty (a principle much cherished by AG Kokott in her opinion in the case at comment), as in fact it is not straightforward how to proceed with the determination of a FE if the legal status

of an entity is, *per se*, irrelevant.

Reference to "the substantive conditions" composing the definition of FE under Article 11 IR (para. 32) is not of much help either, since the actual existence of elements such as "a sufficient degree of permanence" and "a suitable structure in terms of human and technical resources" to enable a FE "to receive and use the services supplied to it for its own needs" must be verified in concrete **[6]**.

Information Asymmetries in EU VAT

The CJEU's decisions in *Dong Yang Electronics* is, however, noticeable also from at least another perspective, which attains to the Court plainly acknowledging the existence of information asymmetries in the field of EU VAT **[7]**.

According to the CJEU, in fact, a supplier cannot be asked "to inquire into contractual relationships between the parent company and the subsidiary even though that information is in principle inaccessible to it" (para. 37). More in detail, the Court found that such an examination is a matter for tax authorities only, which therefore, as also reasoned by AG Kokott, cannot transfer their "investigative tasks" to the supplier, by imposing burdensome "due diligence obligations" on the latter in terms of "complex and far-reaching checks" (paras 72-73 of AG Kokott's opinion in *Dong Yang Electronics*).

It is true that Article 22 IR, in case the customer is established in more than one country (i.e., it has a least one FE), requires the supplier, in order to identify the FE to which the service is actually provided, to pay particular attention – in an hierarchical order, after having examined "the nature and use of the service provided" – to "the contract".

However, such a requirement "concerns the contract for the supply of services between the supplier and the taxable person constituting the customer and not the contractual relationships between that customer and an entity which could, depending on the case, be identified as its fixed establishment" (para. 36) **[8]**.

Accordingly, the Court concluded that "Article 22 [IR] … does not show that the supplier of the services concerned is required to examine contractual relationships between a company established in a non-Member State and its subsidiary established in a Member State in order to determine whether the former has a fixed establishment in that Member State".

The Floodgates Are Open

The circumstance that, based on the CJEU's findings, the supplier/applicant would most likely succeed in the tax litigation proceedings before the referring Court should not be cheered too heartily.

In the author's opinion, it is particularly worrying the outright abandonment of the bright pattern relating to legal certainty traced by AG Kokott in favour of a not quite unknown but certainly unstable concept such as the criterion of economic and commercial realities, whose application was not even limited by the Court (again, another blow to AG Kokott) by the existence of abusive practices. It seems fairly easy to predict that tax litigations, as a result of tax authorities being more lenient to deem subsidiaries as FEs "in disguise" of their parent company, would raise (time to institutionalise the VAT Cross-Border Rulings (CBR) pilot project?).

Acknowledgment of tax asymmetries in EU VAT is an important point in favour of legal certainty (and the taxpayer relying on it) but, unfortunately, by itself it is an insufficient safeguard. In this regard, it worries that the Court has offered the supplier this sort of safe harbour in case information relating to contractual relationships between the parent company and the subsidiary is *in principle* – if we understand it correctly, meaning "not always" (!) – inaccessible to that party **[9]**. This is especially true, given that Article 22 IR requires the supplier, as a very first step in identifying the FE to which the service is supplied, to examine "the nature and the use of the service provided", while, only as a second step, VAT legislation enables the supplier to take account of, *inter alia*, "the contract" **[10]**.

Then, *rien ne va plus*? Not really. From its historical development, the FE has always been a moving (at times ahead and sometimes backward) concept (even in a literal sense, since the first case *Berkholz* (Case C-168/84) indeed concerned whether a FE might be found on a ferryboat) and it would certainly need further considerations in the future, a task which at least both the CJEU and the VEG – not certainly by chance – have high on their respective agendas **[11]**. Stay tuned.

[1] *See* B.J.M. Terra & J. Kajus, *Introduction to European VAT* (IBFD 2020), at para. 11.4.3.1., who recall that, from its case-law, it emerges how the CJEU is generally reluctant to find an establishment (i.e., a FE) other than the main establishment of a taxable person, being the latter the primary point of reference for determining the place of supply. *See also* A. Parolini & A. Rottoli, *The Role of the "Rationality Test" in Attributing Supplies of Service to Fixed Establishments – A Critical Approach to Case C-605/12 (*Welmory*)*, 5 World Journal of VAT/GST Law 1 (2016), at p. 3, who submit that, based on the CJEU's findings in *DFDS*, "it can be inferred that the place where an undertaking has established its business does not lead to a rational result when it does not reflect the VAT regime that should have been applied if one looks to the place of actual consumption".

[2] M.M.W.D. Merkx, *Establishments in European VAT* (EUCOTAX Series on European Taxation No. 39 – Kluwer Law International, 2013), at p. 80, as reiterated later in M.M.W.D. Merkx, *Fixed Establishments in European Value Added Tax: Base Erosion and Profit Shifting's Side Effects?*, 26 EC Tax Review 1 (2017), at p. 41. *See also* M.L. Schippers & J.M.B. Boender, *VAT and Fixed Establishments: Mysteries Solved?*, 43 Intertax 11 (2015), at p. 717, who confidently submit (too much, as shown by the case at comment) that *Daimler and Widex* cases suggest that "a situation such as that of *DFDS* will not reoccur in practice".

[3] K. Spies, *Permanent Establishment in Value Added Tax* (IBFD 2020), at para. 4.2.5.4.3. Such a view is equally shared by other scholars. *See*, in particular, G.-J. van Norden, *The Allocation of Taxing Rights to Fixed Establishments in European VAT Legislation in VAT in an EU and International Perspective: Essays in honour of Han Kogels* (H.P.A.M. van Arendonk, S.B.C.J. Jansen & R.N.G. van der Paardt eds., IBFD 2011), at para. 3.2., and M.E. van Hilten, *Vaste inrichting en BTW: (on)zelfstandig en niet onafhankelijk*, Weekblad voor fiscaal recht 6262 (1997), at p. 1374.

[4] Such a reasonings might have further been reinforced by the circumstance that, in the case at

hand, based on a reservation filed by Poland to the Free Trade Agreement (FTA) (2010) between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part, undertakings incorporated under South Korean law are precluded from directly conducting their economic activity in Poland but a Polish company must be created instead.

[5] *See*, in this regard, A. Charlet & D. Koulouri, *Relations between Head Offices and Permanent Establishments: VAT/GST v. Direct Taxation: The Two Faces of Janus in Value Added Tax and Direct Taxation: Similarities and Differences* (M. Lang, P. Melz & E. Kristoffersson eds., IBFD 2009), at para. 1.2.2., who, from an insightful comparison of the CJEU's decisions in *FCE Bank* (Case C-210/04) and *DFDS* (Case C-260/95) – but I would add to the list also *Skandia America (USA)* (Case C-7/13), which was decided later, posit that the CJEU "prefers an approach somewhere between the 'legal analysis' and the 'economic analysis' approach when dealing with inter-branch transactions from a VAT point of view".

[6] As wittingly noted by R. Mikutienė, *The Preferred Treatment of the Fixed Establishment in European VAT*, 4 World Journal of VAT/GST Law 3 (2014), at p. 171, (also) in *DFDS* (Case C-260/95) "the CJEU did not indicate which functions performed by the subsidiary were vital in deciding on the existence of … [a] fixed establishment" in another Member State.

[7] On information asymmetries in the field of EU VAT, *see*, more extensively, F.J.G. Nellen, *Information Asymmetries in EU VAT* (EUCOTAX Series on European Taxation No. 53 – Kluwer Law International 2017).

[8] *See also* AG Kokott's opinion in *Dong Yang Electronics* (C-547/18), considering that "Article 22(1) of the Implementing Regulation also does not refer to relationships under company law between undertakings receiving services, but rather refers only to the contractual relationship between the service provider and the service recipient. Thus, the contract and the order form are mentioned, for example, but commercial register extracts or the like are not".

[9] By way of example in this regard, consider the situation in which a subsidiary (i.e., the allegedly FE "in disguise") is involved in the material execution of the contract concluded by the parent company with a third-party supplier.

[10] The author agrees with those scholars (*see*, in particular, F.J.G. Nellen, *Information Asymmetries in EU VAT* (EUCOTAX Series on European Taxation No. 53 – Kluwer Law International 2017), at p. 331, and A. van Doesum, H. van Kesteren & G.-J. van Norden, *Fundamentals of EU VAT Law* (Kluwer Law International 2016), at pp. 355-356) who, in order to avoid information asymmetries from acting as a detriment to an unaware supplier, stipulate that contractual arrangements should be elevated to the starting point of the supplier's examination under Article 22 IR.

[11] *See*, in particular, CJEU's requests for a preliminary ruling in *Danske Bank* (Case C-812/19) and *Titanium* (Case C-931/19); VAT Expert Group, *VEG No. 091. Upgrading the EU VAT System – A Reflection on Possible Ways Forward Contribution of the VEG* (2020), at p. 25.

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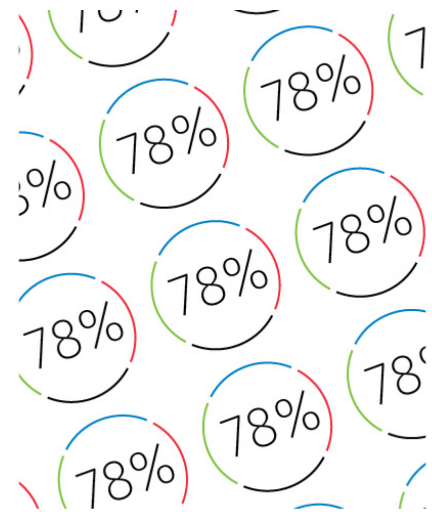

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