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Where is a person “established”?

Jonathan Schwarz (Temple Tax Chambers; King’s College London) · Monday, February 21st, 2022 · PVD article 44

Territorial connection (or its more fashionable name “nexus”) for tax purposes is expressed in a variety of ways in domestic and international legal instruments. Permanent establishment in article 5 of the Model treaties and “fixed base” in article 14 of the UN Model are central concepts in direct tax subject matter jurisdiction.

Fixed establishment

The related, but not identical VAT concept of “fixed establishment” in article 44 of the EU Principle VAT Directive 2006/112 (the PVD) and what it means to be “established in the territory of a Member state in article 11 of the PVD were considered in *HSBC Electronic Data Processing (Guangdong) Ltd and Others v Revenue and Customs* [2022] UKUT 41 (TCC) last week by the UK Upper Tribunal’s tax chamber. The case concerned whether certain companies could be included within a VAT group for purposes of article 11 of the PVD and section 43A of the UK Value Added Taxes Act 1992. Section 43A permits a company to be included if it is established or has a fixed establishment in the United Kingdom.

The group companies were incorporated outside the UK to undertake various back-office processes, such as payment processing and call centre functions and processes in lower cost jurisdictions as part of a business restructuring. Branches of the companies were registered with Companies House as branches of overseas companies for company law purposes. Employees were seconded to staff the UK branches and undertook roles such as collation of data and management information for the governance process, taking minutes and general administrative support. Secondees worked at various locations around the UK in the premises of the HSBC group and, in line with group policy, had desks through HSBC’s “hot desking” facility as well as computers and telephones and other equipment necessary to carry out their duties. The extent of the functions which are in fact carried out in the UK was disputed.

“Established in a Member State”

The CJEU has not adjudicated on the meaning of the expression “persons established in the territory of that Member State” in article 11 and HMRC argued that the expression should follow the case law on fixed establishment required:

- a real trading presence in the UK and must supply goods or services in its own right, those goods or services being neither preparatory or auxiliary, but material to the business of the person in

question,

- sufficient permanent resources to be able to supply those goods or services, and
- sufficient permanent resources to receive supplies needed to provide those goods or services.

The taxpayer argued that:

- article 11 referred to the persons within the group collectively and not to each person individually,
- if each member must be established in the UK, that means no more than the physical presence of a body corporate through its branch, for which registration under the Companies Acts is sufficient, or
- if section 43A of the UK VAT Act is to be interpreted as requiring a fixed establishment in the UK, the definition of that term found in the cases on place of supply must be modified (this is not a requirement of article 11 of the PVD).

The Tribunal held that each person separately must be established in the relevant territory. However, it noted that a person may be established in a territory without undertaking any economic activity there and, thus, without being a taxable person for VAT. Consequently, pure holding companies, for example, that do not themselves carry on any economic activity for VAT may satisfy be established in a Member State within article 11.

Branch

That observation might have led the Tribunal to accept the taxpayer's argument that "established" in article 11 ought not to be interpreted by "established in" and "fixed establishment" in the place of supply rules in article 44. Nonetheless, they rejected the argument that argued that company may be established in the UK merely by having a physical presence through a branch here, which may be demonstrated by the company law branch registration.

The meaning of "branch" itself is obscure and offers little assistance. Company law defines an "establishment" as a branch within the meaning of the Eleventh Company Directive, or a place of business that is not such a branch. The directive itself contains no definition A UK establishment is then defined as an establishment in the UK (See also *Schwarz on Tax Treaties* 6th ed Chapter 7, §7.07).

Place of supply rules

The Tribunal regarded the case law on the place of supply meaning of meaning of establishment and fixed establishment must be taken into account, even if those meanings are not imported into article 11. Furthermore, Articles 10 and 11 of the VAT Implementing Regulation 282/2011, which summarise the case law principles for place of supply purposes was considered to be a "helpful starting point" when read in the light of the CJEU case law.

Ultimately, the decision is frustrating because the Tribunal declined to give a meaning to the terms saying that "the precise meaning of the terms "established" and "fixed establishment" in any given case is highly fact sensitive, and better determined in the context of all the relevant circumstances in any given case." The decision was on preliminary issues only and the Tribunal considered it inappropriate to go further in such a decision. In my view that is an error. The preliminary issues are question of law which need to be decided. If they do not dispose of the case, then the law as

determined must be applied to the facts in light of the evidence.

Another difficulty in this case was viewing the choice as binary, that is between registration as a branch and the excessively expansive meaning of established contended for by HMRC. On the one hand, HMRC's contended meaning goes far beyond the CJEU case law on fixed establishment and conflates that term with permanent establishment in article 5 of the Model treaties. On the other hand, while mere registration may be insufficient, it would be necessary to go behind the level of presence that gave rise to the obligation to register as a branch of an overseas company.

Pension funds and tax treaties

Curiously, HMRC took the opposite position on the question whether the World Bank's retirement scheme was a pension scheme "established in" the United States for purposes of articles 3(1)(o) and 17(1)(b) of the UK-US tax treaty in *Macklin v Revenue And Customs* [2015] UKUT 39 (TCC). In that case, HMRC relied on legal formality and argued that "established in" refers to "being established under and in conformity with the relevant contracting state's tax legislation relating to pension schemes". The Upper Tribunal there ruled that "established in" refers to a pension scheme's physical location. This follows from the ordinary meaning of the expression. In that case, the World Bank pension scheme, which is governed by international law, was physically set up in the United States and fully administered there. On that meaning, the only question in the HSBC Electronic Data Processing case would be whether the degree of physical location is sufficient for the purposes of article 11 of the PVD.

For more on the establishment of pension funds see <http://kluwertaxblog.com/2015/04/08/employees-of-international-organisations-pensions-taxation/>, *Schwarz on Tax Treaties* 6th ed Chapter 6, §6.09.

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