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Indirect Tax Alert

Dutch Government releases decree on fixed establishments for VAT purposes

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Executive summary

The Dutch State Secretary of Finance issued on 17 December 2020 a new Decree providing guidance on various topics concerning fixed establishments for Dutch Value Added Tax (VAT) purposes, including:

- The VAT treatment of transactions between a head office and its fixed establishment where either one of them is part of a Dutch VAT group (Dutch view on the *Skandia* case, section 1).
- The introduction of a "purchase fixed establishment" (section 2).
- Details on how a service provider may identify which establishment of its customer it provides its services to. This is also relevant for VAT recovery purposes in the financial sector (section 3).
- Determining the entitlement to recover Dutch VAT on costs incurred by a Dutch fixed establishment or head office where these costs partially relate to foreign establishments of a taxpayer, with reference to the *Morgan Stanley* case (section 4).
- Other topics, including the force of attraction rules (i.e., when does the reverse charge mechanism apply) and the virtual warehousing rules for foreign taxpayers that have a fixed establishment in the Netherlands (in Dutch: *niet-plaatsgebonden entrepot*).

Building a better working world

The new Decree replaces the Decree that was released in 2002[1] and updates Dutch policy to include various developments in case law and European Union (EU) legislation since 2002.

Detailed discussion

Intra-entity transactions and VAT grouping – comments on the *Skandia* case

Following the FCE Bank ruling in 2006,[2] it is settled case law of the Court of Justice of the EU (CJEU) that transactions between different establishments of the same legal entity (head office, branches/fixed establishments) do not fall within the scope of VAT. However, the *Skandia* case overruled the FCE Bank principle for specific VAT grouping scenarios where the fixed establishment was part of a VAT group.

Therefore, the question arose whether the *Skandia*[3] judgment would also apply to the Dutch VAT grouping regime. Under the Dutch rules, a VAT group which includes a fixed establishment, also extends to the foreign head office. The Decree confirms that transactions between a head office and its fixed establishment, which is part of a Dutch VAT group, fall outside the scope of Dutch VAT due to the nature of the Dutch VAT grouping regime.[4] The same holds true for transactions by a fixed establishment in a foreign country to its head office if the head office is part of a Dutch VAT group.

The "introduction" of the purchase fixed establishment

Although purchase fixed establishments[5] have been codified in article 11 of the VAT Implementation Regulation since 2011, this concept has not been applied in practice in the Netherlands. The previous Decree on fixed establishments (which is replaced by this new Decree) explicitly stated that establishments that exclusively perform activities supporting their foreign head office did not qualify as fixed establishments for VAT purposes.[6]

The new Decree specifies that establishments that purchase goods and services for their own needs may qualify as purchase fixed establishments. We note that currently there is no clear guidance in EU legislation or case law as to whether the concept of a purchase fixed establishment should be construed broadly or narrowly. Therefore, it remains uncertain how the Dutch tax authorities will interpret the application of the rules to a purchase fixed establishment, especially with respect to the requirement that it purchases goods or services for its "own needs."

The introduction of purchase fixed establishments could have major implications for foreign businesses that have an establishment in the Netherlands which exclusively provides support services[7] for its head office. These establishments may, based on the new Decree, have to be VAT registered in the Netherlands in order to report VAT incurred on foreign purchases. Furthermore, the registration may result in the obligation to file Dutch VAT returns. The implications are illustrated in the following example.

Company A, established in country X, has an establishment in the Netherlands which provides support activities for the benefit of its head office. The Dutch establishment (PFE) procures services from Company B, which it receives and uses for its own needs. Before the introduction of a purchase fixed establishment, the services provided by Company B would – from a Dutch perspective – be taxable in country X.

Provided that the PFE receives and uses the services supplied to it for its own needs, the services will now be taxable in the Netherlands (instead of country X). If the service provider is not established in the Netherlands, the obligation to account for VAT will be shifted to the Dutch establishment under the reverse charge mechanism. Company A is thus obliged to VAT register in the Netherlands, even if it does not carry out any taxable supplies in the Netherlands.

Recovery of VAT for the supply of financial services to multiple-location entities

As a rule, VAT incurred on costs that are attributable to VAT-exempt financial and insurance services is not recoverable. However, VAT may be recovered if the recipient of the financial services is established outside the EU.

The new Decree confirms that, for the purposes of determining whether VAT attributable to exempt financial services is recoverable, articles 21 and 22 of the VAT Implementing Regulation[8] should be applied in order to identify the recipient's establishment to which the services are provided. Therefore, the service provider should consider information regarding the nature and use of the service, as well as the information in the agreements, purchase orders, the VAT number communicated by the recipient, as well as the location from which the payment is initiated. If the establishment receiving the service cannot be identified based on this information, the head office of the recipient is deemed to be the recipient for VAT recovery purposes (even if this head office is located outside of the EU).

VAT recovery for cross-border use of purchases (*Morgan Stanley* case)

Following the *Morgan Stanley* case,[9] the Decree outlines how partly exempt businesses established in the Netherlands (either a Dutch branch or a Dutch head office with foreign branches) should determine their entitlement to recover VAT. The rules have become more complex due to recent case law and may result in an additional or reduced VAT cost. These changes apply equally to the situation where a Netherlands-based taxpayer has fixed establishments outside the Netherlands.

VAT on purchases used exclusively by the fixed establishment

Where a fixed establishment incurs costs that only relate to its own activities, the entitlement to recover Dutch VAT on such costs is determined based on the activities of the fixed establishment only, similar to the VAT recovery position of a Dutch subsidiary.

VAT on purchases exclusively used by the head office

With respect to costs which are exclusively allocable to activities of the head office, the Decree provides that the Dutch fixed establishment is entitled to recover Dutch VAT on these costs in so far the right to deduct for those activities would have been granted under the rules applicable in both the EU Member State of the head office **and** in the Netherlands. This is in line with the *Morgan Stanley* case. The pro rata VAT recovery right of the head office should be taken into account, as well as the entitlement of the foreign EU head office to recover VAT incurred based on the Dutch VAT rules.

VAT on purchases used by both the head office and the fixed establishment

With respect to costs which are allocable to the activities of both the head office and the fixed establishment, the pro rata VAT recovery rate is determined on the basis of the turnover of both the fixed establishment and its head office. In the pro rata calculation all the taxable turnover of the fixed establishment should be taken into account. However, the taxable turnover of the head office in another EU Member State will only be regarded as taxable turnover where this turnover would be taxable under the Dutch rules as well.

Implications

This Decree provides clarification of the existing legislation and practice regarding fixed establishments. However, the introduction of the purchase fixed establishment may increase the administrative burden for foreign businesses which have an establishment in the Netherlands which is currently not registered for Dutch VAT purposes. For these establishments, businesses should analyze whether a purchase fixed establishment may exist and (if so) which services are provided to the Dutch establishment that are used for its own needs.

Furthermore, businesses that incur costs in the Netherlands which are (partly) attributable to activities of a foreign establishment, need to accurately allocate costs between the foreign and domestic establishment for VAT recovery purposes. Insofar that costs are (partially) allocable to a foreign establishment, VAT recovery is subject to a double test (i.e., the taxable turnover for the foreign establishment must qualify as taxable turnover from both the foreign and the Dutch perspective). It is important to note that the Decree is silent on the situation where the head office is established outside the EU. It is therefore assumed that the guidance in section 4 only applies to scenarios within the EU.

For Dutch fixed establishments that provide head office support services, even if just occasionally, the pro rata impact may be significant. A relatively small branch in the Netherlands that occasionally supports its foreign head office, may need to include the head office's total turnover in its Dutch pro rata calculation.

Endnotes

1. Decree of 8 October 2002, nr. DGB2002/5520M.
2. CJEU 23 March 2006, case C-210/04 (*FCE Bank plc.*), ECLI:EU:C:2006:196.
3. CJEU 17 September 2014, case C-7/13 (*Skandia America Corporation*), ECLI:EU:C:2014:311.
4. Decree of 17 December 2020, nr. 2020-25513, section 3.2.
5. A business establishment that does not act towards third parties, but merely supports its head office.
6. Decree of 8 October 2002, nr. DGB2002/5520M, section 2.
7. Such as administrative or technical back office services.
8. Council Implementation Regulation (EU) N 282/2011 of 15 March 2011.
9. CJEU 24 January 2019, case C-165/17 (*Morgan Stanley & Co International plc.*), ECLI:EU:C:2019:58.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Belastingadviseurs LLP, Indirect Tax

- Jeroen Bijl, *Amsterdam* jeroen.bijl@nl.ey.com
- Timo Bootsman, *Eindhoven* timo.bootsman@nl.ey.com
- Bas Breimer, *Amsterdam* bas.breimer@nl.ey.com
- Gijsbert Bulk, *Amsterdam* gijsbert.bulk@nl.ey.com
- Folkert Gaarlandt, *Amsterdam* folkert.gaarlandt@nl.ey.com
- Caspar Jansen, *Rotterdam* caspar.jansen@nl.ey.com
- Daniel Kroesen, *Rotterdam* daniel.kroesen@nl.ey.com
- Petra Pleunis, *Rotterdam* petra.pleunis@nl.ey.com
- Jeroen Scholten, *Amsterdam* jeroen.scholten@nl.ey.com
- Walter de Wit, *Amsterdam* walter.de.wit@nl.ey.com
- Remco van der Zwan, *Rotterdam* remco.van.der.zwan@nl.ey.com

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