

Romanian tax authorities revise position on whether a toll manufacturer creates fixed establishment for VAT purposes

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Executive summary

Since the beginning of 2019, a number of cases have been reported where, during Value Added Tax (VAT) audits, the Romanian tax authorities have taken the position that local toll manufacturing arrangements result in a foreign principal having a fixed establishment for VAT purposes in the European Union (EU) Member State of the toll manufacturer, i.e., Romania. Consequently, the Romanian toll manufacturer becomes liable to account for Romanian VAT on the manufacturing services provided to its foreign principal, resulting in the assessment of additional historic VAT liabilities and significant penalties by the Romanian tax authorities.

The tax authority's position appears to be based on the principles established in the European Court of Justice (ECJ) case of *Welmory* (C-605/12) and presumes that the principal is using the toll manufacturer's infrastructure in the furtherance of receiving taxable supplies for VAT purposes in Romania.

Detailed discussion

According to the EU VAT Implementing Regulation 282/2011, a taxable person has a fixed establishment for VAT purposes if a sufficient degree of permanence and human and technical resources enables it to receive and use services for its economic activities.

Based on the above, the Romanian tax authorities consider certain activities performed by Romanian toll manufacturers under common toll manufacturing arrangements sufficient to support that the principal utilizes the necessary human and technical resources to create a fixed establishment for VAT purposes in Romania. In particular, where the Romanian manufacturer provides not only manufacturing services but also auxiliary and administrative services (such as the reception and inspection of raw materials, storage of raw materials and finished products, inventory services, and coordination with the freight forwarder), the human and technical resources of the Romanian toll manufacturer performing said activities are deemed by the Romanian tax authorities to be attributable to the principal's business, thereby creating a fixed establishment for VAT purposes in Romania that enables it to receive and use the toll manufacturing services supplied for its business.

It is, however, not without question whether this interpretation is compatible with EU VAT provisions and the principles established by European case law regarding fixed establishments. Specifically, in light of the fact that the ECJ in the case of *Welmory* has not addressed a number of points which appear relevant here, not least the questions under which exact circumstances human and technical resources/ infrastructure of one business should be attributable to another business and thereby creating a fixed establishment for VAT purposes.

Implications

Based on the above, the Romanian tax authorities have assessed businesses significant additional VAT liabilities on tolling fees for historic VAT periods (subject to statutes of limitations) and associated penalties.

At this point, the most exposed operating models appear to be those where the principal has toll manufacturing agreements involving Romanian toll manufacturers, especially if these are affiliated parties. In Romania, such arrangements are very common in the automotive industry but all industries are potentially affected.

It remains to be seen, however, whether multinational organizations could more generally be affected in circumstances where arrangements in Romania involve the provision/receipt of taxable supplies which involve the utilization of assets or other resources of an affiliate or a third party located in Romania.

Further, it is not clear yet whether the recent developments could have potential knock-on effects on other Romanian taxes such as corporate income tax and permanent establishment risk (as witnessed previously in other Member States) and whether other Member States may follow the Romanian approach.

We are therefore closely monitoring developments.

Next steps

Any potentially affected business should therefore assess the possible implications of this recent change in the Romanian tax authorities' approach for its historic VAT position in Romania as well as how adverse VAT implications can be mitigated going forward. Accordingly, taxpayers should work with their local tax professional to:

- ▶ Review the contractual provisions and actual activities performed to determine exposure.
- ▶ Analyze the VAT treatment in Romania and in the principal's country of establishment to prepare defense files and mitigate the risk of double taxation.
- ▶ Request a non-binding ruling from the tax authorities.
- ▶ Review Romanian toll manufacturing arrangements and explore potential operating model changes to increase efficiencies for VAT purposes and address potential permanent establishment risks.

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