Memorandum on the Allocation of Taxing Rights on VAT in the EU: Research Issues in Light of the Precedents of the Court of Justice of the European Union in the Era of the Sixth Directive*

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Abstract

As a common predecessor to many VAT systems, we have referred frequently to VAT in the European Union (EU). It is natural that there are some aspects we should learn from and others we should not. Nevertheless, the position of VAT in the history of the EU is naturally shaped by the ideals pursued by the EU and its political context.

This paper focuses on the distribution of the right to levy VAT among EU member states. In doing so, this paper examines trends in the Court of Justice of the European Union (CJEU), which is one of the actors that implements Community law. By reviewing and organizing its precedents, especially those concerning fixed establishments and transactions between head offices and branches, this paper aims to enrich the ground for discussing the design of a VAT system for multinational enterprises. Specifically, we will observe how the CJEU has dealt with the major theme of the allocation of taxing rights.

Such work is not future-oriented, but rather retrospective, and thus does not bring any immediate recommendations into the context of Japanese law. However, we recognize several challenges in studying the taxation of VAT with respect to multinational enterprises. For example, questions such as which country has the primary right to tax cross-border corporations, or whether internal transactions among corporations can be considered from the VAT point of view, and so on. These questions highlight the need for research on the allocation of taxing rights across both income taxation and VAT.

Keywords: Value-added tax (VAT), European Union, International taxation, Allocation of taxing rights, Court of Justice of the European Union, Fixed establishment, Transactions between head offices and branches

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I. Prologue

I-1. Issues

Value-Added Tax (VAT) exists in many countries.[1] In Japan, it is known as the consumption tax (‘*shohizei*’). In designing Japan’s consumption tax system and interpreting the Consumption Tax Act, it is common to refer to the VAT of the European Union (EU), hereafter referred to as “EU VAT,” as a predecessor in this domain.[2] Of course, there are aspects to learn from and aspects to avoid learning from the EU VAT system and case law of the Court of Justice of the European Union (CJEU).[3] For example, a judgment on artificially creating input tax deductions (*Halifax* Case[4]) has been introduced in Japan.[5] However, to understand this judgment correctly, it is necessary to have knowledge of the institutional structure of EU VAT and the values it pursues.[6]

The February 2022 invasion of Ukraine by Russia reminded European countries of the importance of solidarity in confronting military threats. Post-war Europe has strived to establish an environment that prevents a repeat of the tragedies of World War II.[7] European integration was a step in that direction, but political integration proved challenging in the short term. In 1957, the Treaty of Rome[8] established the European Economic Community (EEC), which adopted the Common Market.[9] However, turnover tax issues posed a barrier to this integration. Fragmented and cumulative turnover taxes within the region conflicted with the ideals of market integration.

Articles 95 to 97 of the Treaty of Rome required member states to maintain appropriate levels of border tax adjustments, including complementary taxes on imports and rebates on exports. Furthermore, Article 99 of the Treaty mandated the European Commission to consider methods of harmonizing turnover taxes and other indirect taxes to support the Common Market.[10] According to Antal (1963), pp. 42-44, the turnover tax systems in the six EEC member countries[11] were inconsistent regarding tax rates and exemptions. France was the only country employing a non-cumulative system. While VAT had some advantages, in-

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[1] OECD (2022), Section 1.3.1.

[2] For example, see Hayashi (2020). For a general overview primarily from a practical perspective, *see* Mizoguchi (2020).

[3] Hereafter, the abbreviation “CJEU” is used consistently, regardless of any period.

[4] Judgment of the Court (Grand Chamber) of 21 February 2006, Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investment Ltd v. Commissioners of Customs & Excise, ECLI:EC:C:2006:121.

[5] Honbu (2020), p. 16; Matsuda (2007), pp. 110 ff.; Imamura (2008), p. 34. Additionally, Morinobu (2016), p. 15, highlights the Halifax case as a precedent establishing jurisprudence on tax avoidance in VAT, which Japan’s lawyers should also refer to.

[6] In Japan, this judgment has been introduced and discussed in the context of tax avoidance because it addresses whether “abusive practices” can form the basis for applying EU law (see the articles in the previous references). However, it also involves various issues, such as the values emphasized in the development of EU VAT and the scope of CJEU intervention in EU VAT.

[7] Essers (2022), pp. 380-383.

[8] Treaty establishing the European Economic Community (Rome, 25 March 1957).

[9] The so-called Spaak Report (“Rapport des chefs de délégation aux Ministres des Affaires Etrangères,” Brussels, 21 April 1956) played a significant role in the development of the Common Market concept.

[10] Konishi (2020), p. 113. These provisions of the Treaty of Rome suggest that the EEC envisioned a destination-based tax system.

[11] Luxembourg, the Netherlands, Germany, Belgium, France, and Italy.

cluding France's capability to calculate export refunds accurately, it was not the only option from a neutrality perspective.[12]

The pivotal historical event occurred in April 1967 when the EC Council adopted two VAT Directives[13], establishing VAT as the common turnover tax.[14] The political process leading up to this project was complex and not fully accessible from the author's perspective. However, for Japanese legal scholars who study EU VAT law from the viewpoint of comparative law, understanding such a political background is indispensable.[15]

This paper examines the issue of allocating VAT taxation rights within the European community. This issue concerns designing the system of taxation for cross-border economic activities, which is an unavoidable question when describing the nature of EU VAT. The technical question of where VAT should be levied on economic activities across borders translates into determining the "place of supply" and concretely implementing border tax adjustments. Income tax allocation among countries is typically bilateral, achieved through tax treaties. By contrast, VAT allocation is defined unilaterally, with countries establishing their place of supply rules to eliminate double taxation.[16] This unilateral approach often leads to discrepancies between rules among countries. But the EU is a major exception[17]; there, rules about the place of supply are unified under Community law.[18]

This paper describes aspects of this regulation using the decisions of the CJEU, which has played a significant role as the enforcer of the EU's legal system, as its basis.[19] The author's intent is not to argue whether Japan should adopt or ignore these precedents, but rather to observe the internal development of case law in order to enrich the discussion in Japan. As such, this paper is retrospective rather than forward-looking.

The author has learned many fundamental aspects of VAT from Schenk et al. (2015); therefore, the author may be unconsciously influenced by that framework in the work presented. This is noted in advance. Additionally, regarding secondary sources, Masui (2017) provides extensive data which has been referenced in this paper. Furthermore, please note that the main aim of this article is to enrich the foundation for VAT research in Japan, and therefore its primary objective is to introduce the current situation regarding EU VAT to Japan. Therefore, it is not a comprehensive and detailed study on EU VAT.

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[12] Antal (1963), pp. 50-51. He argued that harmonization should aim to make turnover taxes neutral, meaning that the final price of goods and services would reflect a uniform turnover tax rate.

[13] First Council Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (67/227/EEC), OJ 71, 14.4.1967, p. 1301, and Second Council Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (67/228/EEC), OJ 71, 14.4.1967, p. 1303 [hereinafter referred to as the "*Second Directive*"].

[14] *Second Directive*, Article 1.

[15] Konishi (2018) provides a historical account of these political processes and offers valuable insights. *See also* de la Feria (2010).

[16] In Japan, see Article 4, Paragraph 3 of the Consumption Tax Act and Article 6 of the related Enforcement Order.

[17] Spies (2017), p. 705.

[18] Place of supply rules can broadly be considered as conflict-of-law rules. In this sense, the EU's efforts resemble attempts to create universal conflict-of-law principles, while leaving substantive laws to individual countries. *See* Egawa (1970), pp. 10-12.

[19] The role of non-binding norms (soft law) in shaping the EU VAT system should not be overlooked. *See* Lamensch (2016) for further details. However, this paper focuses on an analysis of CJEU case law.

I-2. Structure of this Paper

First, this paper provides an overview of the expansion of EU VAT (Section II). Next, it discusses the advantages and disadvantages of the destination-based VAT model as an idealized framework (Section III). Building on these preparatory discussions, the paper analyzes the development of EU-VAT case law (Section IV). The paper's primary focus is on the place of supply rules during the Sixth Directive era, but its scope also extends to VAT in intercompany transactions between headquarters and branches, which represents another critical pillar of tax jurisdiction allocation. The paper concludes with a final discussion (Section V).

II. Expansion of EU VAT

II-1. Summary of this Chapter

This chapter provides an overview of the historical expansion of the EU VAT. In particular, the author focuses on two topics: first, the establishment of VAT in France, and second, the adoption of VAT as a common turnover tax within the European community.

II-2. France

What is "value added?" According to Mizuno (1989), a pioneering study on VAT in Japan, it is "the value added by a business to goods and services purchased from other businesses, calculated as the total of wages, interest, and profits expended on the production factors of labor, land, and capital."[20] An idea of tax on value-added in this sense existed for a long time. For instance, in the United States, public finance scholar Adams proposed the concept of a "tax on 'approximate net income'" in the early 20th century as a substitute for income tax.[21]

However, what we tend to imagine as the origin of VAT in the EU is *Taxe sur la Valeur Ajoutée* (TVA) in France. This tax not only used value-added as the tax base, but also adopted the form of a turnover tax and features a mechanism where the tax paid in prior stages is deducted, resulting in the tax base being value-added.[22, 23] Carl Shoup described France as an "innovator in taxation," and one of its innovations was VAT.[24]

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[20] Mizuno (1989), p. 4.
[21] Adams (1921), p. 553. Mizuno (1989), pp. 17-23, introduces Adams' idea in Japanese.
[22] According to a great scholar in Japan, Hiroshi Kaneko, there are two types of VAT: the turnover tax model, and the income-type tax model. The latter was exemplified in the First Report of the Shoup Mission (Kaneko, 2010, p. 405; originally published in 1970). The necessity of paying attention to the distinction between these two types was suggested by Hiroyuki Kohyama (Professor, University of Tokyo) during the planning phase of this paper.
[23] Japan's current consumption tax also incorporates input tax deductions as a standard feature (Consumption Tax Act, Article 30). However, the Supreme Court admitted cases where the cascading effect inherent in turnover taxes is not completely eliminated. *See* Supreme Court Decision, March 6, 2023, Supreme Court Reports (*Minshu*), Vol. 77, No. 3, p. 440. The author has also written a brief commentary on this decision (Fujiwara, 2024a).
[24] Shoup (1955), p. 328.

In France, taxes based on sales and turnover were introduced around 1920 to repay wartime debts from World War I.[25] However, these taxes inherently caused cascading effects. Subsequently, a production tax, *taxe à la production*, was introduced in 1936, which taxed goods once during their transition from the production to the distribution stage (*taxe unique*). The production tax already shared certain features with TVA.[26] For example, it was a general ad valorem tax imposed on businesses based on the value they created during the production process. Additionally, with the introduction of a split payment system (*le système du fractionnement*) by the Decree of September 25, 1948, producers could deduct the portion of production tax paid on inputs physically incorporated into final products. However, inputs not physically incorporated into products were not deductible, and providers of intangible services remained subject to multi-stage cascading taxes, raising concerns about neutrality. Maurice Lauré is said to have conceived TVA based on this production tax.[27] As such, the superiority of TVA was promoted from the perspective of economic neutrality.

II-3. Expansion in Europe

Regarding the establishment of European VAT, we must rely heavily on historical studies such as Konishi (2018) and Konishi (2020).[28] Summarizing her studies, the process involved complex political considerations among member states (e.g., France advocating for destination-based taxation and West Germany for origin-based taxation, leading to fierce debates over the necessity of border tax adjustments) and issues related to the competence of Directorate-General IV of the European Commission, which took the initiative on this topic. In any case, the adoption of the French-style VAT as the European VAT was far from a straightforward process. Legal scholars have much to learn from historians about this trajectory.

III. Destination-Based Taxation as a Conceptual Model

III-1. General Discussion

For cross-border transactions, the question of where VAT should be imposed has been framed as a dichotomy between two conceptual models: destination-based taxation and origin-based taxation. Simply put, the former taxes at the location where the demand for the service exists, while the latter taxes at the location where the service originates.[29] For corporate

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[25] Ibid.

[26] The following description owes much to Bouchet, Habibou & Joseph (2014), especially part of "1. Rappel historique."

[27] As prior studies, Salo (2014); Takao (1979).

[28] An abbreviated version of Konishi (2018) is available under the title "*Why Did the European Community Adopt the Common VAT System?*" by Anna Konishi, presented at the Social Science History Association Annual Meeting 2021. This summary can be accessed via her researchmap page, which was consulted by the author on December 14, 2023.

[29] A chain of transactions ultimately ends when the goods reach the consumer. In this sense, consumption can be considered the final form of demand. However, VAT, despite its economic implications, is legally a tax on each sale, and the recipients of services are not necessarily final consumers. For this reason, the term "demand" is used here as a concept encompassing all service recipients, regardless of whether they are final consumers or not. This usage of terminology was inspired by Shiraishi (1994, p. 100) and Shiraishi (2023, p. 38).

income tax, the mainstream approach is to allocate taxing rights based on the latter model.[30]

Both models have their advantages and disadvantages, but a major point supporting the superiority of the destination-based model is its ability to preserve the tax chain.[31] This mechanism reduces the risk of cascading taxes compared to origin-based taxation. Given the historical development of TVA in France, it would be reasonable in principle to adopt a destination-based approach.[32]

Regarding transfer pricing, the following can be said. Transfer pricing refers to the transaction price when there is a controlling relationship between the parties involved, leading to prices differing from market conditions. Under origin-based taxation, manipulation of transfer pricing cannot be avoided, even in VAT.[33] For instance, under origin-based taxation, if a parent company in a high-tax jurisdiction sells products to its subsidiary in a low-tax jurisdiction at below-market prices (exports), the overall tax burden on the group is reduced. Consequently, it becomes necessary to establish transfer pricing regulations or align tax rates between the two countries.

Conversely, under destination-based taxation, the tax base is domestic consumption, so the outflow of the tax base from the production country is not an issue. It has been said that there is an "automatic adjustment mechanism for transfer pricing."[34]

Of course, shifting the tax base from production to consumption is a significant decision. While taxing consumption as the base seems effective, given the disparities in tax rates among countries, this is both a practical issue concerning the allocation of tax revenue and a philosophical question.

III-2. The Method of Border Tax Adjustment

The tax adjustments applied to goods involved in international trade are referred to as "border tax adjustments."[35] When oriented toward destination-based taxation, VAT involves border tax adjustments in the form of refunding input taxes upon export and applying normal taxation upon import. This mechanism may appear, from an economic perspective, to subsidize exports and suppress imports.[36] However, according to Annex 1 of the WTO's

[30] There is, however, a concept of adopting a destination-based approach for corporate income tax. For an overview and analysis of its conceptions in Japanese, *see* Fujioka (2018).

[31] Watanabe (2006), pp. 67-74. In the case of origin-based taxation, when a company from a non-VAT country (e.g., the United States) is involved, it may disrupt the tax chain, similar to how an exempt business might intervene, causing the chain to break without repair. Watanabe (2015) further analyzes the characteristics of destination-based VAT from the perspective of a chain of tax information collection. Of course, note that this analysis presupposes the existence of mechanisms such as the reverse charge system and invoicing. *Also see* Watanabe (2000).

[32] In Japan, securing neutrality through the elimination of tax cascading is considered a goal of the consumption tax (Tax Reform Act, Article 10, Paragraph 2). However, the phrase "as a principle" in the text means the omission of practical enforcement considerations. How to collect VAT on services provided by foreign entities remains an issue. Particularly for services, there are limitations to relying on functions of customs (Watanabe, 2006, p. 66).

[33] Mizuno (1989), p. 174; Masui (2005), p. 83.

[34] Masui (2005), p. 84.

[35] Based on GATT (1970), particularly para. 4. However, the term "border tax adjustments" has been criticized as misleading (Rosendahl, 1970, pp. 89-90 = (fn. 11)).

[36] Okamura (2017), especially from p. 77 onwards. The author, being a non-specialist in economics, is unable to present an accurate understanding of factors such as exchange rate impacts. Nevertheless, it can be said that tax systems, whether direct or indirect, influence trade balances to varying degrees, which is why, as observed below, it has provoked debates under GATT.

"Agreement on Subsidies and Countervailing Measures,"[37] the remission of prior-stage indirect taxes (such as sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes, and all taxes other than direct taxes and import charges) is excluded from the category of prohibited export subsidies as long as it does not exceed the level for goods for domestic consumption.[38]

The VAT refund upon export has not generally been considered a prohibited subsidy under Article XVI of the General Agreement on Tariffs and Trade (GATT) since its early days.[39] This arrangement, which relatively favors countries relying on indirect taxes, has drawn criticism from the United States.[40] In December 1970, the GATT working group submitted a report on border tax adjustments.[41] According to this report, there was general agreement that provisions of GATT had codified practices existing at the time of its drafting, but some members of the Working Party considered that such practices regarding border tax adjustments were based on assumptions that were not accepted universally at the time the working group held its discussion.[42] While many countries viewed border tax adjustments for indirect taxes as consistent with trade neutrality and aimed toward equal treatment between domestic and imported goods, they did not completely refute opposing views.[43]

In the EEC, "The EEC Reports on Tax Harmonization" was published in 1963, which considered the possibility of origin-based taxation for turnover taxes. Of course, this was a long-term goal following the abolition of gross turnover taxes and the complete alignment of tax rates, exemptions, and other factors among member states. However, there were expectations that achieving origin-based taxation would lead to the elimination of tax frontiers as a side effect.[44]

III-3. Place of Taxation Rules

Since the OECD Ottawa Conference in 1998,[45] there has been a body of accumulated discussion regarding the allocation of VAT. It has been commonly understood that consumption should be taxed at the place it occurs, and how to achieve that goal has become a subsequent agenda.[46] This perspective is upheld in the OECD's VAT Guidelines, which emphasize tax neutrality.[47]

It is necessary to consider the relationship between the destination principle as a concep-

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[37] The author saw the Japanese-language version on the Ministry of Foreign Affairs website (https://www.mofa.go.jp/mofaj/ecm/it/page25_000424.html), on December 14, 2023.
[38] *See* Article 3 and Annex 1 (h) of the WTO agreement.
[39] Annex I of GATT (ad Article XVI). However, refunds exceeding the amount of tax paid on inputs are prohibited.
[40] Miyazaki (2012), pp. 612 ff.
[41] This report refers to GATT (1970).
[42] Ibid., para. 8.
[43] Miyazaki (2012) analyzes how these developments subsequently led to trade disputes over the United States' DISC tax system and later the FSC tax system.
[44] EEC (1963), pp. 123-126. *Also see* Easson (1980), pp. 100-111.
[45] The results are published as OECD (1998).
[46] OECD (1998), pp. 5-6.
[47] OECD (2017) (hereinafter referred to as the "VAT Guideline"), Guideline 3.1.

tual model and the place of taxation rules. In the OECD VAT Guidelines, place of taxation rules are intended to implement the destination principle while also addressing international neutrality, simplified tax compliance, clarity and certainty, reduced enforcement costs, and the prevention of tax evasion and avoidance.[48]

Border tax adjustments have traditionally been linked to border controls. However, for transactions involving goods not subject to such controls (e.g., services and intangible assets), the notion of cross-border transfers is increasingly a legal fiction, particularly with advances in digital technology. These transactions often involve extraterritorial elements with patterns varying widely. Moreover, both the supplier and the consumer can be highly abstract concepts, not concretely tied to a specific jurisdiction. Therefore, the destination principle in this context implies that the jurisdiction deemed to be the location of the consumer ultimately acquires the taxing rights. In the end, the question of which country exercises taxing rights over a given transaction boils down to which jurisdiction is legally considered the location of demand (consumption). This is determined by the place of taxation—or place of supply—and its rules.[49]

III-4. Transition to the Next Section

In the dichotomy between origin-based and destination-based taxation, the latter dominates both theoretically and practically. It is unlikely that origin-based taxation will regain prominence in the future. However, whether border tax adjustments are implemented or not, it is first necessary to identify which jurisdiction's law governs a given transaction, since VAT is a transaction-based tax.

When a single entity with one corporate identity operates across borders, whether as a supplier or a consumer, the question arises as to whether the VAT law of the head office or the local branch should apply. Additionally, it is necessary to consider whether some form of adjustment is required between the head office and the branch.[50]

IV. Structure and Implementation of Place of Supply Rules in EU VAT

IV-1. VAT Directive[51]

IV-1-1. Current Regulations

Let us first outline the current (as of the end of December 2023) place of supply rules. This section is solely for organizational purposes and does not introduce any novel points.

VAT is imposed on "the supply of services for consideration within the territory of a

[48] OECD, VAT Guideline, para. 3.3.
[49] Thang & Shatalow (2021), p. 445.
[50] A significant prior study in Japanese is Ogawa (2016). This paper, as a result, only provides some supplementary insights from the perspective of EU law. However, it is believed that even such supplementary insights hold research significance.
[51] COUNCIL DIRECTIVE 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L347, 11.12.2006. This serves as the foundational framework and has been subject to frequent amendments.

Member State." (Art. 2(c)) This means that the jurisdiction in which the place of supply is located has the right to tax. The general rules for determining the place of supply of services are summarized as follows:

(1) Transactions between taxable persons (B2B transactions) (Art. 44)
 (i) The place where the recipient of the service has established his business.
 (ii) If the service is provided to a Fixed Establishment (hereinafter, "FE") located elsewhere, the place of that FE.
 (iii) If neither of the above applies, the recipient's permanent address or usual residence.
(2) Transactions between taxable persons and non-taxable persons (B2C transactions) (Art. 45)
 (i) The place where the supplier of the service has established his business.
 (ii) If the service is supplied from an FE of the supplier located elsewhere, the place of that FE.
 (iii) If neither of the above applies, the supplier's permanent address or usual residence.

For B2B transactions, the demand side (recipient of the service) is the determinant for the place of supply. In other words, the location of the recipient—not the supplier—determines the jurisdiction with taxing rights. Regarding electronic services, a special rule has been established concerning the "place of supply" of such services. For telecommunications, broadcasting, and electronic services provided to non-taxable persons, the place of supply is based on the recipient's location (Art. 58). This approach, which differs from the rules articulated in Article 45, aims to eliminate competitive disparities between EU-based and non-EU-based businesses for inbound supplies.[52] In these services, when provided to EU consumers, the supplier's location is disregarded.

Furthermore, there is a special rule for cases where services are provided by EU businesses to non-EU consumers. Under Article 45, VAT would appear to be imposed at the supplier's location. However, Article 59 provides that the place of supply is determined based on the consumer's location for a wide range of services. This means that many outbound supplies are not subject to VAT in EU Member States. This institutionalizes the destination principle, eliminating competitive disadvantages related to VAT for EU businesses.[53]

As outlined above, under the current VAT Directive, the system has been substantially oriented toward using the demand side (recipient) as the determinant for the place of supply, when considering not only the general rules but also these special provisions.[54]

[52] Lamensch (2012), p. 79.
[53] *Id*.
[54] However, the following provision exists as a safety: "to prevent double taxation, non-taxation or distortion of competition," Member States are allowed to adopt some measures based on "the effective use and enjoyment of the service." (Article 59a)

Next, the definitions of "the place where the business of a taxable person is established" and FE can be understood by referring to the VAT Directive's "Implementing Regulation (2011)."[55]

Regarding "the place where the business of a taxable person is established," Article 10 of the Implementing Regulation (2011) provides the definition. The relevant portion is quoted as follows:

"

1. *For the application of Articles 44 and 45 of Directive 2006/112/EC, the place where the business of a taxable person is established shall be the place where the functions of the business's central administration are carried out.*
2. *In order to determine the place referred to in paragraph 1, account shall be taken of the place where essential decisions concerning the general management of the business are taken, the place where the registered office of the business is located, and the place where management meets. Where these criteria do not allow the place of establishment of a business to be determined with certainty, the place where essential decisions concerning the general management of the business are taken shall take precedence.*
3. *The mere presence of a postal address may not be taken to be the place of establishment of a business of a taxable person."*

In this paper, the author interprets "the place where the business of a taxable person is established" as the principal place of the business, as it signifies the central location for decision-making within a business. There may also be cases where the principal place of business cannot be definitively determined due to the decentralization of decision-making functions.[56]

Regarding "fixed establishment (FE)," Article 11 of the Implementing Regulation (2011) provides the definition. The relevant text is quoted as follows:

"

1. *For the application of Article 44 of Directive 2006/112/EC, a 'fixed establishment' shall be any establishment, other than the place of establishment of a business referred to in Article 10 of this Regulation, characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs.*
2. *For the application of the following Articles, a 'fixed establishment' shall be any establishment, other than the place of establishment of a business referred to in Article 10 of this Regulation, characterized by a sufficient degree of permanence and a suitable struc-*

[55] 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, L77, 23.3.2011.
[56] Doesum et al. (2020), p. 194.

ture in terms of human and technical resources to enable it to provide the services which it supplies:

(a) Article 45 of Directive 2006/112/EC;

(b) from 1 January 2013, the second subparagraph of Article 56(2) of Directive 2006/112/EC;

(c) Until 31 December 2014, Article 58 of Directive 2006/112/EC;

(d) Article 192a of Directive 2006/112/EC.

3. The fact of having a VAT identification number shall not in itself be sufficient to consider that a taxable person has a fixed establishment."

To summarize the above in the author's words, an FE refers to an establishment other than the principal place of business, characterized by "a sufficient degree of permanence and a suitable structure in terms of human and technical resources" to receive services. The FE concept is not only a component of the place of supply rules but is also referenced in implementing the reverse charge mechanism.[57] The reverse charge mechanism requires the recipient, rather than the supplier, to pay VAT.[58]

For example, in general B2B transactions, the location of the recipient is deemed the place of VAT taxation (Art. 44). However, for services supplied by a taxable person located outside a Member State, the recipient must pay VAT under the reverse charge system (Art. 196). The determination of whether to use the principal place of business or the FE as the point of reference creates issues for applying the reverse charge system. Article 192a[59] stipulates that a taxable person with an FE within a Member State is considered a non-resident taxable person unless the FE intervenes in the service supply. If the FE does not intervene, the recipient pays VAT under the reverse charge system in cross-border B2B transactions. Conversely, if the FE intervenes, the FE pays VAT, and the reverse charge system does not apply.[60] Article 192a aims to prevent the "principle of force of attraction," where a business outside the jurisdiction of a Member State is deemed domestic solely because it has an FE there.[61]

IV-1-2. Regulations in the Past

This paper focuses on past regulations, tracing the development leading to the current framework. To this end, the legal landscape under the Sixth Directive[62] is examined, as it forms the basis for the evolution of case law surrounding FE and provides the foundation for analyzing numerous precedents.[63]

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[57] As will be discussed in analyzing case laws of CJEU, both human and technical resources are required to recognize a FE. One difference from the PE concept, which does not consider human resources essential, lies here. *See* Spies (2017), p. 710.

[58] Doesum et al. (2020), p. 512.

[59] Inserted by Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services.

[60] Doesum et al. (2020), pp. 520-522.

[61] Bal (2021), p. 360.

[62] SIXTH COUNCIL DIRECTIVE of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes—Common system of value added tax: uniform basis of assessment (77/388/EEC), OJ. L145, hereinafter "Sixth Directive."

Under the Sixth Directive, services provided for consideration within a Member State were subject to VAT in that Member State (Art. 2). The default rule was that the place of supply was the supplier's place of establishment or location of the FE (Art. 9(1)).

Attention will first be given to the concept of FE as interpreted by case law. Additionally, for businesses with FEs in multiple countries, the allocation of taxing rights between the principal place of business and branch locations becomes an issue. This discussion will review key precedents and provide commentary, particularly in the context of multinational enterprises. Such issues in VAT parallel those seen in income taxation, where the allocation of taxing rights is often debated under the "arm's length principle."

IV-2. Intervention by CJEU

IV-2-1. Theme 1: Fixed Establishment

The concept of Fixed Establishment (FE) holds a decisive function in EU VAT law, particularly in determining the place of supply of services, identifying the taxable person under the reverse charge mechanism, and assessing VAT refunds. Despite its significance, since the Sixth Directive, the definition of FE has not been explicitly specified at the Directive level. Instead, it is the case law of the CJEU that has contributed to the understanding of this concept.[64]

This section introduces and analyzes relevant precedents established before the codification of FE in the Implementing Regulation (2011). Using Bal (2021) as a guide, this analysis avoids duplication with that work by adding a perspective on the values emphasized by the CJEU in its case handling.[65]

IV-2-1-1. *Berkholz* Case [1985][66]

The *Berkholz* Case is a landmark decision concerning the significance and definition of FE during the era of the Sixth Directive. According to Article 9(1) of the Sixth Directive, the place where a service is supplied is to be deemed to be "the place where the supplier has established his business or has a fixed establishment from which the service is supplied". The issue in this case was determining the necessary elements constituting an FE. At the same time, we must understand the values the CJEU pursued by requiring such elements.

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[63] Additionally, the rapid development of the digital economy has significantly transformed the legal situation surrounding EU VAT. Including these in the scope of this paper was judged to be difficult due to space and capacity constraints. For this reason, the focus of this paper is limited to the era of the Sixth Directive. Regarding the future of EU VAT, which is the author's homework, this paper mentions only proximate research, such as Tumpel (2023).

[64] Bal (2021), pp. 360-370. *See also* Scalia (2023). This paper heavily relies on these works.

[65] Ogawa (2016), p. 523 and onward, also introduces into Japan the cases discussed in this paper. However, this paper emphasizes the rationale pursued by the CJEU regarding the allocation of taxing rights rather than simply verbalizing the understanding of the FE concept. In this sense, the novelty of this paper remains intact.

[66] Judgment of the Court (Second Chamber) of 4 July 1985, Case 168/84, Gunter Berkholz v. Finanzamt Hamburg-Mitte-Alstadt, ECLI:EU:C:1985:299.

(1) Background to the *Berkholz* Case (paras. 2-3)

Berkholz, whose registered office is in Hamburg, installed some gaming machines on board two ferryboats owned by the Deutsche Bundesbahn which ply between Puttgarden and Rødbyhavn. According to the German tax authorities, approximately 10% of the turnover generated by the gaming machines arises when the vessels are in the German port, 25% during the passage through German territorial waters, and the remainder on the high seas, in Danish territorial waters or in Danish ports.

The *Finanzamt* charged tax on the entire 1980 turnover of Berkholz on the two ferries because it was deemed to have arisen at its business in Hamburg.

The applicant contended that the services in question were provided from an FE located on board the ferries and therefore regarded only 10%, or at most a further 25%, of the turnover generated by the gaming machines on board the ships as chargeable to German turnover tax.[67]

The question to the Court was whether the machines on the ferries constituted an FE.

(2) The Court's Decision

CJEU stated that Article 9 was designed to "secure the rational delimitation of the respective areas covered by national value added tax rules by determining in a uniform manner the place where certain services are deemed to be provided for tax purposes" and that the object of the provisions of Article 9 was to "avoid, first, conflicts of jurisdiction, which may result in double taxation, and, secondly, non-taxation." (para. 14)

The Court also held that "According to Article 9(1), the place where the supplier has established his business is a primary point of reference inasmuch as regard is to be had to another establishment from which the services are supplied only if the reference to the place where the supplier has established his business does not lead to a rational result for tax purposes or creates a conflict with another Member State."(para. 17) Especially in the context of an establishment other than the place where the supplier has established his business, it is necessary that "that establishment is of a certain minimum size and both the human and technical resources necessary for the provision of the services are permanently present." (para. 18)

(3) Comments

The significant point in this case lies not merely in the required elements for constituting an FE but in the fact that the concept was framed to prevent conflicts in taxing jurisdiction. This pursuit of the rational allocation of taxing rights under VAT was initiated with the *Berkholz* Case and can be observed in subsequent case law.

IV-2-1-2. *DFDS* Case [1997][68]—A Specific Example of FE

The *DFDS* Case involves a preliminary ruling on the interpretation of Article 26 of the

[67] Denmark probably would hold the taxing right on the remaining portion.

[68] Judgment of the Court (Fifth Chamber) of 20 February 1997, Case C-260/95, Commissioners of Customs and Excise v. DFDS A/S, ECLI:EU:C:1997:77.

Sixth Directive.[69] This case elaborates on the abstract principle of "rational delimitation" expressed in the *Berkholz* Case by providing specific interpretations.

(1) Facts in the Case and Questions to the Court

DFDS A/S, a company incorporated in Denmark, whose objects are shipping, travel and general transport, has an English subsidiary, DFDS Ltd. as its agent in United Kingdom. In this case, the Court was questioned about "where a tour operator has its headquarters in Member State A but supplies services in the form of package tours to travelers through the agency of a company in Member State B:

(a) in what (if any) circumstances is the supply of those services by the tour operator taxable in Member State B?

(b) in what (if any) circumstances can it be said that the tour operator 'has established [its] business' in Member State B or 'has a fixed establishment from which [it] has provided the services' in Member State B?" (para. 8)

In essence, the issue was whether the UK subsidiary constituted an FE of DFDS A/S.[70]

(2) The Court's Decision

The conclusion of the Court is that "where a tour operator established in one Member State provides services to travellers through the intermediary of a company operating as an agent in another Member State, VAT is payable on those services in the latter State if that company, which acts as a mere auxiliary organ of the tour operator, has the human and technical resources characteristic of a fixed establishment." (para. 29) The reasoning of this conclusion is the following:

First of all, the Court emphasizes that consideration of the actual economic situation is a fundamental criterion for the application of the common VAT system. It points out that Article 26 takes into account the possible diversification of the travel agents' activities in different places and thus systematic reliance on the place where the supplier has established his business could lead to distortions of competition. (para. 23) On the contrary, the Court argues, in those circumstances, such supply of services is taxable not in the State where he has established his business, but in the State where the FE is located. (para. 24)

In this case, the Court decided that the UK subsidiary merely acted as an auxiliary organ of its parent DFDS in spite of its own legal personality because of its economic activities. (para. 26) The Court also decided that the UK subsidiary displayed the above-mentioned features of FE in regards to the number of employees and the actual terms under which it provided services to its customers. (para. 28)

[69] "All transactions performed by the travel agent in respect of a journey shall be treated as a single service supplied by the travel agent to the traveller. It shall be taxable in the Member State in which the travel agent has established his business or has a fixed establishment from which the travel agent has provided the services. (…)" (Paragraph 2 of Article 26)

[70] DFDS argued that taxation should occur at its business headquarters (para. 10), while the UK government contended that DFDS has its FE in the UK, thus making DFDS be taxed in the UK (para. 11).

(3) Comments

This *DFDS* Case is noteworthy for its interpretation of Article 26 of the Sixth Directive. It shows how the Court considered the nature of transactions (e.g., geographically dispersed operations of travel agencies) and ensured rational delimitation in VAT allocation. The author particularly underlines the Court's emphasis in para. 23 that strict adherence to the "place where the supplier has established his business" standard could lead to distortions in competition due to tax avoidance.

IV-2-1-3. *ARO Lease* Case [1997][71]—Another Specific Example of FE

(1) Facts in the Case and Questions to the Court

ARO, which was established in the Netherlands, is a leasing company whose principal business is supplying cars to its customers.

The Belgian tax authorities consider that, since January 1993, the mere presence in Belgium of a fleet of cars owned by ARO means that ARO has a fixed establishment in Belgium from which it supplies cars under leasing agreements, and therefore ARO must pay VAT in Belgium in respect of the services in question. The Netherlands tax authorities, however, consider that the place where the services are supplied is in the Netherlands under Article 9(1) of the Sixth Directive on the ground that ARO has no fixed establishment in Belgium because it has no staff or technical facilities there to conclude the leasing agreements. (para. 7)

(2) The Court's Decision

When can services be deemed to be supplied at an establishment other than the main place of business? CJEU, after citing the framework of *Berkholz* Case, answers that "an establishment must possess a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis." (para. 16)[72, 73]

(3) Comments

The facts of this case closely resemble those in the *Berkholz* Case, so it is not surprising that a similar analytical framework was applied. However, unlike the *DFDS* Case, which gave precedence to the customer location, the *ARO Lease* Case focused on the nature of vehicle leasing transactions. The Court concluded that the place where the supplier has established his business (the Netherlands) should take precedence, as the mobility of vehicles rendered the location-of-use criterion impractical.[74] As a "practical" criterion, the place where the supplier has established his business was deemed the appropriate reference point (para. 14).

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[71] Judgment of the Court (Sixth Chamber) of 17 July 1997, Case C-190/95, ARO Lease BV v. Inspecteur der Belastingdienst Grote Ondernemingen, Amsterdam, ECLI:EU:C:1997:374.

[72] Here too, the CJEU emphasized whether the tax outcome was reasonable and whether conflicts between Member States could be avoided.

[73] In this case, it was determined that the sufficiency requirement was not met. *See* for example para. 27.

[74] The Tenth Council Directive (84/386/EEC, OJ L208) is also mentioned here as a supporting factor (para. 12).

Given that the Sixth Directive differentiates place of supply rules depending on the type of transaction, it can be summarized that the CJEU has sought reasonable outcomes tailored to each type of transaction. This approach was not something that could simply be resolved using a dichotomy of supplier-based or customer-based criteria.

IV-2-2. Theme 2: Intra-Company Transactions

In considering the allocation of taxing rights in addition to the place of supply rules, "transactions" within a legal entity also become an important theme. In income taxation, a legal entity is divided into segments, and arm's length transactions between these segmented units are deemed to occur. Particularly for entities operating in multiple countries, intra-company transactions ultimately determine the allocation of taxing rights between states.[75] The same issue may arise with VAT. For instance, is the transfer of assets between the head office and an FE subject to VAT in the first place? If it is, how should the transaction be characterized?

Under Japan's Consumption Tax Act, taxpayers are defined as business entities (Article 5, paragraph 1 of the Consumption Tax Act), and business operators are defined as "individual businesses and corporations" (Article 2, paragraph 1, item 4 of the same Act). If the transfer of assets within a legal entity were to be subject to VAT, the corporation as a VAT taxpayer would need to be understood as a concept different from a private law corporation. However, this is not the case.[76] In other words, in Japan, the transfer of assets between the head office and an FE is ignored and the place of supply rules are applied in a straightforward manner that concludes the matter. Is such a legal framework inevitable?

In conclusion, within the EU, whether the head office and branch are regarded as separate entities is not definitively determined. Rather, a flexible approach is taken depending on the specific circumstances of the issue.

IV-2-2-1. *FCE Bank* Case [2006][77]

The *FCE Bank* Case is a well-known precedent from the era of the Sixth Directive concerning transactions between a head office and its branch. The facts of the case are as follows: FCE Bank was a UK company, and its business included the provision of financial services exempt from VAT. FCE IT was an Italian subordinate entity of FCE Bank, and it received various services from FCE Bank, including consultancy services. FCE IT sought a refund for the VAT related to these services for the period from 1996 to 1999 based on self-invoices (paras. 14-15).

There were three questions referred to the CJEU, and the Court's judgments on these points were as follows:

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[75] For a comparative legal study on transactions between a head office and branches in the context of income taxation, *see* Fuchi (2016).

[76] Ogawa (2016), p. 541.

[77] Judgment of the Court (Second Chamber) of 23 March 2006, Case C-210/04, Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v. FCE Bank plc, ECLI:EU:C:2006:196.

(1) Three Questions Referred to for a Preliminary Ruling (para. 20)

"1. Must Articles 2(1) and 9(1) of the Sixth Directive be interpreted as meaning that the branch of a company established in another State (belonging to the European Union or otherwise), which has the characteristics of a production unit, may be regarded as an independent person and thus that a legal relationship between the entities can be said to exist with consequent liability for VAT in relation to supplies of services effected by the parent company? Can the "arm's length" standard laid down in Article 7(2) and (3) of the OECD Model Convention on double taxation and the Convention of 21 October 1988 between Italy and the United Kingdom of Great Britain and Northern Ireland be used to define that relationship? Can a legal relationship be said to exist where there is a cost-sharing agreement concerning the supply of services to the subordinate entity? If so, what conditions must be satisfied for such relationship to be considered to exist? Must the notion of legal relationship be dealt with under national law or Community law?

2. Can the passing on of the costs of such services to the branch concerned be regarded as consideration for the services supplied for the purposes of Article2 of the Sixth Directive, regardless of the proportion of the costs passed on and the resulting profit to the company, and if so, to what extent?

3. If the supply of services between the parent company and the branch are regarded in principle as being exempt from VAT because the recipient is not independent and consequently a legal relationship between the two entities cannot be said to exist, is a national administrative practice which considers that the supply is taxable in such a case contrary to the right of establishment laid down in Article 43 EC where the parent company is established in another Member State of the European Union?"

(2) The Court's Decision

- On the first question:

First, the Court confirmed the principle established in case law that "the provision of services is taxable only if there exists between the service provider and the recipient a legal relationship in which there is a reciprocal performance." (para. 34)

For such a legal relationship to be established, this requires determining whether "a branch such as FCE IT may be regarded as being an independent bank, in particular in that it bears the economic risks arising from its business." (para. 35)

In conclusion, since all such risks are borne by FCE Bank, FCE IT is not an independent entity but merely constitutes part of a single taxable person.[78] (para. 37)

- On the second question:

The Court held that there was no need to answer this question, as it had already been

[78] It was noted by the Court that the OECD Convention concerns direct taxes and is unrelated to VAT, which is an indirect tax. Additionally, agreements on the sharing of costs were also irrelevant because they were not made between independent entities. (paras. 39-40)

concluded in response to the first question that FCE IT is not an independent company. (para. 43)

- On the third question:

The Court stated that Italy's tax practice was contrary to the Sixth Directive, making it unnecessary to address the issue of whether it also conflicted with Article 43 of the EC Treaty concerning the freedom of establishment. (para. 52)

(3) Comments

This case has already been extensively studied in Japan[79], and there is little new to add. In essence, the judgment established criteria for recognizing transactions between a head office and a branch from the perspective of VAT. In this case, the Court ultimately concluded that transactions between the head office and the branch were not to be recognized.

However, by the *Skandia* Case (see Supplementary Note), the scope of the *FCE Bank* Case was, in a sense, limited.

<Supplementary Note: *Skandia* Case [2014][80]>

Although this case was not decided under the Sixth Directive but rather under the VAT Directive, it is worth mentioning in relation to the scope of the *FCE Bank* Case.

(1) Facts

SAC, the global purchasing company for IT services of the Skandia Group and a U.S. company, conducted business activities in Sweden through its branch, Skandia Sverige (hereinafter referred to as "SS"). SS refined the IT services supplied by SAC into final products and supplied them to various entities within the group. Both the supply of services from SAC to SS and from SS to the group entities were subject to a 5% markup charge. (para. 17)

The Swedish tax authority determined that the provision of services from SAC to SS constituted taxable transactions and decided to impose VAT on them for the years 2007-2008. It considered that SAC and SS were both liable for VAT, and charged the amount of tax relating to those supplies on the ground that SS was SAC's branch in Sweden. (para. 18)

The key difference from the *FCE Bank* Case lies in the fact that Swedish law had implemented the VAT grouping mechanism. This mechanism, permitted under Article 11 of the VAT Directive[81], allows Member States to adopt such a framework. Under Swedish law, an FE could also be part of a VAT group, and in this case, SS was indeed included in a VAT group in Sweden.

[79] Ogawa (2016), p. 530 and onward.

[80] Judgment of the Court (Second Chamber) of 17 September 2014, Case C-7/13, Skandia America Corp. (USA), filial Sverige v. Skatteverket, ECLI:EU:C:2014:2225. Regarding this case, there is prior Japanese-language research by Matsubara (2006), pp. 87-110.

(2) The questions referred for a preliminary ruling (para. 20)

"1. Do supplies of externally purchased services from a company's main establishment in a third country to its branch in a Member State, with an allocation of costs for the purchase to the branch, constitute taxable transactions if the branch belongs to a VAT group in the Member State?

2. If the answer to the first question is in the affirmative, is the main establishment in the third country to be viewed as a taxable person not established in the Member State within the meaning of Article 196 of [the VAT Directive], with the result that the purchaser is to be taxed for the transactions?"[82]

(3) The Court's Decision

- On the first question:

First, following the framework of the *FCE Bank* Case, the Court found that SS does not operate independently and does not bear the economic risks arising from its business activities. Therefore, SS is not a taxable person within the meaning of Article 9 of the VAT Directive. (paras. 21-27)

However, SS is a member of a VAT group as defined in Article 11 of the VAT Directive. Services provided to an entity that is a member of a VAT group by a third party are considered (for VAT purposes) as services provided to the group as a whole rather than to an individual entity. Therefore, the services provided by SAC to SS are considered to be services provided to the VAT group, of which SS is a member. Consequently, SAC and SS cannot be regarded as a single taxable person and the transaction falls under the taxable transactions referred to in Article 2(1)(c) of the VAT Directive. (paras. 28-32)

- On the second question:

As noted above, for VAT purposes the services are deemed to have been provided by SAC (located in a third country) to the VAT group in the Member State (Sweden). Under the exception provided in Article 196 of the VAT Directive, the VAT group, as the purchaser of the services, becomes the taxable person liable for VAT. (paras. 33-38)

In other words, when VAT group taxation is applied, the concept of the single legal enti-

[81] This is a provision allowing Member States to establish a consolidated tax filing system (VAT group system) after consulting the advisory committee on value added tax (hereafter, the "VAT Committee.") Member States are also granted the option to adopt anti-tax avoidance measures as needed when using this system. See Mizoguchi (2020), p. 46. The provision is excerpted verbatim as follows:

"After consulting the advisory committee on value added tax (hereafter, the 'VAT Committee'), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organizational links.

A Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision."

[82] This refers to taxation under the reverse charge mechanism.

ty is diminished.[83]

Furthermore, when considering the scope of the *FCE Bank* Case, the subsequent *Le Crédit Lyonnais* Case is particularly noteworthy in the context of calculating the deductible proportion for input tax deductions. In principle, a taxable person conducting both taxable and exempt transactions must calculate the deductible proportion under Article 19 of the Sixth Directive so that only the portion corresponding to taxable transactions is deductible. In calculating the deductible proportion, it is thus critically important to determine what range of turnover should be included in the numerator and denominator. In this case, the taxpayer attempted to include the turnover of foreign branches in the calculation.

IV-2-2-2. *Le Crédit Lyonnais (LCL)* Case [2013][84]

In this case, LCL had its principal place of business in France and operated branches in EU Member States, as well as in third countries. (para. 13)

LCL's claim is the following: "in order to determine the deductible proportion of expenses of its principal establishment for VAT purposes, the income of its branches established in other EU Member States and in third States should be taken into account, in so far as those branches must, following the judgment in Case C-210/04 *FCE Bank* [2006] ECR I-2803, be regarded as constituting with that principal establishment, in so far as concerns the relations between them, a single taxable person." (para. 17). The question of whether LCL's claim is possible was referred to the CJEU.

In response, the CJEU ruled that the turnover of branches located in other Member States or third countries could not be included in the calculation of the deductible proportion in the principal place of business (France). As the Court held in its decision,

> "It must be held that, in so far as the calculation of the deductible proportion constitutes an element of the deduction system, the manner in which that calculation must be carried out falls, along with that deduction system, within the scope of the national VAT legislation to which an activity or transaction must be linked for tax purposes." (para. 30)[85]
>
> "Since the Court has held that the fixed establishment, within the meaning of the Sixth Directive, situated in a Member State and the principal establishment situated in another Member State constitute a single taxable person subject to VAT…, it follows that a taxpayer is subject, in addition to the system which applies in the State of its principal establishment, to as many national systems of deduction as there are Member States in which it has fixed establishments."(para. 34)

[83] For the developments in CJEU case law following the *Skandia* case, *see* Scalia (2023), pp. 740-742.

[84] Judgment of the Court (First Chamber), 12 September 2013, Case C-388/11, Le Crédit Lyonnais v. Ministre du Budget, des Comptes publics et de la Réforme de l'État, ECLI:EU:C:2013:541.

[85] Regarding its relevance to Section IV-2-2-3, the Court says about the functions of the input tax deduction as follows: "The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT…" (para. 27)

> "Since the methods of calculation of the proportion constitute a fundamental element of the deduction system, account cannot be taken, in calculating the proportion applicable to the principal establishment of a taxpayer established in a Member State, of the turnover of all of the taxable person's fixed establishments in the other Member States, without seriously jeopardising both the rational allocation of the spheres of application of national legislation in VAT matters and the rationale of the aforesaid proportion." (para. 35)

In the *LCL* Case, despite the singleness of the legal entity, the inclusion of turnover from FEs located in other Member States or third countries in the calculation of the deductible VAT amount at the principal place of business was conversely prohibited.

Regarding VAT deductions, the Member States where each FE is located has primary jurisdiction. As a result, the entity as a whole is effectively treated as if it were segmented into individual units.

IV-2-2-3. *Morgan Stanley (MS)* Case [2019][86]

This case conversely involved the issue of input VAT deduction for the Paris (France) branch of MS, a UK-based corporation.

The Paris branch, as an FE, was subject to French VAT. (para. 16)

The Paris branch conducted banking and financial transactions for local clients which were opted to be liable to VAT while also providing services to its principal establishment located in the UK. The Paris branch treated all VAT incurred on its inputs for both types of services as deductible. (para. 17) It should be noted that the services provided to the head office were used for both taxable and non-taxable transactions at the head office. (para. 24)

There was no issue with allowing the full deduction of input VAT for the Paris branch's sales to local customers. The French tax authorities argued that it was inappropriate to allow a full deduction since part of the input corresponded to non-taxable sales. (para. 18) After all, in the *MS* Case, the inputs procured through the Paris branch were passed on to the UK head office and used there for both taxable and non-taxable transactions.

The question was which items could be included in the calculation of the deductible proportion applicable to the Paris branch in France.

To summarize their decision, the CJEU set the following criteria for the elements to be included in the numerator and denominator when calculating the deductible proportion in this case: (para. 60)

> Denominator: "the transactions carried out by both that branch and that principal establishment"

[86] Judgment of the Court (Fourth Chamber) of 24 January 2019, Case C-165/17, Morgan Stanley & Co International plc v. Ministre de l'Économie et des Finances, ECLI:EU:C:2019:58.

** The Original Version includes some misleading descriptions on this section, the author apologizes and will correct the errors.

Numerator: "the taxed transactions carried out by that branch"
+
"the taxed transactions carried out by that principal establishment must appear, in respect of which VAT would also be deductible if they had been carried out in the State in which the branch concerned is registered."

Basically, French law applies to the calculation of VAT deductions in France. However, the turnover corresponding to the inputs used for the calculation of the deductible proportion is not derived from head office-branch transactions, but rather from the turnover of the UK head office. In practice, it is therefore necessary to consider not only the application of French law, but also that of UK law. This raises concerns about the relationship with the *LCL* Case, where the turnover of FEs in other countries was excluded from the calculation of the deductible proportion at the principal place of business. However, in the *LCL* Case, the issue was that including the turnover of FEs would have increased the deductible amount which distinguishes it from the present case. In fact, in the *MS* case, the CJEU interprets that the reason for excluding the turnover of foreign FEs in the *LCL* Case was because part of the branch's turnover was unrelated to the inputs at the head office. (*MS* Case, para. 51) Therefore, the Court clarifies that the *LCL* Case does not intend to rule out considering transactions that have a direct and immediate link with the input expenditures concerned when it calculates the deductible portion for an FE in one country, even if those transactions are carried out by an FE in another country. (*MS* Case, para. 52) This emphasizes the characteristics of VAT input deduction, whereby tax deductions should be granted only for inputs that correspond directly to taxable outputs.

IV-3. Short Summary

What has been examined above regarding FEs can be described as the threshold issue for countries other than the principal place of business of multinational enterprises to exercise taxing rights. A concept similar to the nexus which is discussed in corporate income tax based on the principle of source taxation is also envisioned in VAT. In corporate income tax this concept is referred to as a Permanent Establishment (PE), whereas in EU VAT it is referred to as a Fixed Establishment (FE). Certainly, an FE is strictly speaking no more than a component of the place of supply rules.[87] Furthermore, there is no guarantee that the concepts of FE and PE are identical.[88] However, underlying both concepts is a shared concern about how taxing rights should be allocated across countries. Just as the way the concept of PE is structured directly affects the scope of taxing rights for source countries, the components of an FE influence VAT taxing rights at the place where services are provided. CJEU case law has generally required the presence of adequate human and technical resources for

[87] Nishiyama (2021), p. 49.
[88] Regarding the traditional understanding of PE, the author has nothing to add to Skaar (2020).

the recognition of an FE, which represents a potential balance point. However, this is just one option and not an inevitable one. For example, as seen in the case of retail sales tax in U.S. states, an alternative could be to use quantitative thresholds, such as turnover.[89]

Additionally, how VAT should be imposed on internal transactions between the head office and branches becomes a point of contention due to the need to secure taxing rights for the country where the branch is located. In this context, the possibility of treating the head office and branches as segmented individual units was suggested in the *FCE Bank* Case.[90] Moreover, in the context of input VAT deduction, the independence of the head office and branches has been emphasized (*LCL* Case), while in other instances, the aim has been toward integration (*MS* Case). The author does not currently possess a theoretical hypothesis to rationally explain the series of approaches taken by the CJEU.[91] Nonetheless, it is evident from the CJEU's judgments that these issues are closely related to how input VAT deduction is positioned under EU law.[92]

Previously, it was suggested that transfer pricing regulations are unnecessary in the world of fully destination-based VAT. However, in the current situation, determining how taxing rights are allocated between the principal place of business and the location of the FE for cross-border economic activities remains a critical issue. There are a variety of options to consider, such as how much of a burden should be placed on the place of supply rules or exploring the possibility of an arm's length-type framework as seen in income taxation.[93, 94, 95]

V. Conclusion

This paper does not aim to provide immediately actionable proposals. However, the discussions based on the background issues outlined above are expected to be beneficial in designing Japan's VAT system. They will also serve as a foundation for research from the perspective of allocating taxing rights among nations. In Japan, determining the distinction between domestic and international transactions—which ultimately defines the scope of VAT's taxing rights—remains a significant problem. In addressing this problem, it is probably useful to learn from the experiences of EU-VAT.

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[89] Thang & Shatalow (2022), p. 428.

[90] Indeed, in the *FCE Bank* case, while the independence of the head office and branch was not ultimately recognized, it is also true that their independence could have been acknowledged depending on the economic risk involved.

[91] Bal (2021), p. 378, points out "[t]he issue of the input VAT deductibility in FE/head-office relationships became more complex after the CJEU decision in Morgan Stanley."

[92] Input tax deduction is referred to as "the right to deduct" in the Sixth Directive (Article 17) and as "a right of deduction" in the current VAT Directive (Article 167). In EU VAT, input tax deduction is often explained as a taxpayer's right (Nishiyama, 2017, p. 25). However, even if it is positioned as a right, questions remain about the extent to which it can be exercised, which remains a research topic.

[93] On this point, Kristoffersson (2023) provides valuable insights by comparing EU VAT with the OECD VAT Guideline.

[94] Attention should also be paid to Article 80 of the current VAT Directive. It indicates that even within VAT, transaction prices can be adjusted to prevent tax avoidance within corporate group transactions, using the concept of "open market value." This concept reflects an approach similar to transfer pricing in correcting the allocation of taxing rights.

[95] In the OECD VAT Guideline, for services provided to companies operating in multiple countries, taxing rights are aimed at the location where the services are used (Guideline 3.4). The recharge method is proposed as one way to achieve this. (para. 3.71) This highlights the need for cross-disciplinary research between corporate income tax and VAT.

However, rather than resolving all issues, this paper leaves many research challenges unanswered. It has highlighted the necessity for more in-depth studies on the allocation of taxing rights concerning multinational enterprises—not only from the perspective of corporate income tax, but also from the perspective of VAT. Even if full destination-based taxation is deemed ideal, if it remains merely an ideal, legal scholars must set it aside temporarily and focus on discussions grounded in the current framework. Issues analogous to those discussed under corporate income tax concepts such as permanent establishments (PEs) and arm's length principles have also emerged in VAT, specifically concerning the criteria for recognizing fixed establishments (FEs) and the handling of intra-entity transactions between head offices and branches. The CJEU has grappled with such issues, continually questioning what constitutes a rational allocation of taxing rights. Such inquiries have parallels in the bilateral tax treaty framework developed for income taxation. In this sense, insights gained from corporate income tax studies can enrich VAT research, and vice versa. If Pillar One is understood as a step toward expanding destination-based taxation[96], the conceptual model of origin-based taxation versus destination-based taxation may become increasingly fluid. While the challenge of determining rational allocations of taxing rights grows ever more complex, meticulous research must continue. This includes reevaluating the tools and mechanisms of VAT to discern what is necessary and what is redundant, without becoming overly immersed in the realm of income taxation.[97]

With these research challenges outlined, this paper comes to a close.[98]

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[96] Fujiwara (2020-2021) analyzes this topic in that direction.

[97] At the federal level in the United States, which does not have a value-added tax, it has been pointed out that recent academic discussions increasingly consider the coexistence of income taxation and consumption taxation. *See* Sekiguchi (2015), p. 298 ff. In the realm of tax jurisdiction allocation, it will likely become important to explore what constitutes a "reasonable" arrangement by comprehensively considering the advantages and disadvantages of each type of taxation.

[98] In this regard, Hammerl & Zechner (2022) represents a recent and intriguing study.

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