Switzerland: Characterization of a PE for VAT purposes

Switzerland’s tax administration issued an administrative decision on 7 January 2016 that clarifies the definition of a permanent establishment (PE, also known as a “fixed establishment”) for VAT purposes, specifically in the context of servers located in the country. The tax administration rejected a VAT refund request from a non-Swiss-established entity on the grounds that the company’s server located in Switzerland constituted a PE of the non-Swiss entity. This decision provides one example of how the concept of a PE is evolving; additionally, multinationals should be aware of broader tax developments (e.g. those relating to the BEPS initiative and EU case law) that may affect whether a PE exists for VAT purposes.

Decision of the Swiss tax administration

In Switzerland, a server can be regarded as a PE based on the published tax guidance of the Swiss tax authorities (VAT Info 13 “electronic and telecommunication services”), provided the server is not used only for preparatory or auxiliary services. It is not necessary for a foreign entity to own the server to create a PE, but it must specifically lease the server itself, and not merely the server’s storage and computing capacity. In determining whether a server forms a VAT PE in Switzerland, the tax authorities will analyze each case on its facts.

Under the facts relating to the refund request, the foreign company utilized co-location services from a Swiss data center and used the Swiss servers to grant the foreign company’s customers access to a variety of cloud-based applications. The Swiss tax administration took the position that the cloud-based applications constituted the core business of the foreign company and that they did not merely have a preparatory or ancillary function. Therefore, the servers formed a VAT PE in Switzerland, through which the foreign company performed its business activities.

Interaction of Swiss position with other developments

The concept of a PE for VAT purposes is important, since whether a PE exists will determine the place where certain services are subject to VAT and whether a business may exercise a right to claim a refund of VAT (as a non-established person).

Recent developments, such as the OECD’s BEPS project, the 2014 decision of the Court of Justice of the European Union (CJEU) in the Welmory case and the EU Union Customs Code (UCC) that became effective on 1 May 2016 are refining the understanding of the concept of a PE, but at the same time are raising questions on how the concept may be applied in practice in the EU (for prior coverage of the CJEU decision, see World Tax Advisor, 24 October 2014 and for prior coverage of the UCC, see World Tax Advisor, 22 April 2016). The Welmory case relates to VAT in the context of e-commerce, while the recommendations under the BEPS project (and the rules under the UCC) are broader in scope.

**URL:** http://newsletters.usdbriefs.com/2014/Tax/WTA/141024_3.html
**URL:** http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_1.html

**BEPS:** In many countries, the definitions of a PE for corporate income tax purposes and for VAT purposes are linked in practice. Implementing the recommendations under action 7 of the BEPS project, “Preventing the Artificial Avoidance of Permanent Establishment Status,” likely would result in far-reaching changes to the rules for determining the taxable presence of an enterprise in a particular country, especially in situations where intermediaries (such as agents, commissionnaires, etc.) are used to avoid creating a PE in a country. For example, the BEPS recommendations lower the threshold for determining when an independent agent would be considered a PE of a company, so that if such an agent acts exclusively (or almost exclusively) for one or more enterprises to which it is closely related, it would not be considered an independent agent. (Similarly, the amended “exporter” definition in the UCC refers to an entity that is established in the customs territory of the EU, holds the contract with the consignee in the non-EU country at the time of filing the export and/or has the power to determine that the goods can be transported out of the EU.)

Additionally, the implementation of action 7 could affect companies operating with an inventory of goods in several countries, since, under the BEPS recommendations, having inventory in a country may create a PE if this inventory is essential for the company’s core activity.
**CJEU decision in Welmory:** The CJEU provided valuable guidance on the question relating to when a fixed establishment will be deemed to exist in the context of e-commerce. The court held that a PE in a digital context requires an appropriate structure in terms of human and technical resources (such as computer equipment, servers and software) to enable the person to receive the services supplied and use them for its business. The decision also confirms that jurisprudence on the interpretation of fixed establishments continues to be relevant after the introduction of the EU VAT package on 1 January 2010 that updated the place of supply rules for the provision of services within the EU.

It would appear that both the BEPS recommendations and the CJEU decision in Welmory imply that if an economic activity can be performed without requiring an effective human and material structure in a country, then another structure (such as a technical structure involving computer equipment, servers and software) may be sufficient to characterize a PE from a VAT perspective. The Swiss tax administration’s position on when a server can create a VAT PE seems broadly in line with this interpretation.

**Comments**

The concept of a PE/fixed establishment clearly is evolving. Businesses operating in Europe with a presence in multiple countries should assess how these developments will affect their existing processes, organization and models for VAT purposes. In addition, for businesses involved in international operations, the future implementation of new business models should be closely monitored to identify any potential risk of a PE/fixed establishment characterization from both a corporate income tax and a VAT perspective, and to avoid incurring additional costs and obligations.

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