EU VAT: SIMPLIFICATION RULES FOR INTRA-EU TRANSACTION CHAINS

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Introduction

Traders based in an EU Member State (MS) selling goods to business customers established in another MS may need to source those goods from a supplier established in a third MS. In order to save time and costs, the parties often agree that the goods are transported directly from the original supplier's MS to that of the final customer, without passing through the MS of the intermediate party. This arrangement is known as "triangulation" and simplification measures are available when certain requirements are met.

Although the EU VAT Directive[2] does not contain rules specifically relating to intra-EU triangular transactions, it does contain a mechanism which simplifies the VAT treatment of specific types of such transactions. The simplification has the effect of avoiding the requirement for the intermediate party of the transaction to register for VAT in either of the MS of origin or the MS of destination of the goods.

It is generally accepted that the simplification is limited to triangular transactions involving three parties established in three different MS. Thus, supplier A established in MS 1 supplies goods to an intermediate supplier B established in MS 2, who then supplies the same goods to a final customer C established in MS 3, and the goods move directly from MS 1 to MS 3.

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2 All references in this article concern articles of the Council Directive 2006/112/EC of 28 November 2006

Where a fourth party (a second intermediate party) is added to the chain, the second intermediate party (B2) may be established in MS 1, 2 or 3, or in a fourth MS. As we shall see, there is no adequate simplification procedure in most such scenarios, which usually has the effect that the intermediate parties (B1 and B2) must be registered in the MS of the first supplier (MS 1) or the MS of the final customer (MS 3)[3]. However, the simplification can also be applied where the four parties (A, B1, B2 and C) are established in three MS, provided that the first supplier (A) and the first intermediate party (B1) are established in the same MS, which must be different from those where the second intermediate party (B2) and the final customer (C) are established.

Triangulation

Where, for example, supplier A established in France supplies goods to an intermediate party B established in the United Kingdom, who supplies the same goods to final customer C established in the Netherlands, and the goods move directly from France to the Netherlands, only one of the supplies is a zero-rated supply[4], commonly known as a zero-rated intra-EU supply.

Under article 138, MS must zero-rate a supply of goods dispatched or transported to a destination outside their territory but within the EU, provided that the customer is a taxable person in a MS other than that in which the dispatch or transport of the goods begins. There is no bar to this provision, which means that the zero rate applies, even where the location of the customer and the destination of the goods are in different MS. If the French supplier A delivers the goods in the Netherlands, A's supply to the UK intermediate party B is the zero-rated intra-EU supply, which gives rise to a taxed intra-EU acquisition of the goods, effected by the customer, i.e. the UK intermediate party (B).

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3 The VAT treatment of triangular transactions is mainly based on unwritten rules. However, in its judgement Eder OHG v Finanzlandesdirektion für Kärnten of 6 April 2006 (C-245/04), the Court of Justice of the European Union (ECJ) confirmed most of those rules and declared that:

- where two successive supplies of the same goods give rise to a single intra-EU dispatch or transport of those goods, that dispatch or transport can be ascribed to only one of the two supplies, which alone will be zero-rated as an intra-EU supply;
- only the supply which gives rise to an intra-EU dispatch or transport of goods is deemed to be made in the MS of departure or in the MS of arrival of that dispatch or transport, depending on whether that supply is the first or the second of the two successive supplies.

4 In the terminology of the VAT Directive, intra-EU supplies of goods are "exempt from VAT conferring on the supplier the right to deduct related input VAT". Those exemptions are commonly labelled as zero rates.

The taxable event "intra-EU acquisition" is comparable to the "importation of goods", although "importers" must in principle pay "import VAT" to the customs authorities on goods entering into a MS from a place outside the EU, whereas "acquirers" must "pay"[5] VAT on the intra-EU acquisition (known as "acquisition VAT") to the tax authorities on goods entering into a MS from another MS.

Article 40 states that the place of the intra-EU acquisition is the MS where the dispatch of the goods ends, which implies that the UK intermediate party B must account for acquisition VAT in the Netherlands. To that end, B must register for VAT in the Netherlands. Having done so, B's subsequent supply to final customer C in the Netherlands is subject to VAT in the Netherlands.

Triangulation – Simplification

Given that registering for VAT in another MS is onerous and costly, the UK intermediate party may fall back on article 141, which releases it from having to account for acquisition VAT in the final customer's MS (the Netherlands) and also in the MS of registration (the United Kingdom) if all of the following conditions are met:

(a) the acquisition is made in a MS (the Netherlands) by a taxable person (the UK intermediate party) who is not established in the MS concerned (the Netherlands) but is identified for VAT purposes in another MS (the United Kingdom);

(b) the acquisition is made for the purposes of a subsequent supply of those goods in the MS concerned (the Netherlands);

(c) the goods are directly dispatched from a MS (France) other than that in which the taxable person (the UK intermediate supplier) is identified for VAT purposes (the United Kingdom) to the person for whom it is to carry out the subsequent supply (the final customer in the Netherlands);

(d) the person to whom the subsequent supply is to be made (the final customer in the Netherlands) is another taxable person who is identified for VAT purposes in the MS concerned (the Netherlands); and

(e) the final customer (C in the Netherlands) has been designated as liable for payment of VAT on the domestic supply (taking place in the Netherlands) made by the UK intermediate supplier (B).

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5 The acquirer does not actually have to pay acquisition VAT to the tax authorities if it is entitled to deduct it as input VAT through the same VAT return.

Under the simplification, regardless of the transaction to which the transport is ascribed, the French supplier makes the zero-rated intra-EU supply; the UK intermediate party (B) does not need to account for acquisition VAT in the Netherlands or in the United Kingdom, and it does not have to charge VAT to the final customer (C) in the Netherlands. Under the simplification, the final customer C must account for VAT in the Netherlands under the reverse charge mechanism on the domestic supply made by the UK intermediate supplier B.

Longer Chains including three Member States

The scenario can be extended so that the intermediate supplier in the United Kingdom (B1) supplies the goods to a second intermediate party in the United Kingdom (B2). B2 then supplies the same goods to the final customer C in the Netherlands and the goods move directly from supplier A in France to the Netherlands.

If the French supplier (A) delivers the goods to the Netherlands, its supply to B1 is the zero-rated intra-EU supply. The complication arises with the supply between the UK intermediate parties B1 and B2. That supply cannot be subject to UK VAT because the goods are at no stage in the United Kingdom. Under article 31, where goods are not dispatched or transported, the place of supply is the place where the goods are located at the time when the supply takes place. Thus, B1's supply to UK intermediate party B2 is deemed to be made in the Netherlands (the place of acquisition under article 40, see above).

If the UK intermediate supplier B1 considers the five points in article 141 (see above), it will find that it does not meet the requirement of point (d). B1 supplies the goods to the UK intermediate party B2 and that party is not registered for VAT in the Member State in which the acquisition is made (the Netherlands). Therefore, article 141 does not apply; B1 has made an intra-Community acquisition of goods in the Netherlands and must register for VAT there in order to account for acquisition VAT.

This scenario creates a further problem, as B1 must then charge Dutch VAT to B2 – the place of supply of the goods is the Netherlands, as B1 has acquired the goods there and is making an onward supply to B2. B2 has no option but to recover the Dutch VAT under Directive 2008/911 (formerly "the Eighth Directive"). Article 3 of that Directive states that refunds cannot be made to businesses which have made a supply of goods in the MS of refund during the refund period, except where the customer must account for VAT on that supply under the reverse charge mechanism. Article 194 states that, where a taxable supply of goods or services is

made by a person who is not established in the MS in which the VAT is due, the MS concerned may provide that the customer is liable for the VAT.

The Netherlands is one of a number of MS which have made use of that provision, which means that B2 does not have to register in the Netherlands in order to account for VAT on the domestic supply to customer C. However, the fact that the final customer C must account for VAT under the reverse charge mechanism does not have any effect on the simplification measure in article 141 because point (e) of that provision requires that, for the purposes of the simplification, the final consumer must be designated to account for VAT under the reverse charge mechanism under article 197 (not article 194). Consequently, B1 must charge Dutch VAT to B2; B2 reclaims this VAT under Directive 2008/9 and does not charge Dutch VAT on its supply to its customer (C) in the Netherlands, leaving it to the customer to account for VAT in the Netherlands under the reverse charge mechanism.

Not all MS apply article 194 in relation to goods. For example, if the final customer and the destination of the goods were in Ireland, instead of the Netherlands, the UK intermediate supplier B2 would need to register for VAT in Ireland and charge Irish VAT on its supply to its Irish customer. However, the VAT consequences of this example may still be simplified if the UK intermediate party B1 were established in France (not in the United Kingdom) and if the transport of the goods from France to the Netherlands were ascribed to the supply made by the French intermediate party B1.

Under those circumstances, the supply made by the French supplier A to the French intermediate party B1 would qualify as a domestic supply in France, which means that A charges French VAT to B1, which B1 can deduct through its French VAT return. The subsequent supply made by French intermediate supplier B1 to UK intermediate party B2 qualifies as a zero-rated intra-EU supply because the goods are transported from France to the Netherlands. The triangular transactions involving B1, B2 and C then fulfil all conditions laid down in article 141:

- the acquirer (B2) is neither established nor registered in the MS where the acquisition is made (the Netherlands);
- B2 acquires the goods for the purposes of a subsequent supply of the goods to the final customer (C);
- the goods acquired by B2 are directly dispatched from a MS (France) where B2 is not registered, and they are transported to C;
- final customer C is identified for VAT purposes in the MS concerned (the Netherlands); and

- final customer C has been designated in the Netherlands to account for VAT under the reverse charge mechanism there on the domestic supply made by the UK intermediate supplier (B2).

Longer Chains involving four Member States

Where, for example, supplier A established in Poland supplies goods to an intermediate party B1 established in Ireland, B1 supplies the same goods to a second intermediate party B2 established in Belgium, who finally supplies the goods to a final customer C established in Slovenia, and the goods move directly from Poland to Slovenia, the supply made by the Polish supplier A to the Irish intermediate party B1 qualifies for zero-rating under article 138, if the Polish supplier A transports the goods to Slovenia (intra-EU transport of the goods is ascribed to the first supply).

The chain of transactions does not qualify for the simplification laid down by article 141, because the Irish acquirer of the goods (B1) supplies the goods to B2, who is neither identified nor designated to account for VAT under the reverse charge mechanism in the MS of acquisition (Slovenia). However, the situation may change if, contrary to the principles on which the simplification is based, the Irish intermediate party decides to register in Poland where it is not established.

Unless the Irish intermediate party (B1) registers in Poland, it must register for VAT in Slovenia and account for acquisition VAT there under article 40. B1 then has to charge Slovenian VAT to the Belgian intermediate party B2, who has to charge Slovenian VAT to the final customer C. The consequence of this scenario is that both the Irish and Belgian intermediate parties must be registered for VAT in Slovenia.

More parties, more Member States involved

Although the simplification in article 141 is aimed at preventing multiple registrations in the framework of triangular transactions, the consequences of the simplification can also be used if intermediate parties voluntarily register or are required to register in another MS, because the only “physical” aspects of the simplification are the place of acquisition (place of physical delivery of the goods) and the condition that the acquirer is not established there (condition (a)).

Four parties established in three Member States

For example, if the UK intermediate party B1 were not only registered in the United Kingdom but also in France, and the intra-EU transport of the goods from

France to the Netherlands were ascribed to the supply made by B1, the simplification in article 141 can be inserted into the chain.

The supply made by the French supplier A to UK intermediate party B1 would then qualify as a domestic supply in France, which means that A charges French VAT to B1. Since it also registered in France, B1 can deduct the French VAT through its French VAT return. The subsequent supply between the two UK intermediate parties qualifies as a zero-rated intra-EU supply because the goods are transported from France to the Netherlands. The triangular transactions involving B1, B2 and C then fulfil all conditions laid down in article 141:

- the acquirer (B2) is neither established nor registered in the MS where the acquisition is made (the Netherlands);
- B2 acquires the goods for the purposes of a subsequent supply of the goods to the final customer (C);
- the goods acquired by B2 are directly dispatched from a MS (France) where B2 is not registered, and they are transported to C;
- the final customer C is identified for VAT purposes in the MS concerned (the Netherlands); and
- the final customer C has been designated in the Netherlands to account for VAT under the reverse charge mechanism there on the domestic supply made by the UK intermediate supplier (B2).

The conclusion was that, since Ireland does not apply the reverse charge mechanism under article 194 to supplies of goods made by non-resident suppliers, the UK intermediate supplier B2 must be registered in Ireland. However, by registering in Ireland, B2 creates a situation in which the conditions of article 141 are fulfilled.

In this scenario the simplification applies because Ireland does not apply the condition that, for the purposes of the simplification, the intermediate supplier cannot be registered in the MS where the goods are delivered (Ireland). An additional condition is that the intra-EU transport of the goods from France to Ireland is ascribed to the supply made by B1. However, the "price" that B1 must pay for the simplification is that the transaction between A and B1 becomes a domestic supply in France, which means that B1 must apply for a refund there. The subsequent transaction between the two UK intermediary parties is then a zero-rated intra-EU supply (B2 must give B1 its Irish VAT identification number) and, although it is registered in Ireland, B2 does not have to pay acquisition VAT there and does not have to charge Irish VAT to its customer (C).

Four parties established in four Member States

The simplification in article 141 can also be inserted into the scenario with four parties in four different MS, provided that the Irish intermediate party B1 registers in Poland and the intra-Community transport of the goods from Poland to Slovenia is ascribed to the supply made by B1.

Under those circumstances, the supply made by the Polish supplier A to the Irish intermediate party B1 qualifies as a domestic supply in Poland, which means that A charges Polish VAT to B1. Since it is also registered in Poland, B1 can deduct that VAT through its Polish VAT return. The subsequent supply made by the Irish intermediate supplier B1 to Belgian intermediate party B2 qualifies as a zero-rated intra-EU supply because the goods are transported from Poland to Slovenia. The triangular transactions involving B1, B2 and C fulfil all conditions laid down in article 141 (see above).

Alteration of shipping arrangements

It is also possible to avoid the need for any party to register for VAT in another MS by changing the shipping arrangements. In the chain involving four parties and three MS, the goods might be shipped from France to the United Kingdom and, then, from the United Kingdom to the Netherlands, rather than directly from France to the Netherlands.

The French supplier (A) zero-rates its supply to its UK customer B1 under article 138, and B1 accounts for acquisition VAT in the United Kingdom. Subsequently, the UK intermediate supplier B1 charges UK VAT to UK intermediate party B2 – articles 138 and 141 do not apply. Finally, the UK intermediate supplier B2 makes a zero-rated intra-EU supply to customer C (article 138 applies, as the goods are dispatched from the United Kingdom – although from B1's premises – to the Netherlands), and customer C accounts for acquisition VAT in the Netherlands. However, this solution can only be applied where intra-EU transport of the goods from the United Kingdom to the Netherlands is ascribed to the supply made by B2.

This solution, which does not involve the simplification, gives rise to additional shipping costs but may still be less onerous than registration by the intermediate parties for VAT in France or the Netherlands. The additional shipping costs in this example are relatively high on account of the more or less isolated position of the United Kingdom. The shipping cost would be much lower if supplier A were established in, for example, Luxembourg, and the intermediate parties B1 and B2 in Belgium.

Likewise, in the example involving four MS, the goods could first be shipped from Poland to Ireland and, then, from Ireland to Slovenia. The supply made by the Polish supplier to its Irish customer would be a straightforward zero-rated intra-EU supply of goods leading to a taxed intra-EU acquisition of the goods effected by B1 in Ireland. The subsequent supplies between B1 and B2, and between B2 and C, would qualify for the simplification for triangular transactions: the Irish supplier B1 makes a zero-rated intra-EU supply, B2 does not account for acquisition VAT in Slovenia or in Belgium and does not charge VAT to final customer C, and C accounts for VAT under the reverse charge mechanism on the domestic supply made to it by B2.

The additional costs of shipping the goods to intermediate party B1's MS would, of course, be much lower if B1 were established in, for example, the Czech Republic, instead of Ireland.

Conclusion

The VAT rules for intra-EU triangulation have operated for many years and are costly and complex in terms of VAT registrations abroad. The costs of multiple registrations can be avoided by delivering the goods to the intermediate parties, but that solution results in additional shipping costs. The costs of additional registration can also be avoided by applying the simplification in article 141. Contrary to popular belief, the simplification is not necessarily limited to triangular transactions involving three parties established in three different Member States.

Although it is aimed at avoiding multiple registrations, the simplification can also be inserted into longer chains involving more than three parties and more than three MS, but the intermediate party or one of the intermediate parties must then be registered in another MS. In addition, the parties must agree to which supply the intra-EU transport of the goods is ascribed.

In practice, businesses do not always follow the VAT rules strictly and, in most cases, the tax authorities do not even notice their creative and practical solutions. However, practical solutions that deviate from the formal rules may lead to serious financial consequences when the tax authorities find that one of the parties in the chain is a missing trader, which happens regularly. Under those circumstances, the tax authorities may attempt to recover the loss of revenue from legitimate businesses in the chain. That attempt may be successful if the legitimate businesses have not followed the formal VAT rules.

The EU Council should seize the announced redrafting of the VAT Directive as an opportunity to simplify the VAT rules for intra-EU transactions involving goods,

including triangular transactions, with a view to making the VAT rules simpler and less vulnerable to fraud and, consequently, less risky for legitimate businesses. More practical rules for intra-EU transactions would no doubt be of great benefit to businesses in the European Union.