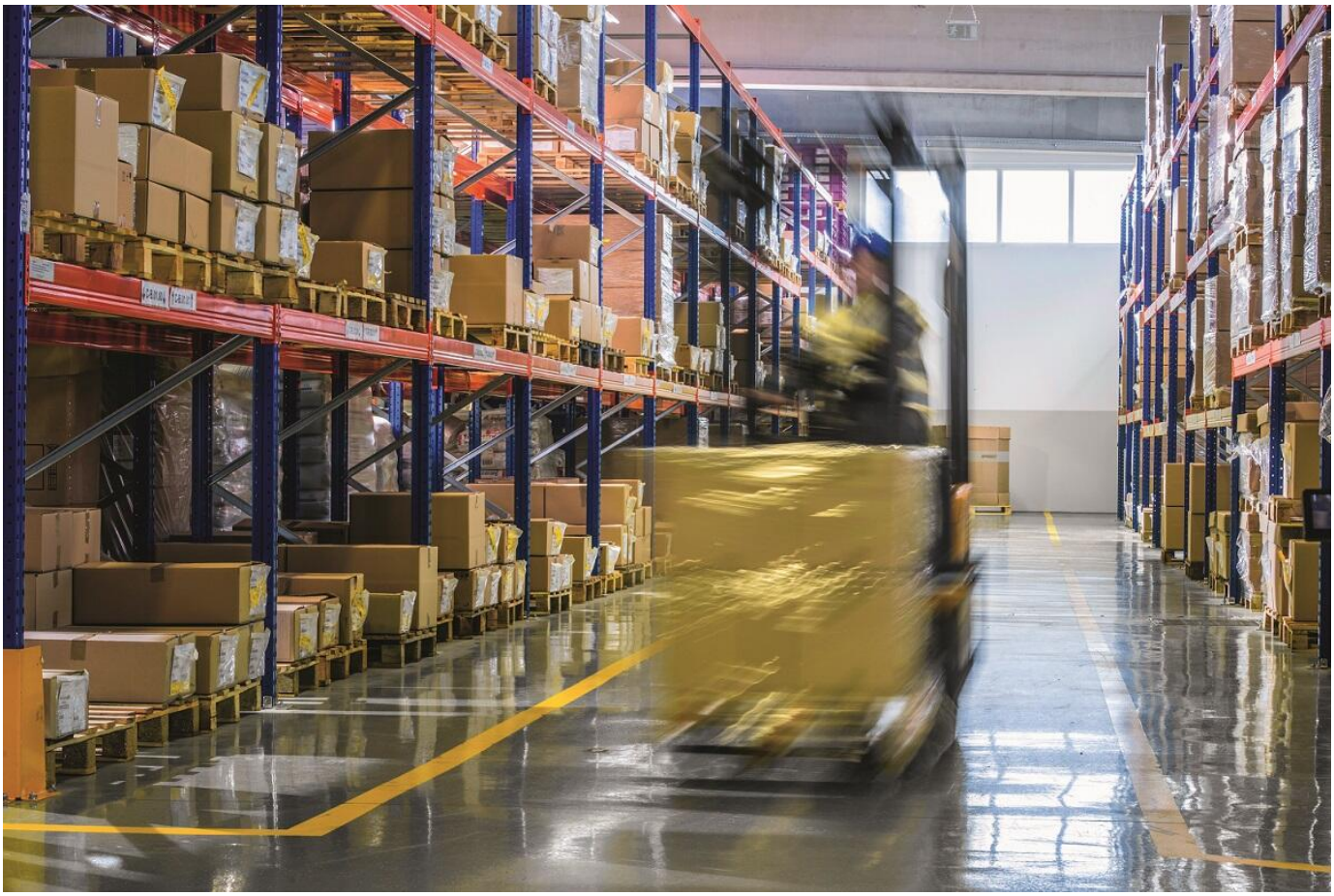
Risk and reward

Indirect Tax



01 June 2015

Iona Brooks covers the key rules regarding the business to business sale of goods in the EU and common issues that businesses may face

Key Points

What is the issue?

Due to the lack of uniformity in how the VAT Directive has been implemented, member states have different rules, requirements and conditions that businesses

are required to adhere to

What does it mean for me?

Where local VAT advice is not sought, businesses that are involved in the B2B sale of goods cross border may be at risk of not complying with local rules

What can I take away?

An understanding of the risks involved with trading goods cross border, together with an awareness of some of the common pitfalls that can arise for businesses

For a business, the ability to trade cross border can open up many new markets and opportunities. Unfortunately, however, by expanding into new territories there is an increased risk, one of which relates to non-compliance with local rules.

General rule

Where goods are sold business to business (B2B) cross border, there are considered to be two supplies: an intra-community dispatch from the member state where the goods leave; and an intra-community acquisition in the member state where the goods are delivered.

Provided that the supplier is able to prove its customer is in business (for example, with the provision of a valid VAT number) and the goods leave the supplier's member state, the supplier is not required to levy VAT on its sale. Instead, this is subject to the zero rate of VAT (commonly referred to as an 'exempt with credit supply' in other member states). The purchaser is required to account for acquisition VAT on its VAT return at the appropriate rate of VAT in force in its member state; essentially, the purchaser carries out a self-assessment of the VAT due.

The treatment of this B2B supply is governed by the VAT Directive (2006/112/EC). The Directive's principal purpose is to detail the common system of VAT and provide a uniform basis for assessment. Unfortunately, what we see in practice is that the member states' implementation of this Directive is not uniform.

Evidence

The extent of evidence required by a supplier in order to zero rate its B2B supply of goods varies across the EU.

Most member states require the supplier to collect its customer's EU VAT number and check that it is valid; using, for example, the VIES checker on the European Commission's website. However, some members states also make the supplier provide a declaration confirming the validity of its customer's VAT number and that there has been no cancellation (either partly or fully) of the order.

For evidencing the removal of the goods, the requirements of various member states can vary significantly.

Taking the UK as an example, commercial evidence must be obtained to demonstrate that the goods have left the UK within a certain time frame – which is usually three months from the time of supply, provided that the goods do not undergo processing. However, other member states are more prescriptive; for example, some member states require numerous supporting documents to evidence the transport, including, where appropriate, the requirement to retain the name of the driver providing the transport, together with the registration number of the vehicle.

Note that in the UK, where the supplier is unable to obtain the evidence that the goods have left the UK within the required time frame, the supplier is required to account for UK VAT on the goods. Should the supplier subsequently obtain the evidence, however, HMRC allow the supplier to recover the VAT paid and treat its supply as that of a zero-rated intra-community supply.

Sadly, other member states do not take the same pragmatic approach.

The risk of not complying with the requirements in any particular member state is that the tax authority may look to assess for local VAT that they consider is payable on the supply, together with possible penalties and interest. Many suppliers may be unable to pass on this additional cost. In an increasingly globalised world, where businesses are being pushed to lower their margin in order to remain competitive, suppliers are at risk of having their margin eliminated should they fall foul of these requirements.

Call off and consignment stock

The terms ‘call off stock’ and ‘consignment stock’ refer to the B2B cross border transfer of goods where the goods are typically transported to another member state and held in a warehouse. Typically, title does not transfer until the customer removes the goods from the warehouse. The key difference between the two types of supply is that for call off stock, the buyer of the goods is known in advance of the transfer. Note that in confirming the VAT treatment with various member states, certain territories use the term ‘consignment stock’ for what is properly ‘call off stock’.

Under normal rules, this should be treated as a movement of own goods, typically resulting in a requirement for the supplier to register for VAT in the member state of destination to account for acquisition tax.

The Directive does allow for member states to apply a simplification that enables suppliers to avoid a local VAT registration. A business customer must account for the acquisition tax on the supplier’s behalf. Unfortunately, as this is an optional simplification, not all member states have applied the simplification. Additional complexities arise where member states require that certain conditions be met in order for the simplification to be applied. For example, formal authorisation is required from certain tax authorities prior to using the simplification.

Before the transaction takes place, it is necessary for suppliers to ascertain whether the member state of destination applies such a simplification. If it does not, VAT registrations may be required in the member states where they transfer their stock, with local VAT possibly due on the onward sale.

Chain transactions

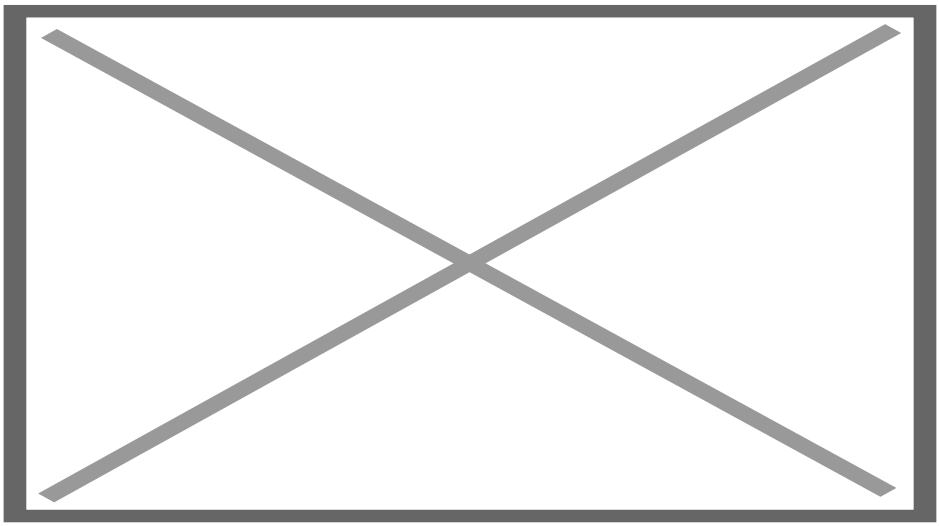
An intra-community chain transaction often refers to the scenario where there are two or more sales of goods between different parties, but only one movement of the goods.

The difficulty for businesses in this scenario comes when determining which transaction in the chain qualifies as the intra-community supply of goods, as there can only be one zero-rated supply. The Directive does not clearly define which transaction should benefit from the zero rating. Therefore, the rules applied by member states are principally derived from case law.

As such, the rules applied across the member states in relation to chain transactions can be unclear and inconsistent. However, in determining which supply qualifies for the intra-community, the majority of member states pay consideration to the Incoterms used (Incoterms® are a set of rules defining the responsibilities of sellers and buyers for the delivery of goods under sales contracts. They are published by the International Chamber of Commerce (ICC) and are widely used in commercial transactions), and the contractual and transport arrangements. Should these items conflict, however, there seems to be little agreement on which factor should be decisive.

Triangulation

A triangular transaction involves three parties (A, B and C) in three different member states (see ***Table 1***). There are two sales (one between A and B; and the second between B and C) and one movement of goods from member state A to member state C.



Under normal rules, company B would be required to account for acquisition VAT in the member state of arrival and charge local VAT on its domestic supply to company C. This should lead to a VAT registration requirement for company B in member state C.

However, in order to avoid unnecessary VAT registrations for businesses, a simplification can be applied. This can be found in Article 141 of the Directive.
In short, provided that certain conditions are met, where the first supply qualifies as an intra-community supply, the intermediary supplier (company B) can elect to use

the simplification on its own sale, thereby removing any VAT registration obligation in member state C that should arise as a result of this transaction. Instead, company C is required to account for the acquisition on its local VAT return.

This sounds relatively straightforward, so where do the complexities come in?

The complexity comes in principally because of the lack of consistency in how Article 141 has been implemented in local legislation across member states. In particular, a considerable number of member states do not allow the simplification to be applied where company B is VAT registered and/or established in the member state of dispatch and/or arrival.

It is also important to note that should the first supply not be considered to be an intra-community supply, then the simplification cannot be applied. Therefore, to determine whether the simplification can be applied, a business needs to understand the VAT rules regarding the movement of goods in member state A, C and potentially B. There does come a point where this simplification stops looking so simple.

Suppliers, therefore, need to ensure that they register for VAT and apply for authorisation to use the simplification where required to do so.

They also need to understand the compliance requirements in member states where they are registered and ensure that they have a process in place for dealing with local VAT audits that may arise.

Is there light at the end of the tunnel?

It is clear that the lack of harmonisation across the member states with respect to B2B supplies of goods poses an increased compliance burden and risk for businesses that trade cross border. The lack of certainty results in transactions being open to challenge, which is demonstrated by the increasing number of cases being referred to the European Court of Justice that relate to the movement of goods.

This has not gone unnoticed. In order to address the inherent problems with the current B2B rules, the European Commission has commissioned a study to look at five alternative models of taxing B2B movement of goods.

The key drivers behind the study are that doing business across the EU should be as simple and safe as engaging in purely domestic activities; and that the cost of VAT compliance for business activities across the EU must be reduced.

The European Commission has appointed EY to undertake the study, with the results due to be released later this year. Interestingly, one of the study's taxation models looks at harmonising the treatment of certain transactions. For example, it considers making the call off stock simplification mandatory across all member states and looks to put in place formal rules around chain transactions and which supply should be treated as the intra-community supply.

The other models range from the relatively simple approach of replacing the requirement to account for acquisition tax with the 'reverse charge' predominantly associated with services, to a full blown one-stop shop return where the supplier is required to account for local VAT based on, under one option, the destination of the goods and, in another option, where the customer is established.

Any agreement on such points covered in this article is likely to be welcomed by businesses which are engaged in the B2B movement of goods cross border. This review is a step in the right direction. However, as we are all too aware, even in a scenario where member states agree on future legislation, problems in the VAT system are likely to remain, arising from legislative interpretation, local case law and local guidance provided by the tax authority. Unless businesses gain local know-how, an additional element of risk will likely remain when trading cross border. Therefore, the only real question for businesses to ask is, is the reward worth the risk?