INTRA EU SUPPLIES: NEW RULES ON CHAIN TRANSACTIONS

Many businesses are unaware of some changes to EU law that came into effect on 1 January 2020. They apply in the UK until the transitional period covering the UK's departure from the EU comes to an end on 31 December 2020.

Two of the clearest changes are that:

- A sale cannot be zero-rated as an intra-community supply if it is not declared on an EC Sales List; and
- A sale cannot be zero-rated as an intra-community supply if it does not contain a statement of the customer's VAT registration number issued by another EU country.

However. it is the impact of the new rules governing chain transaction that seem to present the most commonly overlooked risk.

Background

When a chain of transactions underpins a single movement of goods between two EU countries it can be difficult to determine which supply may be zero-rated (zero-rating of an intra-Community movement can only occur once).

In the chain transaction illustrated below, let us assume that A is in the UK and C is in Ireland, the location to which the goods are shipped:

- Must/may A charge B VAT in the country of dispatch (to allow B to zero-rate the sale to C) (Fig 1 (a)) ; or

- Must/may A zero-rate its sale to B, leading to a potential requirement for B to register for and charge VAT in Ireland (Fig 1(b)); or

- May the businesses decide for themselves which supply to zero-rate? [For example if B is established in the and VAT registered in

the UK then it is more straightforward for A to charge UK VAT and for B to zero-rate its sale.]

Fig. 1(a)

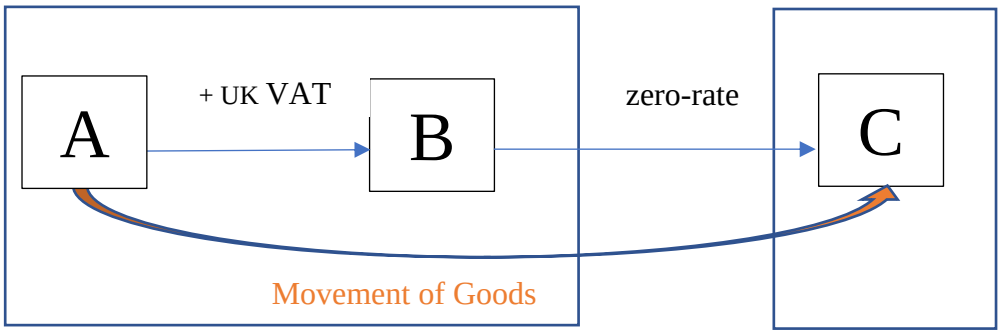
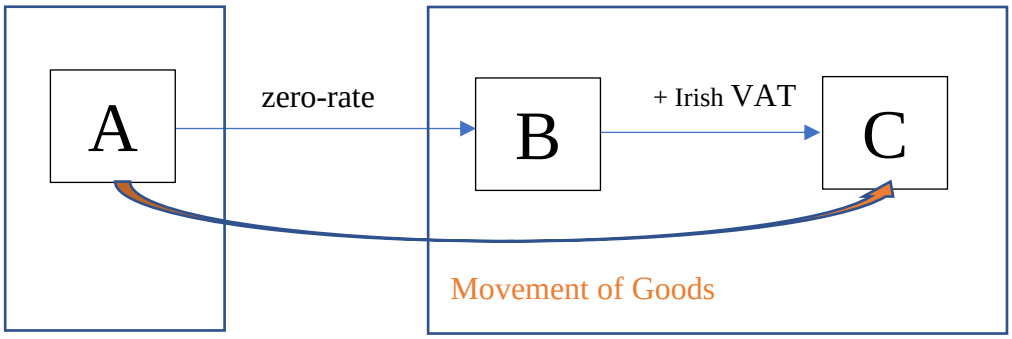


Fig. 1(b)



There has always been a need to ascribe the intra-community supply to one of the transactions (there cannot be two zero-rated sales). However, provided that there was no revenue loss, Member States have, historically, been content to allow businesses to apply the zero-rate to the transaction in the chain which was most administratively straightforward. Unfortunately, allowing pragmatic (but possibly incorrect) judgements led to an unsatisfactory situation (tax risk for taxpayers and potentially unenforceable liabilities for tax authorities) and the Court of Justice of the European Union (CJEU) has issued judgements in specific cases that made the legitimacy of this pragmatism at best questionable (and in practice probably wrong).

The legislative change for chain transactions is intended to make clear who in the supply chain should be viewed as making the intra-community (potentially zero-rated) supply. Unfortunately, this "clarity" is not necessarily what many businesses would have hoped for where it means that their previous practices no longer work.

We have said "potentially" zero-rated in relation to the intra-community movement because the fact that a sale could (in principle) be eligible for zero-rating as an intra-community shipment does not necessarily mean that all of the conditions for zero-rating can be met. If it is the sale from A to B that could be zero-rated this does not mean that the conditions that allow zero-rating will be met. For example, if A does not:

- quote B's non-UK VAT number on its sales invoice,
- hold commercial evidence of the shipment; and
- include the sale on its EC Sales list then,

the substantive conditions that allow zero-rating will not be met. A will need to charge UK VAT. The fact that B is also liable to charge Irish VAT would not negate that obligation.

So what are the new rules?

The new rules are complex and introduce the concept of an "intermediary operator" (a person in the supply chain other that the first supplier or the final customer). They are also ambiguous in some respects.

The new UK legislation (Value Added Tax (Place of Supply of Goods) Order 2004 (SI 2004/3148)) mirrors the change to the EU VAT Directive and reads as follows:

> ***5.*** *Article 16 applies where the same goods are—*
>
> *(a) supplied successively thorough a chain, and*
>
> *(b) dispatched or transported from one member State to another member State directly from the first supplier in the chain to the last customer in the chain.*

> ***16.*** *Where this article applies—*
>
> *(a) the intra-Community supply is to be treated as the supply that involves the removal of the goods from or to the United Kingdom; and*
>
> *(b) all supplies made after the intra-Community supply are to be treated as supplied—*
>
> *(i) outside the United Kingdom in the case of goods removed or to be removed from the United Kingdom to a customer in another member State; or*
>
> *(ii) within the United Kingdom in the case of goods removed or to be removed from another member State to a customer in the United Kingdom.*
>
> ***17.*** *The "intra-Community supply" is—*
>
> *(a) the supply in the chain that is made to the intermediary operator ("I"), or*
>
> *(b) where I has provided its supplier with the VAT identification number issued to I by the member State from which the goods are dispatched or transported, the supply in the chain that is made by I.*
>
> ***18.*** *"Intermediary operator" means a supplier within the chain other than the first supplier in the chain who dispatches or transports the goods either itself or through a third party acting on its behalf."*

The first point of ambiguity is the definition of an intermediary operator. To be such a person it is necessary to dispatch or transport the goods. Therefore, if the first supplier is responsible for such transportation then logically there is no intermediary operator. If there is no intermediary operator, then the definition of which supply is the intra-community supply in Article 17 seems redundant (it only contemplates that supply being the supply to or by an intermediary operator).

This seems like poor legislative drafting to us, although we suspect that HMRC and other EU countries would all say that by default it is the first supply that is the intra-community supply (from A to B in the illustration).

Impact of the new rules?

If your business plays the role of "B" in the above illustration, then the new rules may present no problem if you are already registered for VAT

in the country to which the goods are shipped. However, there is a potential problem for B if it is:

- registered for VAT in the same country as A, and
- wants to pay and reclaim VAT (in that location) on the purchase, and
- wishes to zero-rate its own sale to C.

To do this it must provide A with its local VAT registration number (not a huge burden but not something to be overlooked). It must also be capable of being viewed as the person *"…who dispatches or transports the goods either itself or through a third party acting on its behalf."* This is where the problem starts. In the majority of cases it will be A that is dealing with the shipment so this may be far from straightforward (there is a secondary point also insofar as if A deals with the shipment then B will have limited commercial evidence that the goods have actually been transported, another condition of zero-rating).

B being VAT registered in the destination country and charging local VAT on its sale is certainly the easiest option in theory. However, this raises other issues. Most notably cost. If a business has to deal with multiple overseas VAT registrations then this will cost it a great deal of money unless it has the in-house capability to deal with this.

There is also a possible secondary point insofar as the interaction with domestic rules in some countries. Some EU member states operate a domestic "reverse charge" for non-established businesses selling goods to local businesses (require the local business to account for VAT). We have not attempted to clarify the position these countries but a risk to be considered is "*How can B meet the requirements of a zero-rated purchase from A if it is not allowed to register for VAT in the destination country?*" We won't dwell on this (one must hope that the domestic rules have been adapted to accommodate this problem, perhaps by allowing a VAT registration based on B's "acquisition" of goods in the destination country rather than its own sale).

Returning to the option of accepting a local VAT charge in the country from which the goods are shipped, certainty can be achieved by

ensuring that B is responsible for transporting the goods to C. However, this may involve:

- additional logistical costs (e.g. if the goods are moved from A to a local warehouse operated by B before being shipped to C).

- additional complexity (e.g. if A is still shipping the goods directly then it would need to be clear that it is doing this as B's agent, rather than on its own behalf, and there may be all kinds of problems on commercial points such as "who is at risk in the event of loss/damage").

What would help enormously would be if HMRC adopted a "user friendly" presumption that if A is shipping goods then this is on B's behalf. This may not guarantee that another member state would not challenge the position and seek VAT on B's sale but if acquisition VAT is being declared locally by C then they would have no reason to investigate. It is also the case that C and the local tax authority would have no clear basis to question the treatment (*"How would they know who further down the supply chain took responsibility for shipping the goods?"*).

The final point of risk arises in relation to VAT on domestic VAT charges:

Let us say that A charges B UK VAT because it does not have the required evidence to zero-rate the supply (i.e. a non-UK VAT registration number) but A's sale to B would be the one designated "the intra-community movement".

- The UK VAT would be properly chargeable by A (B did not provide an overseas VAT registration), and
- under UK law VAT properly chargeable can be reclaimed as input tax.

However, as a parallel, the CJEU has held that when acquisition VAT due as a result of providing a VAT registration number (i.e. correctly chargeable) cannot be claimed on a VAT return if the goods do not travel to the country that issued the VAT registration number. Acquisition VAT due "from the use of a VAT registration number"

(despite being properly payable as a point of law) can only be reclaimed once it has been demonstrated that acquisition VAT has been declared in the country to which the goods were physically shipped.

If the matter ever reached the CJEU it does not take a huge leap of imagination to contemplate it ruling that VAT charged from A to B is only reclaimable after B has demonstrated that it has dealt with its legal obligations in the country to which the goods were actually shipped. We would not see this as a "likely outcome" but it is a theoretical risk.

Overview

This is a complex issue but bearing in mind that there is a zero-VAT registration threshold for supplies made by non-established businesses we are in a situation in which all that is apparently necessary to create an obligation to register for VAT in another EU country is for a UK supplier to pick up the phone and say to its own supplier "*Would you please ship the goods directly to my customer at this address (insert any EU address outside the UK)?* "

There may be arguments against this but unless they are based on a very carefully structured supply chain they are likely to fail.

This new rule will leave many UK businesses with overseas VAT registration obligations that they are not expecting/prepared for.

To an extent the new rules provide a clarity that did not previously exist in the sense that overseas VAT registrations may have been required under pre 2020 rules The main change being that a "possible" liability based on "interpreting case law" is a different thing from a "clear liability based on legislation".

Overall these rules must be considered a missed opportunity to deliver a workable and effective solution. If one reads the working papers that preceded the change there seems to have been a failure to grasp the fact that in changing the law there was no need to try and accommodate CJEU decisions concerning the law that preceded it.

We now have the bizarre situation in which if B in the illustration is not established/VAT registered in the country of shipment or arrival there is a simplification that allows it to avoid a VAT registration liability in either country (Triangulation). However, if B is VAT registered in one of those locations then it may still need to register in the other! Not so much a simplification as a complexification.

These rules came in on 1 January 2020. HMRC issued a guidance note on 20 December 2019 (11 days before they took effect) but still has not updated the main public notice on EU trade (Notice 725) to include a comment on such chain transactions. In this sense there is an interpretive challenge that may provide some scope for interpretive discretion. Also, there is a saving grace insofar as the rules are so unworkable that it will be almost impossible to identify when there is a problem – but of course the fact that 99% of businesses with a problem are blissfully unaware will hardly be a great comfort to the 1% that actually get identified as having a problem.

How can we help?

We cannot alter the past. If you have already entered into drop shipment transactions that give rise to overseas VAT registration liabilities then those liabilities will exist regardless of any steps taken today. However, there may be an argument based on existing contracts that makes it possible to defend your position. Also, it the potential problem is eliminated quickly it is likely that in the absence of a revenue loss that there will be a limited appetite for a rigorous application while the rules are bedding down.

As regards future transactions, you should weigh in the balance the potential to revise contracts and ensure that risks are contained/ eliminated. If that is not possible, you need to consider whether you do need to be VAT registered elsewhere and seek help in dealing with those obligations.

If you would like to discuss the issues highlighted in this document please contact Dean Carey on dean.carey@constablevat.com .

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