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Navigating the complexities of EU VAT Triangultion

Legal & Practical Considerations

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INTRODUCTION

Many multi-national companies operating across the EU make use of the “triangulation simplification”. This removes the burden to VAT register in different Member States into which goods are delivered. A question that is often asked is whether or not the triangulation simplification is still available in the following circumstances:

1. Where Party ‘B’ is VAT registered in the destination Member State, or
2. Where Party ‘B” is VAT registered in the Member State of dispatch, or
3. Where Party “C” (the end-customer) picks up the goods from Party ‘A’, or arranges his own transport to the destination country.

As is often the case with EU VAT rules, the answers to the above questions are not straight forward; yet the legal and practical impact can be significant.

BASIC RULES SURROUNDING THE TRIANGULATION SIMPLIFICATION

According to EU VAT law (EU VAT Directive 2006/112/EC, Article 141), the following conditions must be met for the triangulation simplification to apply (see figure 1):

• There are three different parties (i.e. separate taxable persons) VAT registered in three different EU Member States

• The goods are transported directly from Member State A to Member State C

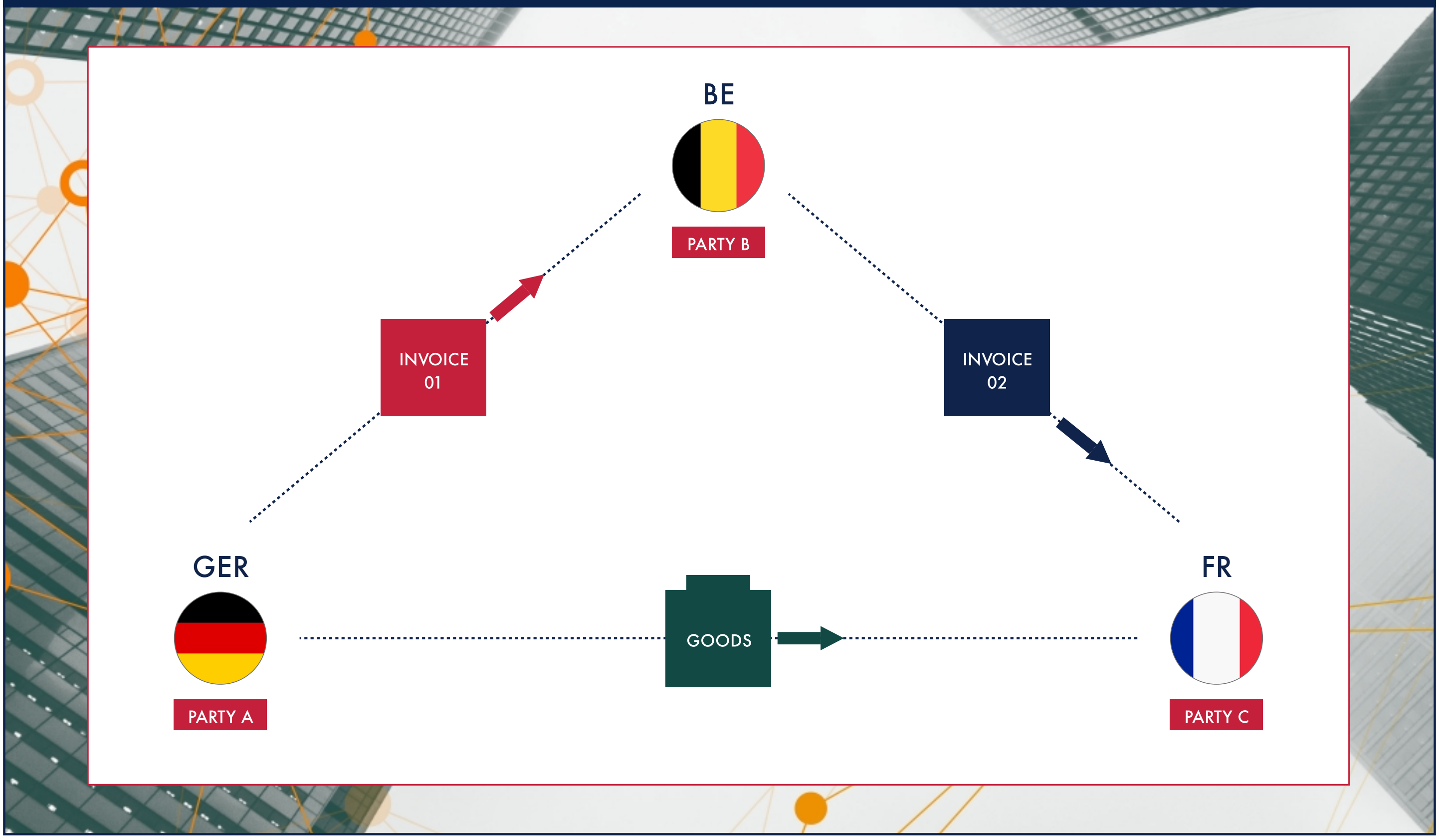
• The invoicing flow involves Party A selling the goods to Party B (the intermediate supplier)

• The intermediate supplier in turn invoices its customer, Party C (in Member State C)

• Party B must obtain from Party C a valid VAT ID from the Member State of destination, and quote this VAT ID on its invoice; and

• Party B must quote "Article 141 simplification" on its invoice to Party C. Under normal EU VAT rules, without the triangulation simplification, Party B (the intermediate supplier) would ordinarily be required to register for VAT in Member State C to account for an intra-Community acquisition. It would then make an onward local supply of goods to its customer, Party C, in Member State C.

FIGURE 01: STANDARD TRIANGULATION

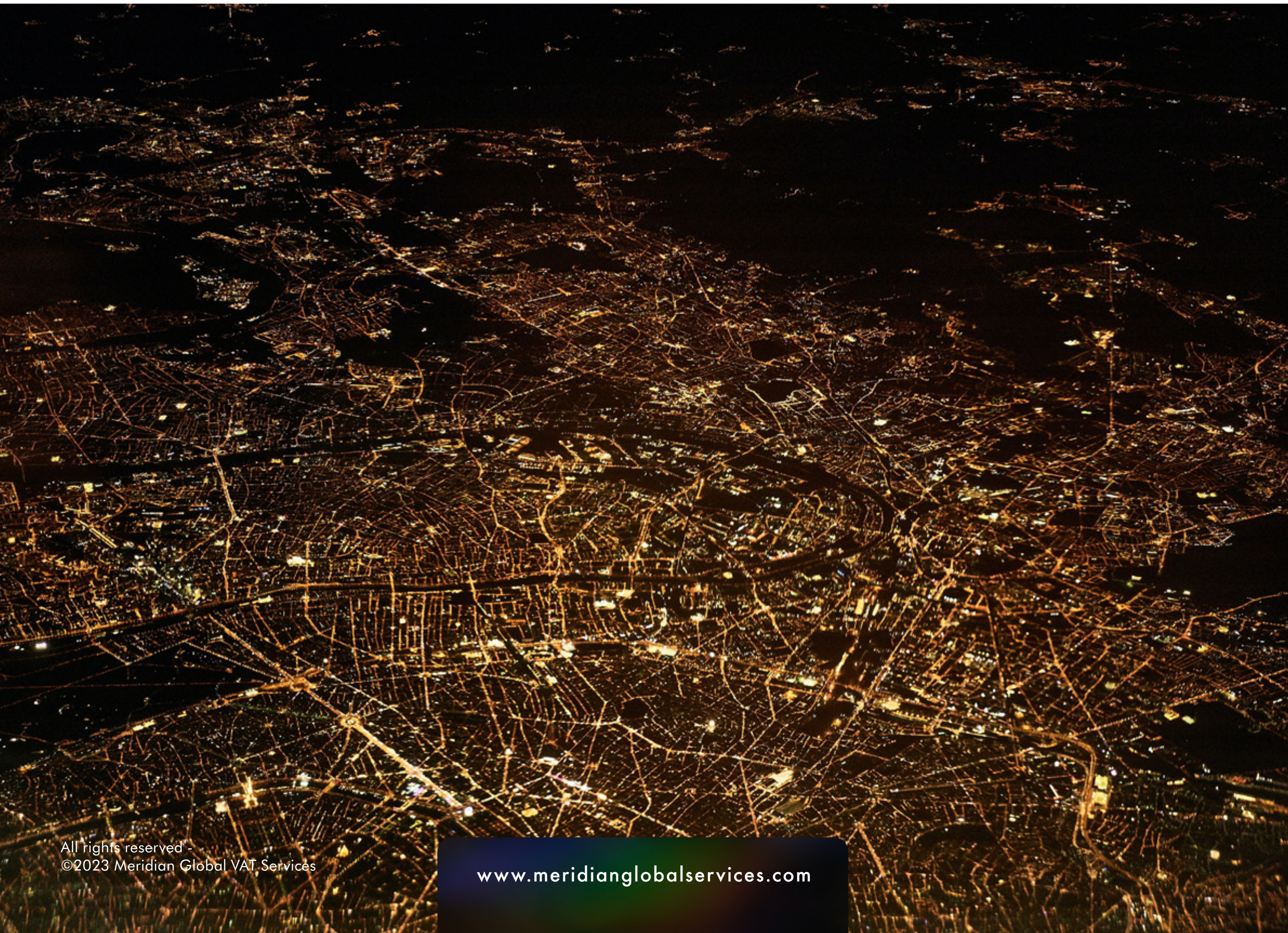


BASIC RULES SURROUNDING THE TRIANGULATION SIMPLIFICATION (CONT'D)

As this is a fairly common supply chain scenario, the EU VAT Directive has in place a simplification regime outlined in Article 141. This removes the need for businesses to register in the destination country for such transactions.

Where these conditions are met, Party B is able to report the transaction in its local VAT return (in Member State B) as a triangulation sale (and it will also have special reporting for the purposes of its EC Sales List).

Now that we have covered off the basic rules surrounding the triangulation simplification in a standard scenario, let's look at the three complexities discussed in the introduction above.



I) PARTY B IS VAT REGISTERED IN THE DESTINATION COUNTRY

The triangulation simplification is specifically in place to allow the intermediate supplier (Party B) to avoid having to register across multiple EU countries when involved in triangulation supplies.

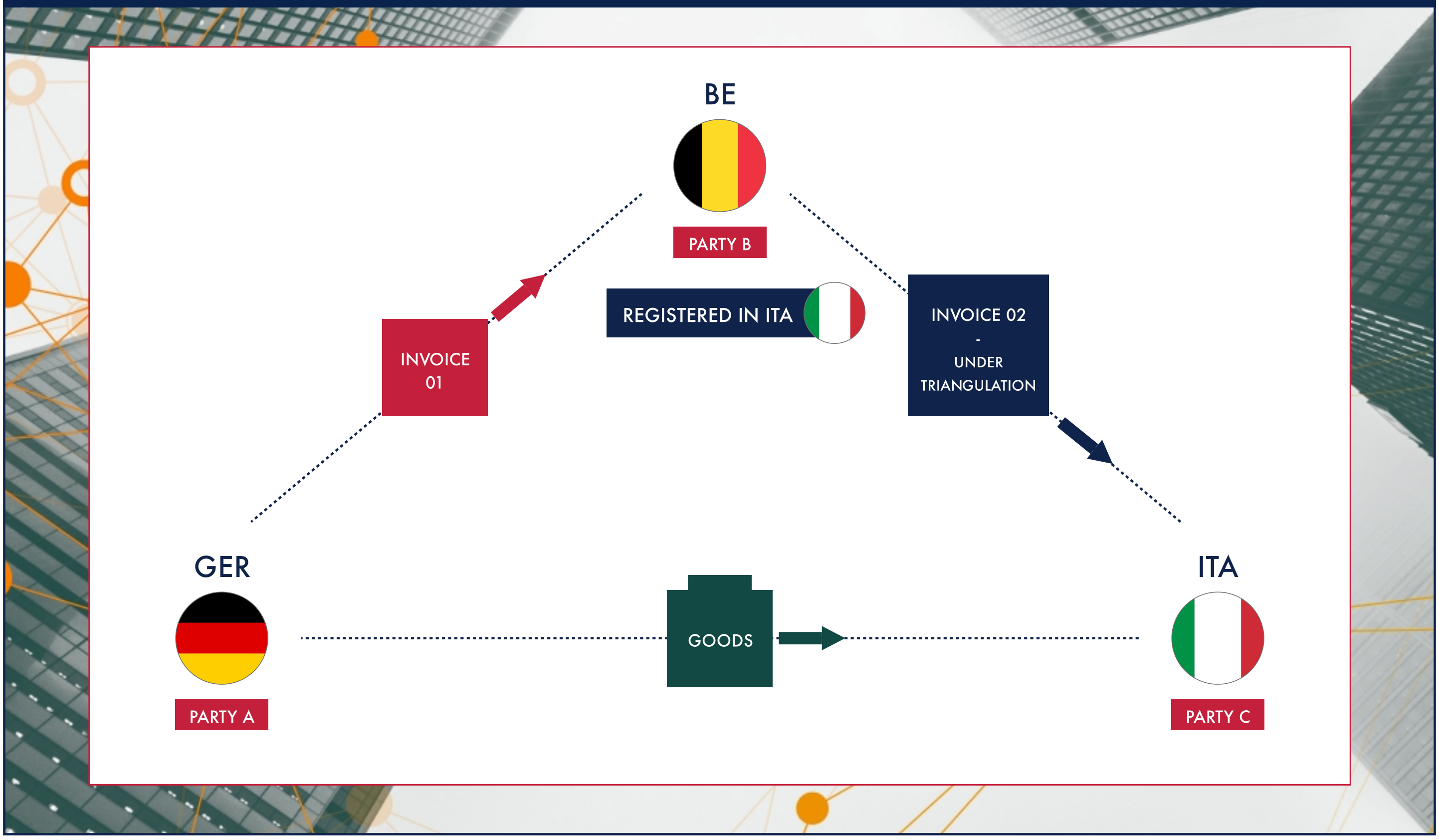
The question that therefore arises is whether it is still possible to employ the triangulation simplification where Party B is already registered in the destination Member State. This may be the case due to other taxable activities in the desitination country, in which Party B is involved. As is often the case with EU VAT, the position is not always clear and different EU Member States apply different rules in such circumstances.

Where Party B is already registered (as a non-established business) in Member State C there are two different approaches that can be taken:

- **Triangulation is still applied** (see figure 2). Party B reports a triangulation supply in Member State B, with Party C accounting for an intra-community acquisition

- **Triangulation cannot be applied** (see figure 3). In such cases, Party B would report an intra-EU acquisition in to the destination country. It would then follow up with a domestic sale to Party C (either with local VAT charged or under the extended reverse charge mechanism)

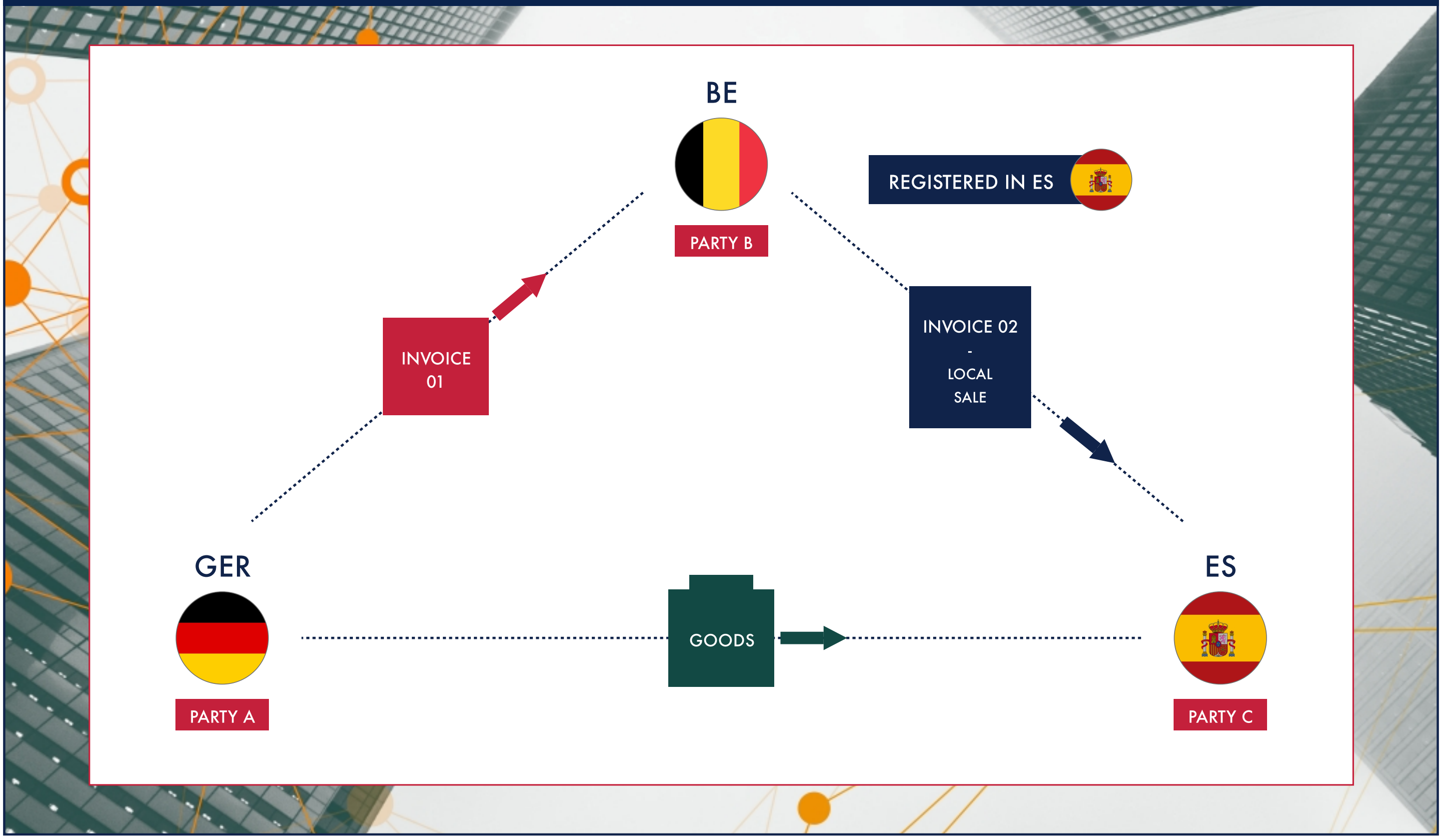
FIGURE 02: (A) I - PARTY B REGISTERED IN DESTINATION COUNTRY - TRIANGULATION POSSIBLE



I) PARTY B IS VAT REGISTERED IN THE DESTINATION COUNTRY (CONT'D)

In practice, it appears that roughly half of EU Member States take the first approach and the other half take the second approach. As a result, it is necessary for businesses to research the individual country rules when determining whether triangulation can be applied in these circumstances.

FIGURE 03: (A) II- PARTY B REGISTERED IN DESTINATION COUNTRY - TRIANGULATION CANNOT BE APPLIED



II) PARTY B IS VAT REGISTERED IN THE COUNTRY OF DISPATCH

As mentioned above, the triangulation simplification is in place to allow Party B to avoid registration in Country C. So it seems surprising that the VAT registration status of Party B in the Member State of dispatch could be a consideration in its application. However, as ever, the VAT rules in this area are not particularly clear and there is a danger that different Member States may take different approaches on this issue. From a legal point, the crucial text on this issue is found in Article 141, point (c) of the EU VAT Directive:

"The goods thus acquired by the taxable person referred to in point (a) are directly dispatched or transported, from a Member State other than that in which he is identified for VAT purposes, to the person for whom he is to carry out the subsequent supply"

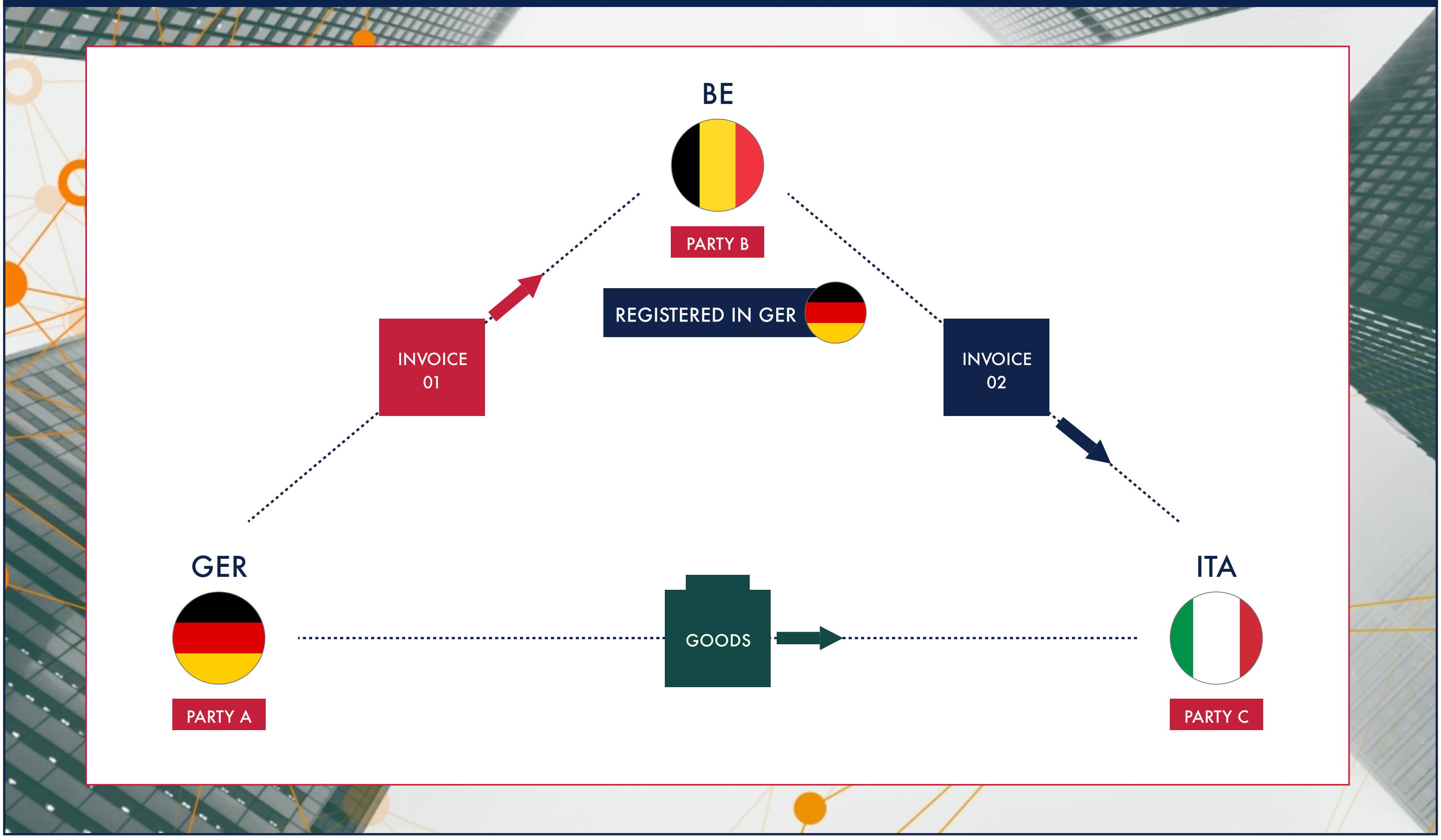
(It should be noted that the taxable person referred to in point (a) is the intermediate party or Party B).

The above article could be read in two ways:

- **Party B should be identified** (for VAT) in a Member State other than the Member State of dispatch
- **Party B should not be identified** (for VAT) in the Member State of dispatch.

The first approach above is the less restrictive reading of the paragraph. In this reading of the legislation, Party B can presumably be registered in the Member State of dispatch but as long as it is able to provide a VAT ID from outside the Member State of dispatch it can still apply triangulation, providing the other conditions of triangulation are met (see figure 4).

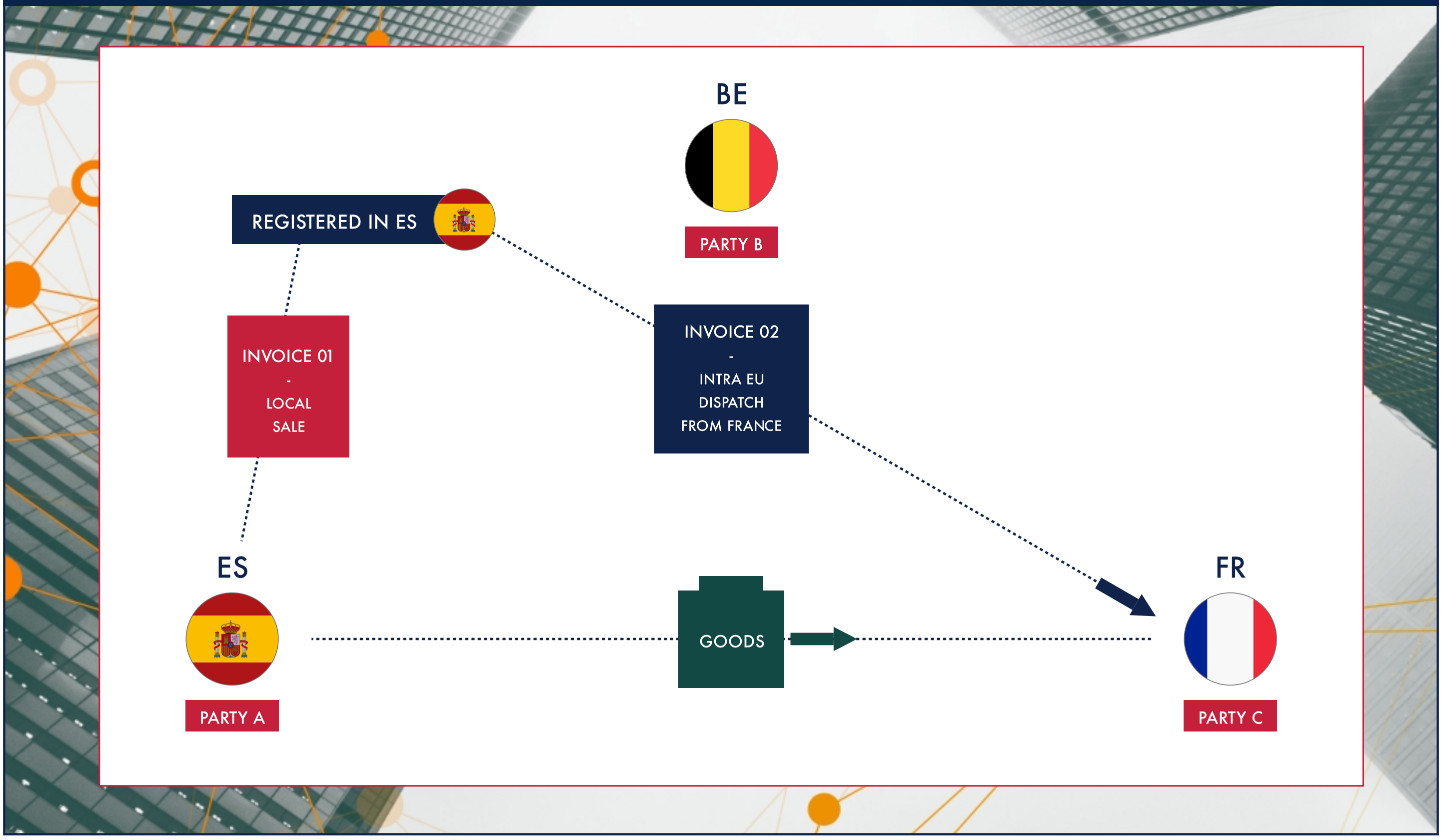
FIGURE 04: (B) I- PARTY B REGISTERED IN DEPARTURE - TRIANGULATION POSSIBLE



II) PARTY B IS VAT REGISTERED IN THE COUNTRY OF DISPATCH (CONT'D)

The second approach above would appear to be a more literal reading. In this approach, triangulation is always disallowed if Party B is registered in the Member State of dispatch (see figure 5).

FIGURE 05: (B) II- PARTY B REGISTERED IN DEPARTURE - TRIANGULATION CANNOT BE APPLIED



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II) PARTY B IS VAT REGISTERED IN THE COUNTRY OF DISPATCH (CONT'D)

Recent ECJ case.

It should be noted that the ECJ looked at this very specific issue in the case of Firma Hans Buhler (C-580/16). In this particular case FHB (which was Party B in the supply chain) was:

- **established and VAT registered in Germany**
- **also VAT registered in Austria**

It requested a German vendor (Party A in the supply chain) to deliver goods from Germany to FHB's customer (Party C) in the Czech Republic.

FHB used its Austrian VAT ID to report Party B triangulation although it initially failed to report such transactions correctly in its EC Sales List. The Austrian tax authorities disallowed the application of triangulation in its Austrian VAT return and to make matters worse assessed FHB for VAT in respect of a deemed acquisition into Austria.

FHB challenged the decision and eventually the Austrian courts referred the following two questions to the ECJ:

1. Can triangulations till be applied if Party B is VAT registered / established in Country A (even where it uses a VAT ID from another EU Member State).

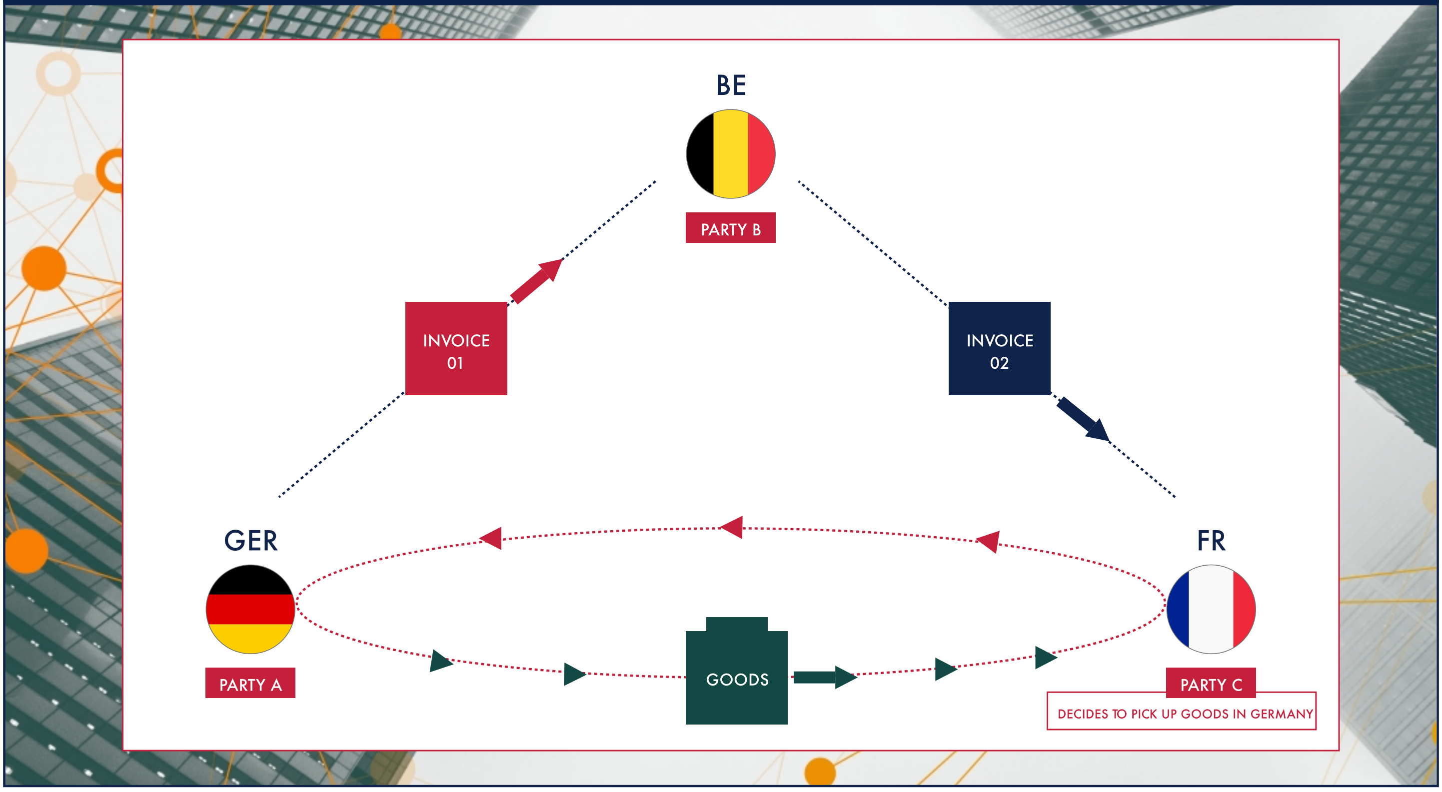
2. Are the conditions of applying triangulation still met where Party B fails to report the transactions correctly and in good time within the EC Sale Lists.

After considering the facts in this particular case, the ECJ ruled in favour of FHB on both questions. In its judgement the Court made clear that triangulations can and should still be applied even where Party B is VAT registered / established in Country A as long as it has a VAT ID in another EU Member State. It also decided that incorrectly reporting the transactions within the EC Sales List was not grounds in itself to disallow the application of triangulation.

The above ruling, which clearly takes a more expansive view of Article 141 therefore calls into question the approach that some countries have taken in disallowing triangulation where Party B is VAT registered in Country A. It remains to be seen where all countries will adopt the above approach in a timely manner but at the very least suggest some Member States have been over-zealous in their interpretation of the triangulation simplification.

III) CUSTOMER PICK-UPS

FIGURE 06: (C) CUSTOMER PICK-UPS



In this scenario, the goods are still going direct from Member State A to Member State C. However, neither Party A nor Party B is responsible for arranging the transport of the goods. Instead, the customer will be responsible for picking up the goods in Member State A, or more likely it will employ its own logistics provider or freight forwarder to move the goods to a location in Member State C (see figure 6). The question that now arises is whether the triangulation simplification can still be used by Party B in respect of its sale to Party C. Intriguingly, Article 141 is silent on the issue of who arranges this transport.

However, in order to correctly answer this question, we need to recognise that in a standard triangulation scenario, there are two transactions for VAT purposes:

- The first transaction is a supply by Party A to Party B. This is a simple intra-EU dispatch of goods (under Article 138 of the EU VAT Directive)

- The second transaction is a supply of goods by Party B to Party C. It is this transaction that would be subject to the triangulation simplification (under Article 141)

In circumstances where Party C is picking up the goods, an immediate issue arises in respect of the **first transaction**. This is because Article 138 of the EU VAT Directive makes clear that an intra-EU dispatch of goods only applies where the transport of goods is carried out by either the supplier (or someone acting on his behalf) or the customer (or someone acting on his behalf.

III) CUSTOMER PICK-UPS (CONT'D)

In this case, it is clear that neither the supplier (Party A) nor the customer (Party B) is arranging the transport. Instead, it is the customer's customer (Party C) who is responsible for arranging the transport. As such, prima facie, the first transaction does not qualify for exemption as an intra-EU supply.

One potential counter-argument to the above view is that Party C could be seen as arranging the transport on behalf of either Party A or Party B. However, Party C is extremely unlikely to be arranging transport on behalf of Party A given that it does not have a commercial relationship with the latter.

Furthermore the contention that Party C is arranging transport on Party B's behalf is counter-intuitive. After all, if Party C was arranging the transport on behalf of Party B, this would imply that the latter is bearing the cost of such arrangements (i.e. being recharged the costs from Party C). In practice this is extremely unlikely given that customers insisting on pick-ups usually do so as they are able to achieve more favourable logistic costs when arranging the transport themselves. If we therefore come to the conclusion that the first transaction does not qualify for intra-EU exemption, the supply from Party A to Party B must, by definition, be a domestic supply in Member State A.

In turn, this would suggest it is no longer possible for Party B to treat its onward supply to Party C as a triangulation supply. After all, one of the parties within the supply chain must be responsible for making an intra-EU dispatch from Member State A and we have already concluded that it can't be Party A. This would therefore suggest a VAT registration requirement for Party B in Member State A. **Its onward supply to Party C could then be handled in two different ways:**

• A domestic supply of goods in Member State A (with local VAT being charged in most cases)

• An intra-EU dispatch of goods that qualifies for exemption under the indirect dispatch rules. This in itself will need to satisfy a number of conditions that Member State A would ordinarily impose on such movements (including requirements for Party B to obtain proof of transport from Party C, evidencing that the goods have indeed left the country).

III) CUSTOMER PICK-UPS (CONT'D)

Practical Issues

Based on the above reasoning, it is our view that the EU Directive does not allow the use of the triangulation simplification in cases where the end customer (Party C) is arranging the transport.

The next question that arises is whether this is a mere technical breach of the EU VAT rules or whether there are real and practical VAT risks associated with employing the simplification in these cases.

In order to arrive at a conclusion on this issue, we need to assess the position for each party in turn (assuming that we were to go ahead and use the triangulation simplification):

• Party C will be accounting for an acquisition in Member State C. This is certainly correct from their perspective and unlikely to be challenged by the tax authorities in Member State C given that the acquisition into Member State C has been accounted for.

• Party B will be accounting for a triangulation supply in Member State B. From the perspective of Member State B, the tax authorities are likely to be satisfied if Party B is correctly reporting this in its VAT return, EC Sales List and invoice. Furthermore, if Party B is able to demonstrate that the end customer is accounting for the acquisition into Member State C, the tax authorities are unlikely to question the use of the triangulation simplification.

• Party A will be accounting for an intracommunity supply in Member State A. Ordinarily the tax authorities would be looking for two things in this scenario. Firstly, that Party A obtains from its customer a valid VAT ID from an EU Member State other than the Member State of departure (and that Party A quotes this VAT number on the invoice with the appropriate exemption text). Secondly, that Party A retains (and in the event of a tax audit is able to produce) evidence that the goods have indeed left Member State A.

It would therefore seem that the main risk arises for Party A in this supply chain. Given that it hasn't arranged the transport and neither has its customer, Party A is in the uncomfortable position of relying on Party C to provide the relevant logistics and transport documentation. In the event that it is unable to provide such documentation to the tax authorities during an audit, it will potentially be assessed the output VAT that would have been due on such sales if they were sold domestically (plus any applicable penalties and interest).

Depending on contractual terms this could have a knock-on impact on Party B. It may be that Party A attempts to recover any output VAT assessed from its customer. In turn, this would create a cost for Party B as it would be unable to recover this VAT in Member State A (as the input tax would be relating to an onward supply of goods from Member State A which required local VAT registration).

III) CUSTOMER PICK-UPS (CONT'D)

Conclusion

Under a strict reading of the EU VAT Directive, the triangulation simplification cannot be used where Party C is responsible for picking up the goods and / or arranging the transport to the destination country. Of course, on a national level there may well be countries who don't apply such a restriction.

Furthermore, in practice, Party B is unlikely to be challenged in its own country for treating its onward supply as triangulation. Likewise Party C can validly account for acquisition VAT in Member State C. Instead, it is Party A that is most at risk in this scenario. It is unable to legitimately make use of the indirect dispatch regime and as such should be charging local VAT on its supply as appropriate. In the event of an audit, if it is unable to furnish evidence of the goods having left the country, it is at risk of an assessment of underpaid VAT as well as penalties and interest. Technically, even if it produces the requisite documentation, it could be assessed for breaching the indirect dispatch conditions (although it would take a particularly officious tax officer to pick this up).

ERP CONSIDERATIONS

As outlined above, the legal and practical considerations when examining the triangulation simplification are considerable. The party responsible for the transport as well as the registration status of Party B (either in the Member State of dispatch or destination) can have a material impact on the VAT treatment that should be applied. Furthermore, we see differences in interpretation of the simplification on a country by country basis complicating the issue further for multinational businesses that operate across the EU.

As such, it is best practice to ensure that the system automatically determines the VAT treatment of sales transactions that potentially fall within the triangulation simplification. After all, it is very unlikely that sales order staff will have the requisite depth of knowledge to understand the nuances of the EU VAT rules in this area. It is far better, to have the system automatically detected when triangulation can no longer apply and where it is necessary to report a domestic transaction (either in the Member State of dispatch or destination).

For further information, on how it is possible to achieve fully automated tax determination for triangulation sales (as well as other sales and purchase transactions) within SAP

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Contact Us

Ireland
Meridian Global Services
3009 Lake Drive
Citywest
Dublin
D24 KHNO
T: +353 (0)1 4590500

Germany
Meridian Global Services
Hamburger Büro
Parkstraße 1
D-21244 Buchholz
Germany
T: +49 32223270134

France
Meridian Global Services
115 Avenue de Paris
94160 Saint-Mandé
France
T: +33 158 64 59 22

Contact one of our senior international VAT consultants
at **taxtechnology@meridianglobalservices.com**

www.meridianglobalservices.com