VAT TRIANGULATION WITH A US MIDDLEMAN
VSTR, C-587/10

Boston University School of Law Working Paper No. 12-55
(December 14, 2012)

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It is not every day that an American firm finds itself in the middle of an EU VAT controversy that significantly develops the law. However, the September 27, 2012 decision of the European Court of Justice (ECJ) does just that. The case is *Vogtländische Straßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR) v. Finanzamt Plauen*.\(^1\)

In November 1998 Atlantic International Trading Company (AIT), an American company established in New York, NY, purchased two stone-crushers from VSTR, a firm established in Germany. AIT quickly re-sold the stone-crushers to an end user established in Finland. The VSTR/AIT contract was “ex works,” that is AIT was responsible for transporting the goods from Germany, and AIT did this by hiring a heavy equipment transport company to move the goods by road and sea directly to Finland (not first to the USA, and then to Finland).

This type of transaction is known in the EU as an ABC, or triangular transaction. It is composed of two back-to-back sales, A/B followed by B/C, with a single delivery from A directly to C. AIT is the middleman at point B of the triangle.

The VAT treatment of ABC transactions can be complex.\(^2\) The VAT Directive contains no specific rules for triangular transactions, but it does have a mechanism (Article 141) that provides simplified treatment for one specific type of ABC transaction.\(^3\) This treatment is so favorable for B, that it is common for traders to design their trades to fit the simplification mandate. Generally, simplification applies when three businesses, registered in three different member States, use two successive contracts and one movement of goods to complete a trade. On its face the VSTR transaction does not fit the simplification, because AIT is established outside the EU. AIT would need to be registered (and have a VAT ID) in a Member State, and it does not.

Triangulation case law has been developing. The most notable developments are the recent cases of *EMAG Handel Eder OHG v. Finanzlandesdirektion für Kärnten (Berufungssenat II)*,\(^4\) followed by *Euro Tyre Holding v. Staatssecretaris van Financiën*,\(^5\) and Both of these cases impact the VSTR decision. Collectively, these three cases define our present understanding of triangulation.

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1. Case C-587/10 (September 27, 2012).
4. Case C-245/04 (April 6, 2006).
5. Case C-430/09 (December 16, 2010).
This paper presents the law in this area, with particular attention to third country middleman who, like AIT, may find themselves facilitating ABC transactions with EU participants, but who are denied the benefits of simplification because of their place of establishment. The paper concludes that because of penalties provisions in each of the Member States it is advisable for third-country middlemen to register in one Member State and adopt simplified triangulation reporting.

FURTHER FACTS OF VSTR

The heart of VSTR is AIT’s lack of registration (that is, it has no VAT ID). Most of the complexity in the case comes from AIT’s functioning as an ex-works middleman from a third country without an ID and the extent of knowledge that VSTR and the other parties may have about this situation.

AIT’s VAT ID & VSTR’s knowledge. After agreeing to the terms of sale, VSTR asked AIT for its VAT ID. Both the Judgment of the Court and the Advocate General’s (AG) Opinion characterize AIT’s response the same way. Instead of providing its VAT ID or indicating that it was (or was not) registered, “… [AIT] replied that it had sold the [stone-crushing] machines on to a company established in Finland and gave the seller the VAT identification number of the Finnish company. The branch [the expression used by the AG is the German seller] verified this information.”6 What was verified?

The verification was certainly not that the Finnish number belonged to AIT. AIT is not registered anywhere. At most this verification simply confirmed that the Finnish number was a valid ID. But, does VSTR believe that AIT is registered? We do not know.

This is where the VSTR decision begs the real question. German law is very clear – to zero-rate an intra-Community supply VSTR must secure its customer’s VAT ID. VSTR obtains the VAT ID of its customer’s customer. So, we need to know – was there a mutual mistake, or did VSTR intentionally chart an illegal course? How much did VSTR really know about the whole chain? Did VSTR know that AIT was an unregistered buyer, and proceed anyway? Or did AIT present VSTR with the ID of its customer in a manner, and in a context where VSTR was intentionally deceived? These questions are important (but unanswered). The VSTR decision pivots on the lack of fraud between VSTR and AIT, but there is very little factual development by either party of the fraud issue.

What we do know is that VSTR did zero-rate the invoice it issued to AIT, and VSTR did use the Finnish ID of AIT’s customer in support of this exemption. We do not

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6 VSTR at ¶15 & Opinion of Advocate General Cruz Villalón, Vogtändische Straßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR) v. Finanzamt Plauen, Case C-587/10 at ¶18. Note: there is apparently some difficulty in the German system when trying to confirm that a particular VAT ID is associated with a specific named party. Secrecy concerns limit access, so that the only thing that can be confirmed is the validity of a VAT ID, but not party’s name associated with the number.
know why this occurred. There is no indication anywhere that VSTR did or did not understand the whole truth of the transaction.

The tax audit and the appeals. When VSTR zero-rated the sale of stone-crushing machines to AIT as an intra-Community supply, the German national tax authority (NTA) audited and found that this supply could not be VAT-exempt. The German court of first-instance, the Sächsisches Finanzgericht (Finance Court, Saxony), upheld the NTA.

The specific reason for the NTA’s denial was that German law required an enterprise making an intra-Community supply to secure his customer’s VAT ID and place that number on the invoice. Paragraph 17c(1) of the Umsatzsteuer-Durchführungsverordnung (Regulation implementing the UStG) indicates:

In the case of intra-Community supplies (Paragraph 6a(1) and (2) of the UStG), the trader to whom this provision applies must provide evidence in the accounts that the requirements for exemption from tax have been complied with, including the VAT identification number of the person acquiring the goods. The accounts must show clearly and in an easily verifiable manner that the requirements have been met.7

VSTR appealed the lower court’s decision to the Bundesfinanzhof (Federal Finance Court). The Bundesfinanzhof made a number of findings, but two of them are critical. First, it found that the transaction in question was triangular. There are two successive supplies followed by a single movement of goods (A/B and then B/C followed by a delivery of goods from A-to-C).

Next, following EMAG and Euro Tyre the Bundesfinanzhof performs an attribution of transport to the A/B transaction. Euro Tyre indicates that the facts will control where the transport is attributed. That is, the attribution “… must be conducted in the light of an overall assessment of all the circumstances of the case.”8 However, the AG in VSRT notes that instead of a detailed factual inquiry, the Bundesfinanzhof seems to take it for granted that, in principle, the transport should be ascribed in this case to the first supply, in which the seller is the German undertaking VSTR and the person acquiring the goods is the US undertaking Atlantis [note: the AG mistakes “Atlantic” for “Atlantis” a number of time in his Opinion] (7) and I do not think that this analysis is inconsistent with the case-law referred to above [i.e., Euro Tyre and EMAG]. [At footnote (7) the AG observes: “And there is no indication in the case file that the Finanzgericht, which heard the case at first instance, took a different view on this point.”]9

7 VSTR, at ¶13 (emphasis added).
8 Euro Tyre, at ¶44.
9 Opinion of Advocate General Cruz Villalón, at ¶34 (emphasis added).
What is never fully explained by the AG or the ECJ is why the Bundesfinanzhof seemed to take the attribution of transport to A/B “for granted.” The reason is (once again) the German statute.

The *Umsatzsteuer-Anwendungserlass* *(Turnover Tax [Implementing Instruction]*) takes the position that, where B performs the transport in an ABC transaction (as it does in *VSTR*, *Euro Tyro*, and *EMAG*) that the transport should ordinarily be ascribed to the first supply.\(^{10}\) This is not a case-specific factual inquiry; it is an all-purpose general rule. This is exactly what the Bundesfinanzhof followed, even though the ECJ seems to assume that a true factual inquiry and analysis was undertaken.

Just to make things very clear, the *Umsatzsteuer-Anwendungserlass* considers the alternative. It allows transport to be allocated to the second supply *only if* B:

- purchases the goods under a VAT ID number assigned by the Member State in which the intra-Community transport begins; and
- bears the risk and cost of the intra-Community transport.\(^{11}\)

Because AIT does not have a German VAT ID (or any VAT ID for that matter), the statute makes it impossible to ever ascribe the transport (and the zero-rating) to the second supply (B/C).\(^{12}\) Thus, the German statute pre-determines the factual analysis that *EMAG* and *Euro Tyre* expect the Bundesfinanzhof to perform (case-by-case).

As a result, the Bundesfinanzhof is conflicted. It finds both (1) that the A/B supply *could be* (conditionally) exempted from VAT,\(^{13}\) but it also finds (2) that the exemption from VAT *could be* refused.\(^{14}\) The Bundesfinanzhof seeks the advice of the ECJ:

(1) Does [the Sixth Directive] allow the Member States to accept an intra-Community supply as tax-exempt *only* where the taxable person provides evidence in the accounts of the VAT identification number of the person acquiring the goods?

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\(^{10}\) *See:* section 3.14(10) of October 1, 2010, IV D 3 – S 7015/10/10002, BStBl. I 2010, 846. Under the German view transport must *always* be ascribed to the second supply if C is responsible for transporting the goods [second sentence of section 3.14(8)].

\(^{11}\) This requirement would be met if B supplies the goods to C under CIF, DAP or DDP Incoterms.

\(^{12}\) Stefan Maunz & Hendrik Marchal, *Zero Rating Cross-Border Triangular Transactions under EU VAT*, INT. VAT MONITOR 2012 (September/October) 307, 309-10. The statutory rules appear to be based on an assumption – that every B will have a VAT ID. The possibility of an AIT fact pattern – where B acts as a middleman without a VAT ID anywhere – was never anticipated.

\(^{13}\) Those conditions included: (a) that the person acquiring the good is actually subject to tax in Finland, and (b) that the person acquiring the goods actually have a VAT ID in the Member State of destination. *VSTR* at ¶22.

\(^{14}\) *VSTR* at ¶23:

The exemption from VAT could be refused pursuant to the first sentence of Paragraph 17c(1) of the Regulation implementing the UStG, which requires the supplier to provide evidence in the accounts of the VAT identification number of the person acquiring the goods.
(2) Is it relevant to the answer to that question:
- that the person acquiring the goods was a **trader with its seat in a third State**, which, although it dispatched the object of the supply in the course of a chain transaction from one Member State to another Member State, is not registered for VAT purposes in any Member State, and
- whether the taxable person has proved that the person acquiring the goods submitted a **tax return concerning the intra-Community acquisition**?\(^{15}\)

**VSTR DECISION**

**VSTR** is a cross-border triangulation case. The leg of the triangle (either the first leg or the second leg) to which the single transport is attributed is **potentially exempt** under Article 138 if the person acquiring the goods is a taxable person.

*The first requirement (the attribution of transport).* The ECJ accepts the *Bundesfinanzhof*'s finding on this point. It is a *finding of fact by the national court* that the transport in this case is ascribed to the first leg. The ECJ will not disturb this finding. Thus, the VSTR/AIT transaction (not the AIT/Finnish transaction) is **potentially exempt** if it fulfills the second requirement.

*The second requirement (the customer’s status as a taxable person).* Article 9 defines a taxable person as any person who carries out in any place any economic activity whatever the purpose or result of that activity. Thus, in the VSTR fact pattern, AIT is a taxable person (**without** a VAT ID) just as much as the un-identified Finnish company is a taxable person (**with** a VAT ID).

Article 138’s exemption provision **does not** require more. It does not require the seller to secure the buyer’s VAT ID as a pre-condition to the exemption.\(^{16}\) It would not have mattered for Article 138 purposes, which leg of the triangle had transport ascribed to it. Both legs would pass the Article 138 tests.

*Impact of Article 131.* But, there is one more aspect to the ECJ’s decision – the impact of Article 131. Article 131 permits Member States to set **conditions** on exemptions that are otherwise allowed by the Directive, if those conditions ensure a correct application of the tax and prevent evasion, avoidance or abuse.\(^{17}\) Germany opts to

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\(^{15}\) *VSTR* at ¶26 (emphasis added).

\(^{16}\) In fact the only references to a supplier’s obligation related to securing the VAT ID of his customer is in Article 226 (which indicates that a supplier must place his customer’s VAT ID on the invoice), and Article 262 (which indicates that the supplier must put his customer’s VAT ID on the recapitulative statement).

\(^{17}\) Article 131 states:

The exemptions provided in Chapters 2 to 9 shall apply without prejudice to other Community provisions and in accordance with **conditions** which the member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse.
take advantage of Article 131, and this is why the *Umsatzsteuer-Anwendungserlass* requires sellers to secure their customer’s VAT ID if they seek to exempt cross-border sales. The question for the ECJ is whether this is a *condition* that goes too far – does it breach fundamental principles of the EU VAT system? The ECJ determines that it does.

Thus, following the *Bundesfinanzhof*’s allocation of transport to the VSTR/AIT transaction, and in spite of AIT being a taxable person without a VAT ID, the ECJ determines that it is perfectly appropriate for VSTR to exempt its sale to AIT. There is no likelihood or evidence of fraud in this case, thus rigid enforcement of the VAT ID condition would violate the principle of fiscal neutrality.\(^\text{18}\)

More than one European commentator has found this result to be extraordinary.\(^\text{19}\) ID requirements similar to those in German law can be found in every Member State. In light of this wide acceptance, Joep J.P. Swinkels finds the court’s reasoning “incomprehensible.”\(^\text{20}\) It is very surprising therefore to find an American business literally in the middle of this case, and to find sales to this company are the basis for a change the VAT treatment of intra-Community triangular transactions throughout the EU.

In reaching its decision the ECJ distinguishes *substantive* from *formal* exemption requirements. Substantive requirements must be adhered to; formal requirements are just as real, but they can be satisfied in a more flexible manner – either directly or indirectly. The substantive requirements of the Article 138 exemption are:

- proving that the customer is a taxable person,
- proving that the right to dispose of the goods as owner has been transferred, and
- demonstrating that the goods are actually brought outside the territory from which they depart, and that they arrive at a destination within the Community.\(^\text{21}\)

Mentioning the customer’s VAT ID on the invoice is a different kind of requirement. Article 131 imports it into Article 138. This kind of formal requirement can be met in many different ways. It is a bulwark against fraud and evasion, but it is not always necessary.\(^\text{22}\) Producing the customer’s valid VAT ID is not necessary in this instance because the purpose for having the requirement can be achieved through alternate means. For example:

- examining the nature of the goods (and showing that these goods are unlikely to be used in frauds);\(^\text{23}\)
- proving that the supplier acted in good faith,\(^\text{24}\) and

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\(^{18}\) VSTR at ¶46.  
\(^{19}\) Jade Hall, *VSTR – Possible relaxation of the conditions to zero-rate intra-community supplies?* DEVOIL INDIRECT TAX INTELLIGENCE, 197 (18) (October 1, 2012).  
\(^{21}\) VSTR at ¶30.  
\(^{22}\) VSTR at ¶51.  
\(^{23}\) VSTR at ¶53.  
\(^{24}\) VSTR at ¶¶52 & 58.
demonstrating that the supplier has taken every reasonable measure to ensure that the transaction does not lead to participation in fraud.\textsuperscript{25}

Based on the foregoing analysis, the ECJ determines that VSTR is entitled to zero-rate the sale of the stone-crushing machines to AIT even though AIT does not have a VAT ID.

CONCLUSION:

IMPACT OF VSTR ON NON-REGISTERED AMERICAN BUSINESSES (AND OTHER THIRD STATE ENTERPRISES)

It is tempting to read VSTR as a decision that allows businesses that are not registered in the EU to participate in cross-border intra-Community triangular trades from a distance without incurring VAT obligations. That is not the case.

VSTR indicates that VSTR can zero-rate its sales to AIT in spite of the fact that AIT is not registered for VAT in the EU; it does not indicate that AIT is free from VAT obligations stemming from its involvement as a middleman in ABC transactions. In fact the penalties that AIT appears to be subject to in VSTR can be significant.

Because VSTR has made an intra-Community supply \textit{in Germany}, AIT must have made an intra-Community acquisition \textit{in Finland}. AIT has also made an onward domestic sale to the Finnish buyer that is taxable in Finland.

AIT is obliged to register for Finnish VAT. It must collect the VAT due, and remit it to the tax authority.\textsuperscript{26} Penalties for delayed filing of the return are rarely imposed in Finland, but penalties for delayed VAT payments are common (with considerable discretion as to the amount of penalty) between 1% and 50% of the delayed VAT payment. These penalties can rise to a maximum of 300% of the VAT amount.\textsuperscript{27}

In addition, there are non-proportional tax increases in Finland that rise as high as €15,000, as well as non-proportional administrative penalties. AIT also owes recapitulative statements in Finland, and the applicable penalty for not doing so is between €80 and €1,700.

\textsuperscript{25} VSTR at ¶¶ 52-4 & 58.

\textsuperscript{26} If a business has made taxable supplies during a tax period. There is not a specific late registration penalty. The amount of additional taxes and penalties due is based on the length of the delay of the late/non-payment of VAT. KPMG, \textit{Global Indirect Tax Finland (2011)}, at 3. Recently the formula was 11.5% \times \text{days delayed} \times \text{VAT amount delayed}/360 is the calculation in Chris Platteeuw, Yves Geens & Steve Burrows, \textit{QUICK REFERENCE GUIDE TO EUROPEAN VAT COMPLIANCE 2011}, at F-15.

\textsuperscript{27} Even though the Finnish buyer has reverse charged the VAT due on this transaction, AIT has significant VAT obligations in Finland. In fact VSTR presented the court with the Finnish returns on which the reverse charge was recorded. \textit{VSTR} at ¶55.
AIT would face some of the same penalties in Germany, if the ECJ had determined that the AIT/Finland transaction was exempt (rather than the VSTR/AIT transaction). Overall the German penalty regime is much more severe than the Finnish.  

In Germany there are penalties of 1% of the VAT due for each month the tax remains unpaid. This would be a penalty imposed on VSTR. Late payment penalties can go up to €50,000. After collecting the VAT AIT would need to file a German return to get the VAT back. Late filing of this return attracts a penalty of 10% of the VAT, but not more that €25,000. In Germany penalties for non-compliance with administrative rules are imposed personally on the executive, and may not be higher than €5,000 per offence.

In addition, non-compliance with the obligation to properly file recapitulative statements would fall on AIT. There is a penalty of €5,000 per offence, and for late filing penalties of 1% of the reportable transactions are imposed (up to €2,500).

As noted in the beginning, simplification triangulation would provide AIT with a much more favorable outcome. To use simplification AIT would need to involve its Portuguese subsidiary (AIT-P) in the VSTR transaction. AIT-P would have to be registered for VAT in Portugal, and there is no indication that this was the case in this instance. If it had been, then this case would have fallen squarely within Article 141.

Simplification mitigates costly registration requirements for the middleman. If AIT performed its role as a middleman between VSTR and the Finnish buyer out AIT-P, then AIT-P would not need to register in the Member State of arrival of the goods (Finland), nor would it need to account for acquisition VAT (in Finland). In addition, simplification would relieve AIT-P from accounting for acquisition VAT in Portugal under the “safety net” provisions.

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28 See: Jochen Meyer-Burow & Ocka Stumm, Recent Developments in German Criminal Law and Their Impact on VAT Compliance, 2011 INT. VAT MONITOR (May/Jun) at 161 indicating:
It is becoming increasingly difficult for businesses in Germany to avoid committing VAT offences. From the perspective of businesses, there have been a number of rather unsettling developments in the last few years. In particular, German courts now apply stricter compliance criteria in their decisions on VAT-related offences since the First Criminal Chamber of the Bundesgerichtshof (Federal Supreme Court) replaced the former Fifth Chamber, in June 2008. The Bundesgerichtshof imposes heavier penalties for filing incorrect monthly VAT returns and it has broadened the obligation on businesses to correct inaccuracies in their previous VAT returns. In this context, the judges of the Bundesgerichtshof generally take the view that businesses must comply with higher standards in order to play their role as “VAT collectors for the government” with due diligence.

29 Article 240 of the Fiscal Code.
30 Umsatzsteuergesetz, Article 26b (VAT Act).
31 Article 152 of the Fiscal Code.
32 Umsatzsteuergesetz, Article 26a (VAT Act).
The simplification framework would accomplish this by *deeming* AIT-P’s acquisition of goods (dispatched from Germany to Finland) to have *already been subject to VAT* in Finland. All AIT-P would need to do is “designate” the Finnish company as the party to report VAT under the reverse charge mechanism. AIT-P would still have an obligation to file a recapitulative statement. In fact, Article 42(b) expressly conditions simplification on fulfilling of this requirement. However, this burden is a relatively small one.

Simplification triangulation is the preferred mechanism for third-country middlemen involved in ABC transactions. Registration in one EU Member State is required.

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33 Article 42 indicates (in part, emphasis added):

> The first paragraph of Article 41 shall not apply and VAT shall be deemed to have been applied to the intra-Community acquisition of goods in accordance with Article 40 …

34 Article 42(a) indicates:

> the person acquiring the goods [B] establishes that he has made the intra-Community acquisition for the purposes of a subsequent supply [to C], within the territory of the Member State identified in accordance with Article 40, for which the person to whom the supply is made [C] has been designated in accordance with Article 197 as liable for payment of VAT;

35 Article 42(b) indicates:

> the person acquiring the goods [B] has satisfied the obligations laid down in Article 265 relating to submission of the recapitulative statement.