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Indirect Taxation and Tax administration
Value added tax

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VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 894

QUESTION
CONCERNING THE APPLICATION OF EU VAT PROVISIONS

ORIGIN: Commission

REFERENCE: Article 146(1)(a) and (b)

SUBJECT: VAT treatment of export of goods after transformation work in another Member State

1. INTRODUCTION

The Commission hereby submits a question concerning the VAT treatment of export of goods after transformation work in another Member State. There have already been discussions in the EU VAT Forum¹, on the basis of an interpretation/simplification suggestion from the EU VAT Forum's sub-group "Tax authorities and Business Enhanced Cooperation and Fight Against Fraud" (TABECFAF sub-group).

During the discussion in the EU VAT Forum, business representatives stressed that such transactions are a common situation. They also underlined how important it is that Member States agree to apply reasonable/simple rules in this kind of situations, in order to avoid that the transformation activities relocate to third countries.

Some representatives of the Member States, while acknowledging that this may be an issue for the business, pointed out that such configurations also raise important issues of potential fraud. A business representative recalled that clear rules concerning the VAT treatment help to avoid fraud in this situation.

All Member States' participants agreed that the interpretation/simplification suggested in the EU VAT Forum did not fall in the remit of the EU VAT Forum but of the VAT Committee.

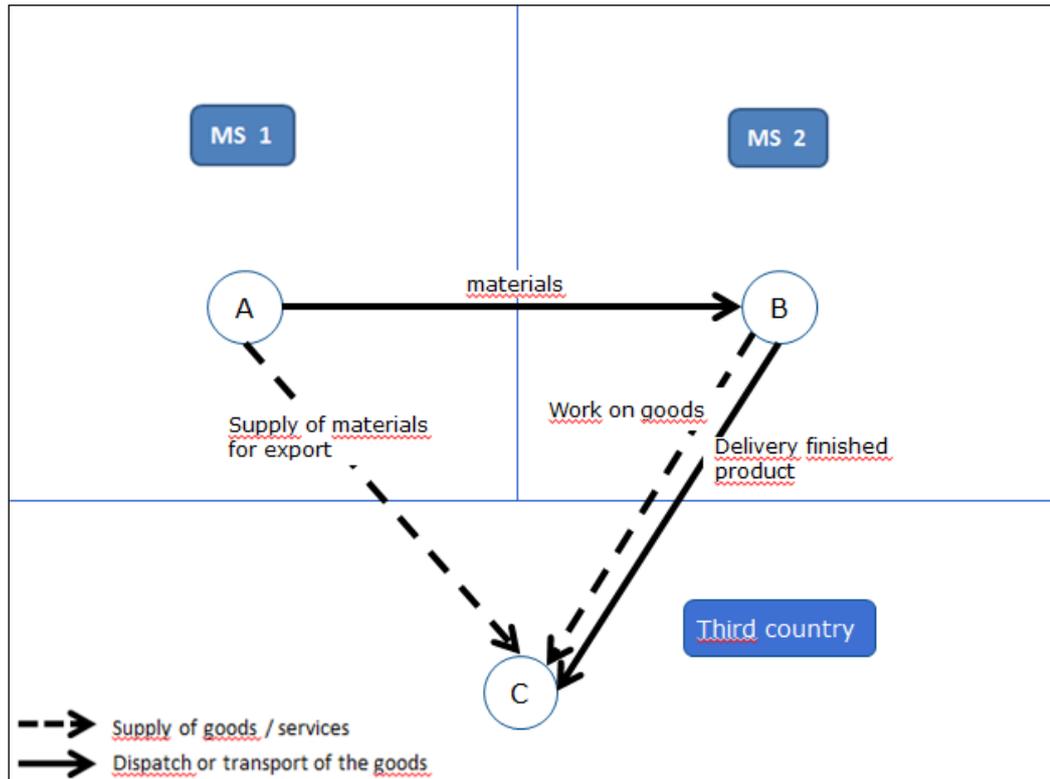
Accordingly, the delegates in the EU VAT Forum agreed to ask the Commission to submit the question to the VAT Committee, given the fact that the VAT Committee has already discussed similar issues.

2. SUBJECT MATTER

The question is what the VAT obligations are if a company A, established in Member State 1, sells goods to a customer C outside the EU in view of an exportation, under the following conditions:

- before the exportation, the goods are sent to a service provider B in Member State 2, in view of work to be carried out on these goods;
- the work on the goods is carried out on behalf of the customer C (i.e. the company established outside the EU, who bought the goods from company A);
- the finished product is exported to the customer outside the EU.

¹ The EU VAT Forum was set up by a Commission Decision of 3 July 2012 to allow businesses and tax authorities to exchange views and best practices with the aim of improving the smooth functioning of the current EU VAT system (Decision 2012/C 198/05, OJ C 198 of 6 July 2012).



The service “work on movable property” provided by the taxable person B in Member State 2 is not problematic: if the service is provided to customer C, established outside the EU, the service will not be subject to VAT in the EU.

The question is however whether the supply by the taxable person A in Member State 1 can be exempted on the basis of Article 146(1)(a) or (b) of the VAT Directive², which provides for the following exemption for exportation of the goods:

“Member States shall exempt the following transactions:

- (a) *the supply of goods dispatched or transported to a destination outside the Community by or on behalf of the vendor;*
- (b) *the supply of goods dispatched or transported to a destination outside the Community by or on behalf of a customer not established within their respective territory, (...);”*

The fact that goods are exported through another Member State is not in itself an obstacle to the application of the exemption for exported goods (although there may be questions with regard to the proof that the goods concerned effectively left the EU).

The issue at stake is whether this exemption can be applied here, as the goods that are exported are not the original goods but the finished products (obtained after the work that was carried out in Member State 2).

² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006).

3. BACKGROUND

3.1. The EU VAT Forum and its TABECFAF sub-group on a possible approach

In the EU VAT Forum and its TABECFAF sub-group, business members expressed the concern that the above situation should not be more burdensome than the transactions involving work on movable goods that are imported temporarily³.

It was reminded that in the past some simplifications had been agreed upon in the VAT Committee, in the former agreement on the VAT treatment of “work on movable tangible property”, and it was felt by members of the EU VAT Forum and its TABECFAF sub-group that inspiration could be found in that former agreement to suggest an interpretation concerning the above case, in line with the former decision of the VAT Committee.

This agreement in the VAT Committee related to the simplification of some contract work transactions, of which one is comparable to the above case.

The VAT Committee at its 48th meeting agreed on several simplification measures with regard to these transactions⁴:

“The Committee unanimously takes note of the up-dating work on the simplification of a number of contract work transactions already agreed by the Working Party No 1 at its meeting on 25 and 26 May 1993. The changes are made necessary (i) by the removal of the term 'contract work' (deletion of Article 5(5)(a)) and the amendment of Article 28a(5), and (ii) by the insertion of a new section F in Article 28b in connection with the adoption of Council Directive 95/7/EC of 10 April 1995.

The delegations agreed unanimously that:

- 1. All the simplification cases have the following elements in common:*
 - the agreed simplification for applying tax consists in treating, in an identical manner, transactions which are similar from a tax and economic viewpoint;*
 - the conditions governing the application of section F of Article 28b are met as the goods, that have to undergo the work, are dispatched or transported outside the Member State where the services were physically carried out;*
 - if the goods to be worked on are making temporary stops or are strictly speaking not subject of an expedition or re-expedition towards the principal, the finished products have, from the outset, a well known final destination: they are solely destined to the client/principal.*

³ See Article 146(1)(d) of the VAT Directive, which provides that Member States shall exempt the following transactions: *“the supply of services consisting in work on movable property acquired or imported for the purpose of undergoing such work within the Community, and dispatched or transported out of the Community by the supplier, by the customer if not established within their respective territory or on behalf of either of them.”*

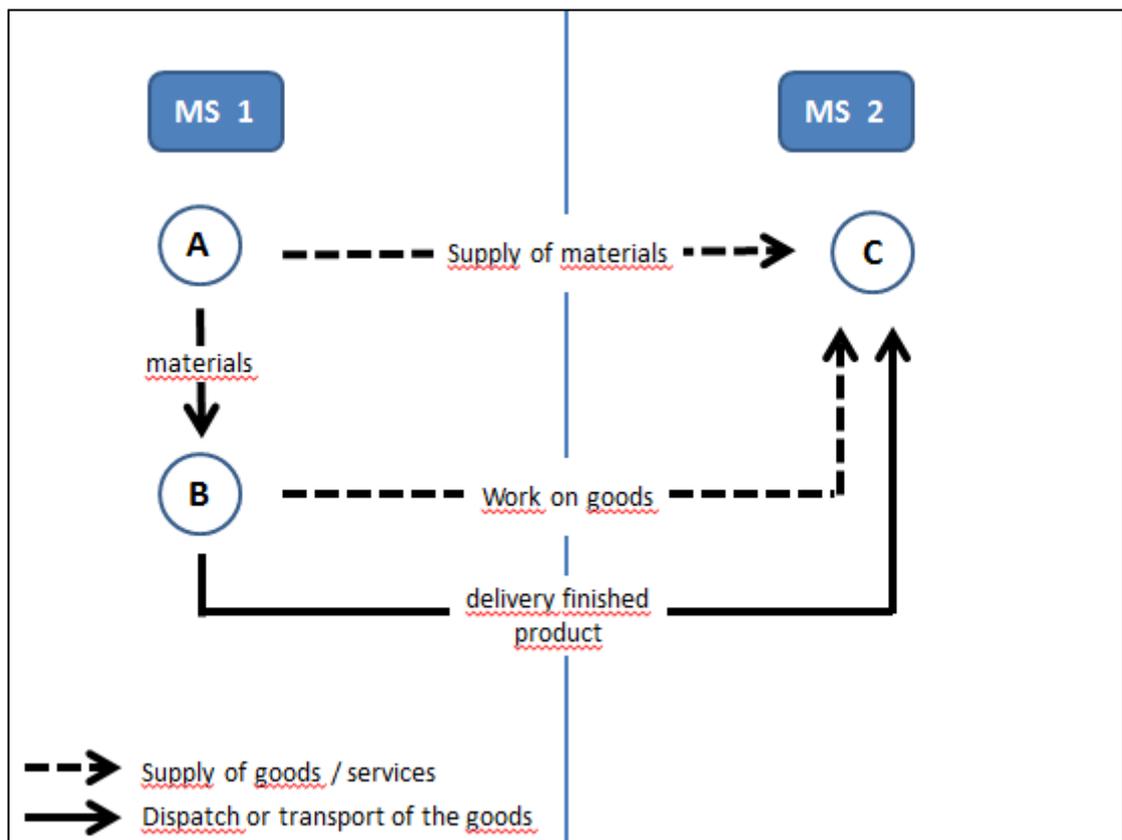
⁴ http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/vat_committee/guidelines-vat-committee-meetings_en.pdf; Guidelines resulting from the 48th meeting of 25 June 1996; XXI/97/177 (p. 72).

2. *All simplifications are based on the same interpretation: the requirement that the finished products be returned to the Member State of initial departure, as foreseen in Article 28a paragraph 5 (b) 5th indent, is deemed to have been satisfied even where temporary stops occur. This presupposes that the individual places in which the work is carried out are not regarded as places of arrival of the goods to be worked on.*

The simplification examples described constituted typical cases for which precise conditions have been laid down to enable simplifications to be made. Provided that other Community tax legislation was not affected and subject to the conditions laid down being observed, each of the simplifications envisaged could in practice be combined with any of the other simplifications.

The Committee unanimously considers that the document XXI/2118/95 Rev. 2 could be published in order to make this information available to operators and to strengthen the coherence of the implementation of these simplifications within the Union.”

The first simplification case related to the following situation:



The following VAT treatment was agreed in the VAT Committee⁵:

“Provided that Member State 1 is satisfied that the raw materials have been transported from its territory and that trader A possesses satisfactory proof of that transport

⁵ Working paper No 188-Rev.2 (document XXI/95/2.118-Rev.2) of the 48th meeting (which served as basis for the guidelines subsequently agreed, see footnote 4).

operation, the sale of the raw materials can be regarded as an intra-Community supply of goods effected by A that gives rise to an intra-Community acquisition of goods by C in Member State 2. The declaration obligations corresponding to this taxable transaction will have to be fully observed by the persons liable to pay tax. In accordance with Section F of Article 28b, the services provided by B will be located in Member State 2.

Conclusion in Case No 1

Where a principal identified for VAT purposes in a Member State other than that where the work on movable tangible property is physically carried out purchases raw materials within the territory of a Member State where these raw materials will be the subject of work performed by another taxable person, all the Member States and the Commission have agreed to apply the following practical rules:

- *the supply of the goods on which work is to be carried out is exempted as an intra-Community supply of goods where the exemption conditions laid down in Article 28c(A)(a) are met;*
- *for this purpose, the condition concerning the transport of the goods will be assessed on the basis of the proof furnished by the supplier of the raw materials and relating to the transport of the finished product to the Member State in which the principal is identified for VAT purposes.*

In the above situation, it was considered that:

- there was an intra-Community supply of the original goods (raw materials),
- even though the goods were only physically transported to another Member State after the processing of these goods.

In the EU VAT Forum and its TABECFAF sub-group, it was suggested that a corresponding simplification could be applied in the situation here at stake, with regard to the goods that are exported after the processing of these goods in another Member State:

- the original goods could be considered to be exported (from Member State 2),
- even though the goods are only physically exported after the processing (in that Member State).

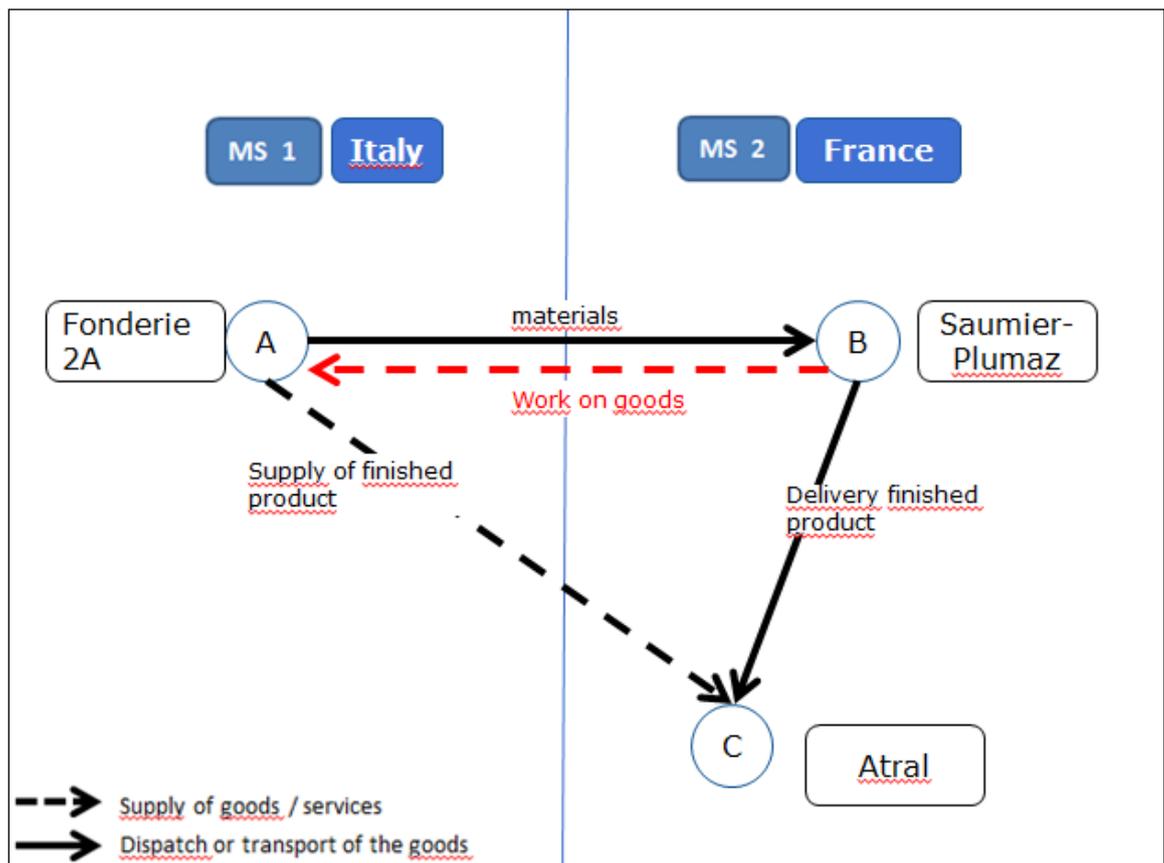
Here as well, the taxable person invoking the exemption (not for an intra-Community supply but for the exportation of the goods) would have to provide the necessary proof relating to the transport operation and to the exportation of the finished product.

3.2. Other comments raised

During discussions in the EU VAT Forum and its TABECFAF subgroup, it was pointed out that the recent judgment by the Court of Justice of the European Union (CJEU)⁶, should be taken into account when discussing possible approaches. The facts of this case were described as follows in paragraphs 14-18 of the judgment:

⁶ CJEU, judgment of 2 October 2014 in case C-446/13 *Fonderie 2A*.

- “14 In 2001 the applicant in the main proceedings manufactured metal parts in Italy which it sold to Atral, a company whose registered office is in France.
- 15 Before those parts were supplied to Atral, the applicant in the main proceedings dispatched them, on its own behalf, to another French company, Saunier-Plumaz, in order for it to carry out finishing work on them, that is to say, painting work, and then forward them directly to the final purchaser.
- 16 The sale price for the parts on Fonderie 2A’s invoice to Atral included the finishing work. The service provider, that is to say, Saunier-Plumaz, invoiced Fonderie 2A in respect of the finishing work, for an amount which also included VAT on that work.
- 17 Fonderie 2A applied to the French tax authorities, on the basis of the national provisions implementing the Eighth Directive, for a refund of the VAT which it had thereby been charged.
- 18 That application was refused on the ground that, under the national provisions implementing the Sixth Directive, the place of supply of the goods was in France.”



It was however observed that the facts of that judgment were not fully comparable with the issue at stake (although participants agreed that it is also about determining the correct place of the intra-Community supply of goods when some further processing/manufacturing of the goods takes place in another Member State). On this point, it was emphasised that the situation here at stake concerns the case where the work on the goods is carried out on behalf of the customer C (i.e. the company established outside the EU,

who bought the goods from company A). It means that the situation here to be analysed is not completely the same as in the *Fonderie 2A*-case.

It was further observed that the facts may be simple in some situations, e.g. where the further processing of the goods is limited to painting the initial product. In such a case, it is clear that the initial supply of goods can still be broadly reconnected with the following exportation of the end products. However, it would not be the case for all types of further manufacturing of raw materials.

The idea of implementing an “extensive warehouse VAT regime” to create a tax suspended environment before the final products are exported was also envisaged. However, it would mean that the foreign company would have to be registered and this was precisely the kind of burden that businesses strive to alleviate, taking into account that each Member State has its own registration procedures and requirements. More importantly, in this warehouse environment, the proof will still have to be given that the “initial goods” have been exported outside of the EU which may not be so easy when the goods have been subject to a remanufacturing process, a real transformation out of which completely different products are exported. It was stressed that in order to limit the risks in such circumstances a time limit for the processing of the raw material meant to be exported would be needed (one year).

It was observed that such a simplification should not lead to new administrative cooperation requirements, and that attention should also be paid to the cooperation between the VAT authorities and the customs authorities.

It was acknowledged that there were opportunities for abuse. It was stressed that identification of the ownership, the level of transformation and export control could be problematic issues which should be properly addressed. In this regard, the following was stated:

The application of rules concerning the system of intra-Community transactions in goods and supply of services and also the exemption on exports should be done with the utmost rigor and aligned with control measures, especially after the serious fraud schemes detected in intra-Community trade, in imports and exports and in operations combining both.

This is particularly important in the context of trade in raw materials, known as been fertile to fraud situations, whether purely domestic, intra-Community or international.

This eventual exemption would not be applicable on complex production processes as the risk for abuse increases the greater the number of raw materials and/or Member States involved.

Note that the production process in Member State 2 can generate “wastes” with commercial value.

There can be an “under-report” of production or an “over-report” of production losses, so part of the real production is not exported and ends up supplying the black market.

4. DELEGATIONS' OPINION

The delegates are invited to have an exchange of views on this important issue and to express their opinion on the possible way forward.

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