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KMLZ VAT NEWSLETTER

Consignment stocks – treatment depends on content of contracts

Tax court disagrees with fiscal authorities

In a decision of 18 June 2015, the tax court Niedersachsen (Lower Saxony) expressed its disagreement with the tax authorities' opinion regarding consignment stocks (case no. 5 K 335/14). The case concerned supplies from the EU to a call-off stock in Germany. The tax court decided that the respective contractual agreements of the parties are essential for the VAT treatment. It is yet to be determined whether an unconditional purchase agreement had already been put in place prior to the goods being shipped to the warehouse. It is now evident that companies may not rely on the rules for consignment stocks as contained in the German VAT Circular. Both, suppliers and customers need to carefully check what is agreed in terms of their consignment stock contracts.

1. Facts

A British automotive supplier (plaintiff) supplied decorative trims to a German automobile producer (customer). The goods were manufactured in Great Britain and then sent to Germany. The goods were temporarily stored in a warehouse rented by the plaintiff where they were registered in the customer's ERP system and repacked for the customer. The customer removed the goods from the stock for production purposes after a few days or a maximum of 4 months later. Call-offs/orders were placed 8 to 10 weeks prior to the goods being required for the customer's production process. Extensive agreements had been concluded by the relevant parties, including an agreement that risk, title and the right to dispose of the goods were to be transferred at the time goods were removed from the stock.

2. Legal situation

According to the German tax authorities, the place of supply is deemed to be where the stock is located if goods are supplied via warehouses and consignment stocks. Shipping goods to the stock from other EU Member States is deemed to be an intra-Community supply. This derives from sec 3.12 para 3 sentence 7 and sec. 1a.2 para 6 of the German VAT Circular. The Hessian tax court raised doubts regarding this opinion in its decisions 1 V 2518/10 of 21 June 2011 and 1 K 108/11 of 30 October 2014. Even the Federal Fiscal Court made a decision contrary to the tax authorities' view in a judgment on 30 October 2008 (XI R 67/07). In this case goods were stored temporarily with a ship-to-hold clause to the effect that the storage was not relevant. As a result, many concluded that the treatment of consignment stocks would have to change. However, the tax authorities have objected to this, most notably in the administrative circular published by the upper tax authority (OFD) Frankfurt am Main on 17 October 2010.

3. Decision of the tax court

The tax court confirmed that a taxable supply is deemed to be carried out if a concrete legally binding agreement, usually a purchase contract, exists according to which the supplier has to transfer the right to dispose of the goods to a certain or at least identifiable customer. As the VAT law

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does not contain any individual regulation regarding consignment stocks, they have to be treated in accordance with this general principle.

Therefore, the VAT treatment of consignment stocks depends on the respective agreements made in the consignment stock contracts. The parties may agree that a purchase contract only comes into being at the time the goods are taken from the stock by the customer and a simultaneous supply by the supplier and purchase by the customer takes place. The contractual parties may also conclude an unconditional purchase contract regarding the stock of the warehouse with a simultaneous retention of title to the stock by the supplier and deferral of the purchase price. It is to be determined which contractual designs were chosen based on the interpretation of the consignment contract at hand.

After having examined the contract documents submitted, the tax court was convinced that each of the supplies of goods by the plaintiff was directly attributable to an unconditional purchase contract which was in place between the plaintiff and the customer and which had been entered into prior to the goods being shipped to the stock. This was concluded by the tax court for the following reasons:

- Only one specific customer was entitled to take the goods from the stock (call-off-stock) and the goods were manufactured especially for the customer.
- Binding orders (call-offs) and respective unconditional purchase contracts were always concluded prior to the delivery from Great Britain.
- Customer specification regarding labeling and registration in the customer's ERP system evidenced the attribution to the customer.
- Storage cost and insurance were to be borne by the supplier, however, these costs were ultimately passed to the customer.
- The theoretical possibility for the supplier to take goods from the stock was not to be considered as this would be economically useless for the supplier.
- The contractual regulation regarding the right to dispose of the goods being transferred in accordance with the German VAT Act was considered to be a legal evaluation without any tax relevance and contradictory in terms of the other contractual agreements and the actual facts of the case.
- The accounting treatment, based on income tax and trade law, was found to be irrelevant.

4. Conclusions

The tax office did not file an appeal against the tax courts decision. Therefore, there is yet to be a high-court decision made regarding consignment stocks. The German tax authorities have no desire to change their opinion. From what we hear, the EU Commission is currently considering the treatment of consignment stocks. However, we do not expect any results in the short to medium term.

The case law confirms the need for suppliers and customers to carefully check what is included in their consignment stock contracts. It is essential to know what type of contract was concluded by the parties and when the right to dispose of the goods is transferred. This is difficult to evaluate in most cases. Therefore, we stress the need to optimize and clearly draft all contracts being concluded for the future. Sales and purchasing departments need to be informed and should be encouraged to contact the tax department before concluding any new contracts. All pre-existing contracts should be checked in order to determine whether the transfer of the right to dispose of the goods is clearly regulated so that the VAT evaluation is in line with both the tax authorities' view as well as the case law.