VAT Fraud in the Customer Chain - The German Perfect Storm Cases

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VAT FRAUD IN THE CUSTOMER CHAIN -
THE GERMAN PERFECT STORM CASES

Richard T. Ainsworth

German civil and criminal courts have not always agreed over whether to allow a taxpayer to zero-rate intra-Community supplies when the taxpayer making the supply knew (or should have known) that his buyer in the other Member State intended to fraudulently evade VAT as a missing trader. This is no longer the case. Zero-rating of intra-community supplies is now being denied in German civil and criminal courts.

This paper considers how far Germany appears to be extending the law in this area. In civil courts a lesser standard of knowledge (should have known) is available. In some cases this lower standard has proven sufficient to deny zero-rating.1 In 2011 six cases were heard by the Bundesfinanzhof (German Supreme Tax Court)2 that demonstrate both (a) the civil court’s adoption of criminal analysis and (b) the development of a middle ground between actual knowledge and absence of knowledge of fraud in the customer chain. This middle ground can be seen in cases where dispatching traders should have known of their customer’s scheme to fraudulently evade VAT.

PRIMARY ANALYSIS

After the December 7, 2010 decision by the Court of Justice of the European Union (CJEU) in Criminal Proceedings against R (“R”),3 the Bundesfinanzhof made it

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1 There is no agreement on whether or not this lesser (should have known) standard should be applied. Jochen Meyer-Burow & Ocka Stumm, Recent Developments in German Criminal Law and Their Impact on VAT Compliance, INT'L. VAT MONITOR (May/June 2011) 161, 165 (indicating that it is “… correct [to] infer from the ECJ’s judgment in the criminal proceedings against R that the intra-Community supplies of goods would still be zero rated if the supplier should have known that his contract partners had committed fraud.”) Meyer-Burow & Stumm at 165, n. 21 observe the conflict in opinion in five further references: (1) Küffner/vonStreit, Anmerkung zum Urteil des EuGH vom 07.12.2010 – Az.: C-285/09, DStR 2010 [Note to the Judgment on the ECJ on December 7, 2010], at 2576 and (2) Schenkewitz, Aktuelles zur steuerstrafrechtlichen Behandlung fingierter Ausfuhrlieferungen gem. §6 USfG [Update on criminal tax treatment fictitious export deliveries], BB 2011, at 350 and 357 (who explain that violation of formal obligations must not preclude the supplier from applying the zero rate under the case law of the ECJ). (3) Höink, EuGH-Vorlageverfahren für innergemeinschaftliche Lieferungen, [ECJ preliminary ruling procedure for intra-Community supplies] DStR 2010, at 1772; and (4) Sterzinger, Anmerkung zum Urteil des EuGH v. 07.12.2010 - Rs. [Note on the Judgment of the ECJ of December 7, 2010 - Rs C-285/09”, UR 2011, at 15 (who contends that only “intentional” abuse has the effect that suppliers may lose the right to apply the zero rate). However, in (5) Die Rechtssache “R” - Der EuGH setzt seine Rechtsprechung zur missbräuchlichen Erlangung umsatzsteuerlicher Vorteile fort [The Case ”R” - The Court Continues its Case Law on Obtaining Fraudulent Sales Tax Benefits], USfB 2011, at 52 and 55, Hundt-ßwein disagrees and points to case law of the ECJ indicating that the supplier’s intentional actions have the effect that he loses the right to zero rate intra-Community supplies of goods but also the circumstance that he “should have known” about his customer’s fraud.

2 The Bundesfinanzhof is one of five federal supreme courts in Germany. It takes appeals of only tax and customs cases that come up from the Finanzgericht (the Finance Courts) which are specialized courts established in each federal state.

clear that it would follow the reasoning of the German criminal courts. Civil courts have
now denied taxpayers the right to zero-rate dispatches to another Member State, when the
taxpayer knew (or should have known) based on objective factors, that its buyer intended
to use the transfer to fraudulently evade VAT in the other Member State.

The unfortunate outcome may be that a single transaction can be taxed twice:

once through the denial of the zero-rate on dispatch, and a second time through an
enforcement action in the buyer’s jurisdiction. Commentators do not agree that double
taxation is necessary. However, the issuance of corrected invoices after a court’s ruling

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4 The Bundesgerichtshof (Federal Court of Justice – criminal courts) had previously decided two very
similar criminal cases in the same manner: On November 20, 2008 it decided Case 1 StR 354/08, and on
February 19, 2009 it decided Case 1 StR 633/08. An appeal was brought against the first of these cases
before the Bundesverfassungsgericht (Federal Constitutional Court), which suspended the prison term that
had been imposed pending a final decision in “R.”

5 German civil and criminal courts were in conflict over the treatment of Mr. R. In this case the German
tax authorities denied Mr. R the right to zero-rate his sale of automobiles to Portugal, and criminal fraud
penalties were imposed. The Landgericht Mannheim (Mannheim regional criminal court of first instance)
upheld the penalties. In doing so, the Landgericht was following a 2008 decision of the Bundesgerichtshof
(Federal Supreme Court).

However, the Finanzgericht (tax court of first instance) and the Bundesfinanzhof saw the matter
differently. According to the civil courts the zero-rate on Mr. R’s intra-Community supply could not be
refused because the requirements for an intra-Community supply were met. The objective conditions set
down in Albert Collée v. Finanzamt Limburg an der Lahn, Case C-146/05 [2007] ECR 1-7861 (September
27, 2007) had been satisfied. Under these conditions zero-rating could only be refused if there was a risk of
loss of tax revenue, or if the levying of VAT was in jeopardy. The civil courts reasoned that any risk of
VAT loss arose in Portugal, not Germany. A zero-rate was therefore appropriate.

6 Advocate General Cruz Villalón, Opinion of Advocate General in Criminal Proceedings against R, Case
C-285/09 delivered June 29, 2010 noted this possibility at 63 & 64 observed:

Accordingly, if Mr. R is refused the exemption and, at the same time, the
Portuguese authorities succeed in collecting the VAT to which they are entitled, it would
create a situation of double taxation which would also be contrary to the principle of
neutrality.

In its question, the Bundesgerichtshof states that that double taxation may be
avoided if the German authorities refund the collected VAT to Mr. R when it is
established that tax has already been paid on the same transaction in Portugal. I consider,
however, that that refund mechanism (provided for in Paragraph 227 of the AO) does not
serve to prevent double taxation, but only to remedy its effects once it has occurred.
Accordingly, it seems insufficient to safeguard the principle of neutrality of the tax.

7 Meyer-Burow & Stumm, supra note 1, at 165 observes:

In its judgment in the criminal proceedings against R, the ECJ has indicated that,
inasmuch as the supplier’s involvement in the evasion is a decisive factor, refusing to
allow the supplier to zero rate the intra-Community supply would lead to double taxation
of the transactions concerned. However, the ECJ has not fully clarified whether double
taxation is an inevitable consequence of the refusal to apply the zero rate. For example, it
may be possible for the German supplier to issue corrected VAT invoices that mention
German VAT, which the customers could recover under the VAT refund procedure or,
depending on the circumstances, deduct through their periodic VAT returns. It could be
argued that, provided that the Portuguese car dealers show that they have paid the VAT
due in Portugal, the German tax authorities should not be allowed to reject the car
dealers’ applications for refund of the German VAT charged to them on the corrected in-
voices. Refunding the German VAT to the Portuguese car dealers would, under those
circumstances, be required by the neutrality principle of the VAT system. VAT should
could easily be time-barred. In addition, an input tax deduction could be prohibited if the taxpayer’s conduct has been shown to be in “bad faith,” or if there is a high “risk of revenue loss.”

This is an aggressive approach to combating missing trader fraud. There do not appear to be comparable efforts in other Member States.

Two elements of the German cases considered here are noteworthy. First, these are cases that involve fraud in the customer chain rather than the more typical fraud in the supply chain – in other words these cases look forward to fraud in future transactions, rather than backwards at fraud in historical transactions. Secondly, the questions in these six cases involve the denial of a zero rate on an intra-community supply rather than the more common denial of a deduction on a domestic purchase.

AN ALTERNATE ANALYSIS

Instead of just considering the interplay of German criminal and civil law in these cases it is possible to see them as part of a constellation of court decisions orbiting the CJEU’s reasoning in two sets of joined cases: Alex Kittel v. Belgium and Belgium v. Recolta Recycling SPRL (Kittel/Recolta),9 and Mahagében kft v. Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Főgazgatósága and Péter Dávid v. Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Főgazgatósága (Mahagében/Dávid).10 These are supply-side (input deduction denial), not customer-side (zero-rate denial) cases, but they have been instrumental in developing the law around missing trader fraud.

Kittel/Recolta denies domestic input deductions when a missing trader is the taxpayer’s supplier; Mahagében/Dávid expressly extends this analysis throughout the purchase chain. The six German cases following “R” are similar. They deny zero-rating when the missing trader is a customer, but the case law does not (yet) extend throughout the customer chain.11 The linchpin binding all of these cases together is the question about the degree of knowledge – do we need actual knowledge of fraud or can the knowledge element be reduced to something the taxpayer should have known, or ought to have known before a tax advantage can be denied?12

not be used as an instrument to penalize offences by unnecessarily assessing VAT twice on the same transactions.

8 Judgment of CJEU of May 8, 2008 in the joined Cases C-95/07 and C-96/07, Esctrade SpA v. Agenzia delle Entrate – Ufficio de Genova 3 (indicating that the right to deduct is not time-barred when a tax authority assesses a taxpayer for inadvertently failing to perform a reverse charge at a time when the four-year period for assessments was open even though the two-year period for deduction had closed, provided the error was not the result of bad faith or evasion and there was no risk of tax loss).


10 Joined cases C-80/11 and C-142/11.

11 However, an express extension of this effort into the full customer chain is only a matter of time. Consider the four permutations of this fraud in the used car sector outlined by the Portuguese tax auditor Sandra Luzia Assunçã Rocha. It would be a simple matter of inserting a “buffer” between then importer and the missing trader, if the rule was otherwise. See infra notes 19, 20, 21, and 22.

12 Should have known is the expression used in Kittel/Recolta whereas ought to have known is the expression in Mahagében/Dávid. They are linguistic synonyms. Substituting one expression for the other would not be a significant matter, if a dispute had not developed over the meaning of should have known in
From a tax policy perspective Kittel/Recolta, Mahagében/Dávid, “R,” and the six German cases present three basic questions: (1) does it matter when the fraud occurs (earlier, on the purchase-side of the taxpayer’s supply chain, or later, on the sale-side of the taxpayer’s customer chain); (2) does it matter where the fraud arises (domestically or in another Member State); and (3) does it matter which VAT benefit is denied to the fraudster as a remedy (the right of deducting input VAT, or the right to zero-rate an intra-community supply)?

The answer in each instance appears to be: “No.” It does not matter when, or where the fraud occurs, or which benefit [deduction or zero-rating] is denied the taxpayer. The evaluative standard is the same: did the taxpayer know or should he have known, based on objective factors, that his transaction was connected with fraudulent evasion of VAT? If so, benefits may be curtailed.

Stated in terms of the Perfect Storm, this analysis of the six German cases is considered in the section entitled Kittel Stage 3: The Search for Assets.

Criminal Proceedings against R, Case C-285/09

The facts in “R” are not unusual. The EU has a considerable problem with VAT fraud in the second-hand car market. Sandra Luzia Assunçã Rocha, a tax auditor with the Portuguese Directorate-General for Taxation recently sketched the details of four of the most common methods employed by fraudsters in the used car sector: (a) the chain fraud model, (b) traditional fake triangular operations model, (c) the use of multiple Kittel

Kittel/Recolta. An effort was made (most notably in UK litigation) to significantly restrict this term so that it narrowly meant could not have helped but to have known. These arguments are based in how to translate the French expression aurait dû savoir used in the official “language of the case.” For an extended discussion of the interrelationship of Kittel/Recolta and Mahagében/Dávid see Richard T. Ainsworth, Mahagében kft & Péter Dávid: Re-directing the EU VAT’s Perfect Storm, XX TAX NOTES INT’L XX (JULY X, 2012)

13 Kittel/Recolta and Mahagében/Dávid are purchase-side cases. “R” is a sales-side case.
14 Mahagében/Dávid is a purely domestic case with the fraud arising domestically. Both Kittel/Recolta and “R” involve cross-border trades, but the Kittel/Recolta fraud arises domestically, whereas the fraud in “R” occurs in the other Member State.
15 Kittel/Recolta and Mahagében/Dávid are concerned with the denial of the right of deduction. “R” is concerned with denial of a zero-rate.
17 For the past seven years Ms. Assunçã Rocha has been a member of a specialized team of auditors investigating second-hand car fraud. In an effort to convey the scope of this fraud the figures for one recent case are reproduced. It involved 2,729,465€ in car sales that were effectively sold tax-free. The cars came from five Member States, and passed through a Portuguese “buffer company” before being sold on to Spanish traders and final consumers as well as Danish traders. The audit period spanned three months from August 2, 2010 through November 8, 2010.
19 The chain fraud model involves two Member States. Invoices are sent to a buffer enterprise (missing trader) that engages in a margin sale to a third enterprise (to whom the cars are drop-shipped) and who then sells on to a final consumer in the same Member State.
20 The fake triangular operation model involves three Member States. Under this scheme the buffer is placed in the third Member State, and the cars are shipped to a trader in another Member State who
buffer companies in multiple Member States, and (d) the use of fake purchase invoices. The facts in “R” indicate that a combination of the methods mention at (a) and (d) were used by Mr. R.

**Facts.** Mr. R, a Portuguese national, managed a German company trading in luxury cars. More than 500 vehicles were sold each year. Most of the buyers were automobile distributors in Portugal.

In 2002 Mr. R began manipulating records to conceal the true identity of his purchasers. This deception enabled his buyers to evade audit detection. For German purposes Mr. R declared that his sales were exempt intra-Community supplies. Mr. R recorded these supplies as VAT-free transactions on annual VAT returns. To support the German return Mr. R prepared false invoices. These invoices were drafted in the name of real businesses, with correct addresses and VAT ID numbers, but the businesses were not the true purchasers. Frequently these businesses did not know that their identities had been stolen. False shipping documents were also prepared indicating that shipments were made to the false buyers.

For Portuguese purposes a different set of invoices were prepared. This time the sales were represented as used car sales, taxable under the margin scheme. The false paperwork made it appear that these transactions were already taxed in Germany. If a final consumer was known before delivery, Mr. R produced:

- Vehicle registration documents in the name and address of the final consumer indicating that this was a sale of a used vehicle, and
- A (false) notation was inscribed on the invoice: “taxation of profit margin pursuant to ¶25a of the UStG.”

**Criminal courts.** After audit the German tax authorities denied Mr. R the right to zero-rate his sales. Criminal fraud penalties were imposed, and the Landgericht Mannheim (Mannheim regional criminal court of first instance) upheld the tax administration’s determination. Mr. R was sentenced to a three-year prison term for tax fraud. The Landgericht Mannheim determined that the falsified sales to Portugal were not intra-Community supplies within the meaning of the Sixth Directive. In reaching its decision the Landgericht followed a 2008 case of the Bundesgerichtshof (Federal Supreme Court).
Civil courts. This was not the way that the Finanzgericht (tax court of first instance) and the Bundesfinanzhof (Federal Supreme Court for Tax Matters) saw the matter.25 According to the civil courts the zero-rate on Mr. R’s intra-Community supply could not be refused. The cars were sold and actually dispatched to Portugal. As a result the requirements for an intra-Community supply were met.

The civil courts reasoned that the objective conditions set down in Albert Collée v. Finanzamt Limburg an der Lahn,26 had been met. Under these conditions, a zero-rate can only be refused if there is a risk of loss of tax revenue, or if the levying of VAT is in jeopardy. Any risk of loss arises in Portugal, not Germany, thus it is Portugal’s obligation (not Germany’s) to enforce the rules.

In light of the Bundesfinanzhof’s opinion, the Bundesgerichtshof asked the CJEU if a taxpayer should be denied use of a zero rate, if on the basis of objective evidence it is established that the taxpayer knew that, by his supply, he was participating in a transaction aimed at evading VAT, or if he took actions aimed at concealing the true identity of the person to whom the goods were supplied in order to enable the latter person or a third person to evade VAT?

ECJ decision. The ECJ determined that when a taxpayer prepares deliberately fraudulent invoices, declarations, and engages in substantial manipulation of evidence in support of an intra-Community supply, a Member State is required to refuse the zero-rate.

In other words, the ECJ agrees with the German criminal courts. The proper way to look at this case is not German-centric (how should the German tax authority respond to Mr. R’s fraud in their duty to protect the German fisc). The correct perspective is Euro-centric (how should any Member State respond to Mr. R’s fraud to protect the “proper functioning of the [Community’s] common system of VAT.”27)

Six German Cases

This section considers six German civil cases from 2011 that involved the question of denying a zero-rate for an intra-community supply. The cases are organized by trial date at the Bundesfinanzhof (Federal Supreme Court for Tax Matters): two cases were heard on February 17, 2011 (V R 28/10 and V R 30/10),28 one on May 12, 2011 (V

26 Albert Collée as full legal successor to Collée KG v. Finanzamt Limburg an der Lahn, Case C-146/05 [2007] ECR 1-7861 (27 September 2007).
27 “R,” at ¶48. Emblematic of this shift in focus is apparent in the citations. Where the Bundesgerichtshof specifically asks about Art. 28c(A)(a) [VAT Directive 138(1)] the ECJ directs most of its attention to the heading, Art.28c(A) [VAT Directive 131].
28 The Bundesfinanzhof published these judgments simultaneously (February 17, 2011) in an effort to “… clarify … a number of controversial issues regarding so-called intra-Community supplies to businesses in other member States, in particular issues of fraudulent use of sales tax exemption for delivery transactions within the European Union.” Press Release of the Bundesfinanzhof, No. 51 of 13 July 2011, VAT on intra-
R 46/10), and three on August 11, 2011 (V R 50/09, V R 3/10 and V R 19/10). Each case was on appeal from a tax court of first instance, Finanzgericht. Facts of the separate cases will be considered first, aggregate analysis will follow.

(1) V R 28/10. This case was heard by the Bundesfinanzhof (Federal Supreme Court for Tax Matters) on appeal from the Tax Court (Finanzgericht) of Baden Württemberg. It is one of the two related cases heard on February 17, 2011.

V R 28/10 concerns the delivery of luxury cars (Mercedes A 170) in a purported triangular transaction. The cars are sold to three traders in Italy, and then re-sold to Italian consumers. Each trader authorized the same German resident to act as its representative for securing cars. The reality of the relationship was reversed. It was the “agent” who in fact controlled (and created) the traders. German auto suppliers were asked to sell cars to the traders, but deliver them directly to final consumers. The traders did not file Italian VAT returns.

The German tax authority denied the supplier’s zero-rate. The Finanzgericht agreed and decided against the supplier based on a failure to comply with formal documentation requirements. The Bundesfinanzhof however, rejected this formalistic approach. It indicated that the case should instead turn on the supplier’s knowledge.

The Bundesfinanzhof remanded the case to the Finanzgericht with the instruction that the decision needed to conform to the CJEU’s decision in “R,” C-285/09. The Finanzgericht was told to determine if the German supplier had determined the true buyer’s identity (the final consumers).

Community Supplies in the Internal Market, available at: http://juris.bundesfinanzhof.de/cgi-bin/rechtsprechung/document.py?Gericht=bfh&Art=pm&Datum=2011&nr=24053&linked=pm

29 BFH, judgment of February 17, 2011 – V R 28/10 (FG Baden Württemberg May 20, 2010 12 K247/06).
30 Id., ¶28.
31 Id., ¶1.
32 Id., ¶11.
33 Id., ¶2.
34 Id., ¶11 (Italian audit investigation indicated that the traders were “economically non-existent customers).
35 Id., ¶¶5, 7 & 9 Indicating that there were problems with the CRM bills being adequate evidence of dispatch if not properly filled out, a signature, vehicle identification numbers and a confirmation receipt in addition to the fact that delivery was made to the final consumers without good evidence of the person to whom they were delivered. However, this data is not required. Id., ¶¶23, 24, 25 &29.
36 The decision does not have a clear discussion of a “should have known” standard. Even though mention is made of a “diligence of the prudent businessman” standard, the case seems binary – either there is knowledge or there is none.
37 Id., ¶38.
38 Id., ¶16 (referencing the personal identity requirements of §6a Abs. 1 Satz 1 Nr. 2 Buchst. a & b, Nr. 3 UStG. These requirements mandate that the supplier know to whom he is making his delivery, because it is this person who will assume the responsibility for the VAT in the destination state – Italy. These are requirements that the Bundesfinanzhof specifically associates with the CJEU decision in “R” at ¶15 & headnote in that decision and ¶38 herein).
The result of the remand is a foregone conclusion. The purpose of the arrangement was for the “agent” to establish Italian (missing) traders to disguise the identity of the true buyers.39 Did the suppliers know?

The Bundesfinanzhof indicated that if (after exercising the diligence of a prudent businessman) the supplier had a genuine belief in the validity of the three-way transaction, and if the supplier had taken all reasonable precautions to ascertain his customer’s identities, then an intra-Community supply was appropriate and the supplier could not be held liable for the fraud.40

If however, the supplier was aware of the fraud then “R” indicates that the real buyers were the Italian consumers.41 The fictitious sales to the traders should be ignored. The transactions would be taxable in Germany (and the zero-rate would ne denied).

(2) V R 30/10.42 This case was heard by the Bundesfinanzhof on appeal from the Finanzgericht of Saarlandes. This is the companion case heard together with V R 28/10 on February 17, 2011.

V R 30/10 involves a traditional carousel fraud in cell phones. The German supplier sold phones to Austrian customers who re-sold them to other Austrian taxpayers. The phones were eventually re-exported to Germany, and ultimately back to the original supplier who once again sold then onward to the Austrian buyer. Italian entities were also involved, and a single managing director of controlled each of the entities in the carousel.43

As with V R 28/10 the immediate VAT loss was not in Germany - Austrian VAT was lost in this case. Nevertheless, German tax authorities denied the German supplier’s zero-rate. The Finanzgericht agreed, and based its decision on the “… known involvement of a board member of the companies in a ‘VAT carousel.’”44

The Bundesfinanzhof disagreed. It set aside the judgment and remanded the case to the Finanzgericht with instructions that “mere involvement in a VAT carousel” was not sufficient to deny the zero-rate on an intra-community supply.45

39 Id., ¶8 (this is the point where the inadequacy of the CRM notes crosses the analysis of the Bundesfinanzhof. The CRMs did not indicate a specific delivery location, just a city (the billing address was the address of the traders, but the cars were not delivered there). The name and address of the final customers were not preserved, nor were the vehicle identification numbers available. The shipping confirmations were provided with unknown signatures.

40 The Bundesfinanzhof is clear at ¶37 that if the supplier is deceived by “… incorrect information provided by the purchaser and the contractor cannot recognize the falsity of that information … then the exemption may legitimately be granted.”

41 Id., ¶18.

42 BFH, judgment of February 17, 2011 – V R 30/10 (FG des Saarlandes, June 30, 2010 1 K 1319/07) EFG 2010, 1740.

43 Id., ¶1.

44 Id., ¶3.

45 Id., ¶10.
As in V R 28/10 the Bundesfinanzhof once again emphasized that under §6a Abs. 1 Satz 1 Nr. 2 Buchst. a & b, Nr. 3 UStG the supplier must know to whom he is making his delivery.\textsuperscript{46} In this case the Bundesfinanzhof is even clearer about why this is important, and why it places considerable reliance on the CJEU’s “R” decision. The Bundesfinanzhof notes that in “R” it had, … requested a preliminary decision [from the CJEU] on whether a tax exemption [can be] denied on an actual Community supply, if it is ascertained, that the taxable seller either "knew that with the delivery of goods he was involved in a transaction which is created to evade tax "or" did acts that were aimed to conceal the true identity of the purchaser to allow this or any third party to evade tax.

The ECJ ruled that intra-Community supplies are taxable if the conditions of an intra-Community supply, although objectively accurate, are "deliberately factually incorrect" [such as where] bills are issued that "disguise the identity of the real purchaser" [ECJ judgment R at ¶47, 49 and holding] …\textsuperscript{47}

The Bundesfinanzhof places considerable emphasis on the second part of the question it posed to the CJEU. It is very concerned with “acts that were aimed to conceal the true identity of the purchaser to allow this or any third party to evade tax.” German law makes the same point. §6a Abs. 1 Satz 1 Nr. 2 Buchst. a & b, Nr. 3 UStG requires the supplier to know his buyer. This is a standard that is somewhat lesser than \textit{actual knowledge} – the criterion on the first part of the disjunctive (“or”) question posed to the CJEU.

\textit{Acts aimed to conceal} are clearly apparent in V R 30/10 (the carousel in cell phones is clearly set out), and they are also part of the case in V R 28/10 (false invoices sent to “paper” traders set up by the supposed German “agent” of these traders). Finding these acts of this nature is akin to \textit{turning a blind eye} to the fraud. This is not proof of the taxpayer’s \textit{actual knowledge}, but it is proof of knowledge that the taxpayer \textit{should have}.

(3) V R 46/10.\textsuperscript{48} This case was heard by the Bundesfinanzhof on appeal from the Finanzgericht of Rheinland-Pfalz on May 12, 2011.

VR 46/10 is largely about “other obligations to prevent evasion” that Member States may impose under the former Article 22(8) of the Sixth Directive [Article 273 of the current VAT Directive].\textsuperscript{49} V R 30/10 and V R 28/10 were primarily concerned with

\textsuperscript{46} Id., ¶15, Indicating that the identity of the purchaser is of crucial importance for the tax exemption for intra-Community supply, since intra-Community supply and intra-Community acquisition are "one and the same economic process." The purpose of an intra-Community transaction is to shift tax revenue to the Member State of final consumption, which is where the goods are delivered: citing: \textit{Teleos and Others v. HMRC}, Case C-409/04 [2007] ECR 1-7797 at ¶¶23f, 36, 37 & 41. \textit{Twoh International v. Staatssecretaris van Financiën}, Case C-184/05 [2007] ECR 1-7897, at ¶22.

\textsuperscript{47} Id., ¶¶22 & 23 (emphasis added).

\textsuperscript{48} BFH, judgment of May 12, 2011 – V R 46/10 (FG Rheinland-Pfalz, October 14, 2010 6 K 1644/08).

\textsuperscript{49} Article 273 of the VAT Directive reads:
§6a Abs. 1 Satz 1 Nr. 2 Buchst. a & b, Nr. 3 UStG, the domestic law requirement that a German supplier know his buyer. V R 46/10 references other requirements:

- In particular, §14(4) UStG which requires that the VAT-free status of an intra-community supply be indicated on the invoice, and
- The series of rules in §17a ff UStDV (the VAT Implementation Order) that specifies verification duties (frequently called “book evidence” documents) like transportation documents that will show the dispatch of goods.

Generally speaking, at §17a ¶2, No.1 & No. 4 UStDV, Germany requires a very thoroughly preserved audit trail.

In V R 46/10 an Italian buyer agrees to purchase, pick-up and then transport to his location in Italy thirteen high-end used cars from a German supplier. The buyer has authorized his son to complete the transfer. The warrant presented to the supplier is questionable. It is barely legible, and composed in bad German. The son arrives with a car transporter, makes full payment in cash, and provides a receipt made out on the letterhead of a different business. The receipt indicates that Italy is the destination of the vehicles, but it omits any mention of the specific place of destination, and the identity of the consignee.

Nevertheless, the German supplier issues an invoice (made out to the presumed Italian purchaser). The invoice does not show VAT, but gives no indication why the sale should be exempt. Efforts were allegedly made by the supplier to determine the identity of the Italian business. What he should have found should have raised additional concerns. The Italian purchaser had never dealt in automobiles before and had no facilities to display them. The question raised by V R 46/10 is: Did the supplier meet the “… obligations which [Germany] deems necessary to ensure the correct collection of VAT and to prevent evasion?”

An auditor, like Sandra Luzia Assunçã Rocha, would be suspicious. Are these cars actually being delivered to Italy? Could this be the first stage of a MITC chain fraud (where an Italian buyer is simply a buffer re-selling at a low margin)? Or perhaps

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Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

The option under the first paragraph may not be relied upon in order to impose additional invoicing obligations over and above those laid down in Chapter 3.

50 Id. ¶3.
51 Id. ¶1.
52 Id. ¶3 (in at least one instance it was reasonably clear that the automobile was not destined for Italy)
53 Id. ¶22.
54 Id. ¶18 & 20 (there was no indication of vehicle delivery, tax ID of the buyer, or indication of exemption reason; UStG §§ 14 & 14a; UStG §25a; UStDV §17a ¶2).
55 Id. ¶1 (confirmed by the Italian tax administration).
56 Supra note 19.
this is the first leg of a *fake triangular* MTIC fraud \(^{57}\) (where an Italian buffer facilitates a margin sale in a third Member State). A *multiple buffer company* MTIC fraud is equally possible, \(^{58}\) as is a fraud using *fake purchase invoices*. \(^{59}\)

Is the German seller justified in assuming that this transaction is exempt? \(^{60}\) No. The *Bundesfinanzhof* agrees with the *Finanzgericht*. The supplier’s zero-rate is not justified. The *Bundesfinanzhof* indicates that the German supplier *should have known* that moving forward with its transaction (given the documentation problems he encountered) would be risky as there is objective evidence that this transaction might be involved in fraud. The *Bundesfinanzhof* states:

> The plaintiff therefore has not taken all reasonable measures to prevent an objective involvement in tax evasion, without that a subjective evaluation of compliance is difficult to confirm. \(^{61}\)

Thus, V R 46/10 is similar to V R 30/10 and V R 28/10. The primary difference is *actual knowledge* of fraud verses *should have known* about potential fraud. A single person controlled (or managed) all the entities in V R 30/10 and V R 28/10. That was not the case in V R 46/10, but the German supplier *should have known* better than to move forward without better evidence.

(4) *V R 50/09*. \(^{62}\) This case was heard by the *Bundesfinanzhof* on appeal from the *Finanzgericht* of Baden Württemberg. It was one of three heard on August 11, 2011.

V R 50/09 replicates the decisional history of “R.” A German partnership delivered luxury cars to addresses in Italy where the actual recipients were automobile dealers, but the invoices were drafted in the name of Italian import traders as intra-community supplies. \(^{63}\)

The traders did not report the intra-community acquisitions, and the partnership destroyed most of its records to prevent audit follow-up. \(^{64}\) The cover-up was unsuccessful, criminal proceeding were initiated for tax evasion, where a full confession and guilty plea resulted in a two-year suspended sentence. \(^{65}\) Because the partnership had falsely declared the names of their customers the requirements for an intra-community

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57 *Supra* note 20.
58 *Supra* note 21.
59 *Supra* note 22.
60 *Supra* note 48, at ¶29 (the court suggests that the taxpayer commit to pay the tax at a later time if the evidence upon which he is basing his exemption proves to be erroneous).
61 *Id.*, ¶31.
63 *Id.*, ¶2.
64 *Id.*, ¶6 (indicating also that the supplier colluded with the Italian buyer to obscure the buyers with fake interim acquisitions, imports and billings as well as conducting most transactions in cash to make them hard to trace).
65 *Id.*, ¶3 (the court noted that this fraud was “a widespread illegal business practice” in Italy) and ¶5 (discussing its full confession and admission of guilt).
supply were not met and German VAT was due on all sales. The tax office assessed the partnership after the trial.\textsuperscript{66}

The partnership appealed on the grounds that proof of actual delivery to VAT-registered businesses could be demonstrated, and the fact that an incorrect name was used on the invoice should be an immaterial (minor) error. The tax evasion (which was proven and admitted) was entirely in Italy.\textsuperscript{67}

The Finanzgericht of Baden Württemberg upheld the assessments. The Bundesfinanzhof determined that the taxpayer’s appeal was “… without merit and therefore rejected. The [automobile] deliveries of the applicant are not exempt intra-Community supplies.”\textsuperscript{68}

The Bundesfinanzhof expressly references the authority of Member States to establish conditions on exemptions under Article 273 to prevent “evasion, avoidance or abuse.”\textsuperscript{69} It then couples this authority with express language from “R” and Collée indicating that even when objective evidence would support a zero-rate, “false invoices, providing incorrect information and other manipulations of the correct collection of VAT” can pre-empt its exercise.\textsuperscript{70}

Just as in “R” the partnership in V R 50/09 was “involved willfully in a tax fraud [by] … concealing the identity of the real purchaser, to enable it to evade tax.”\textsuperscript{71} Thus, even though there was a split between the German criminal and civil courts on this issue, after the CJEU’s decision in “R” it is no longer acceptable to zero-rate an inter-community supply that contributes to VAT fraud in another Member State.

(5) V R 3/10.\textsuperscript{72} This case was heard by the Bundesfinanzhof on appeal from the Finanzgericht of Nürnberg. It is the second of three cases heard on August 11, 2011.

In V R 3/10 a German motor car dealer is selling a car to a Spanish dealer who resells the car to a French final consumer. The Spanish dealer sends a driver to pick up the car in Germany with instructions to drive it to the end customer in France without the knowledge of the German dealer.

The German dealer is under an honest (but mistaken) belief that the car is being taken to the buyer in Spain. In addition the dealer took all appropriate precautions to

\textsuperscript{66} Id., ¶13 (the assessment was for four years: 2000 for €373,102.02; 2001 for €654,157.32; 2002 for €618,896.23; and 2003 for €254,957.77).
\textsuperscript{67} Id., ¶3.
\textsuperscript{68} Id., ¶16.
\textsuperscript{69} Id., ¶20.
\textsuperscript{70} Id., ¶20-22 (“R” at supra note 3 at ¶¶ 15 & 46; Collée at supra note 26 at ¶31).
\textsuperscript{71} Id., ¶24 (referencing “R” at supra note 3 at ¶¶ 48-55).
establish the Spanish buyer’s identity and VAT status. He did not know, and had no means of knowing that the car had been re-sold before it was picked up. He did not know and had no reason to know that the car was being redirected to France. The Spanish buyer had drafted the invoice. The invoice showed no VAT, and indicated that the reason was because this was an intra-community supply. The tax authority contended that because the car was re-sold to a French end consumer before it was picked up in Germany, that the German dealer had in fact made a domestic sale to the Spanish dealer (which was subject to German VAT) and that it was the Spanish dealer who had made a zero-rated intra-community supply to the French buyer.

The Finanzgericht held for the taxpayer, and so did the Bundesfinanzhof on appeal. There was no reason for the German suspect anything other than a normal intra-community supply was taking place. The German dealer had complied with all documentation requirements, and had otherwise no reason to know of the deception by the Spanish dealer. V R 3/10 stands for the proposition that just because the taxpayer’s “reliable proof” is wrong does not prevent a zero-rate, particularly if there is no evidence that the taxpayer, “… has obscured the true identity of the purchaser to enable them to evade tax.”

(6) V R 19/10. This case was heard by the Bundesfinanzhof on appeal from the Finanzgericht of Niedersächsisches. It is the third of three cases heard on August 11, 2011.

The tax fraud in V R 19/10 is very clearly set out. A German resident is the managing director and sole shareholder of both a German and Dutch private (limited

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73 Id., ¶1 the taxpayer confirmed with the Federal Central Tax Office on the same day that it receive the FAX order from the Spanish Dealer the tax ID, the name, location postal code and street address of the buyer).

74 Id., ¶1 & 8 (The court indicates that the person who picked up the car was French, but the drive presented an affidavit of receipt for the vehicle indicating that the vehicle was being taken to Spain, and presented a written power of attorney issued by the Spanish buyer. The German dealer also made a copy of the driver’s identity card. The court also found nothing unusual in the appearance of a French driver, because the Spanish dealer was located on the Franco-Spanish border.)

75 Id., ¶1.

76 Id., ¶5.

77 Id., ¶18 (the situation would be different if the Spanish dealer had announced the French sale “prior to the transport or dispatch,” citing CJEU judgment of December 16, 2010 in Euro Tyre Holding, Case C-430/09).

78 Id., ¶11 & 21 (referencing Article 28c(A) of the Sixth Directive; Article 131 of the current VAT Directive, and the power of attorney given to the German dealer also represented that the Spanish dealer was receiving the dispatch of the car).

79 Id., ¶27 citing Albert Collée as full legal successor to Collée KG v. Finanzamt Limburg an der Lahn, Case C-436/05 [2007] ECR 1-7861 (27 September 2007) at ¶31.


liability) company (a GmbH, and a BV). The BV owns 99% of a French subsidiary (SARL).\textsuperscript{82} The SARL identifies retail customers seeking to purchase automobiles.\textsuperscript{83}

When the SARL locates a customer it notifies an independent Spanish car dealer with whom a purchase/sale agreement had been worked out that allows the dealer a margin of €500.\textsuperscript{84} The dealer then purchases the vehicle from the GmbH,\textsuperscript{85} and declares that the car is being brought to Spain.\textsuperscript{86} Instead the car is delivered directly to the final consumer in the name of the SARL. The GmbH declares the transaction a tax-free intra-community supply.\textsuperscript{87}

The GmbH registers the cars in Germany before the sale, and the Spanish dealer invoices the SARL on the margin scheme for second-hand cars. No acquisition tax is declared or paid in Spain or in France on the cars.\textsuperscript{88} Under Sandra Luzia Assunçã Rocha’s classifications this is a \textit{fake triangular operation}.\textsuperscript{89} A buffer is employer in a third Member State (Spain) to convert the intra-community sale to the margin scheme, so that the trader (SARL) can sell to the final consumer on margin.

Through its managing director the GmbH has full knowledge of the entire customer chain. It not only knew that the Spanish dealer would not bring the vehicles to Spain, it knew of the improper use of the margin scheme and the avoidance of VAT in Spain and France.

Relying on the recent CJEU decision in “R,” the Bundesfinanzhof overturns the decision of the Finanzgericht and upholds the determination of the tax authority. In spite of satisfying necessary “objective conditions,”\textsuperscript{90} a transaction is taxable if “… accounting records [are used to] obscure the identity of the purchaser and thereby allow the avoidance of the VAT.”\textsuperscript{91}

CONCLUSION
Assessing the German Cases

The CJEU’s decision in “R” not only (a) harmonizes the approach of the German civil and criminal courts on the denial of a supplier’s zero-rate if a supplier makes an intra-community supply with \textit{actual knowledge} that his buyer will use the transfer to evade VAT in another Member State, but it also (b) provides an avenue for extending enforcement into cases where the supplier has \textit{less than actual knowledge} of this fraud.

\textsuperscript{82} Id., ¶2.
\textsuperscript{83} Id., ¶6 (in all cases except two where Dutch consumers were involved, the final customers were French).
\textsuperscript{84} Id., ¶3.
\textsuperscript{85} Id., ¶3-8.
\textsuperscript{86} Id., ¶7 (insurance was purchased indicating that the car would be brought to Barcelona, Spain).
\textsuperscript{87} Id., ¶8 (indicating that the only reason for including the Spanish entity in the customer chain was to simulate intra-community supplies, because otherwise its presence was “nonsensical”).
\textsuperscript{88} Id., ¶¶14 & 35.
\textsuperscript{89} Supra note 20.
\textsuperscript{90} Id., ¶¶24 - 35.
The narrow facts of “R” present a taxpayer who has (a) actual knowledge of his buyer’s fraud, but who also takes (b) affirmative steps to facilitate the fraud by drafting false invoices, shipping documents, and German car registrations for identified end consumers.

These narrow facts generate the question that the CJEU was asked. The Bundesfinanzhöft takes particular note that the question, and the answer in “R” is disjunctive - whether the taxpayer “… knew that with the delivery of goods he was involved in a transaction which is created to evade tax "or" did acts that were aimed to conceal the true identity of the purchaser to allow this or any third party to evade tax.”

The first clause references actual knowledge of fraud, the second references a lesser standard. It asks about affirmative acts that facilitate fraud, and which actually result in tax evasion by the customer, or a customer’s customer in the purchase chain. This is not knowledge of the fraud; it is knowledge that a supplier should have as a reasonable businessman when he considers the consequences of his actions.

The second clause then, presents a should have known standard rooted in objective conditions expressly adopted under German statute and Article 273 of the VAT Directive to prevent “evasion, avoidance or abuse.”

The knowledge element in the six cases. These cases present a full range of knowledge analysis. In three cases V R 28/10, V R 30/10 and V R 19/10 actual knowledge of the fraud is easy to demonstrate. The same person controls all of the entities (domestic and foreign). Actions and intent are easy to document. In a fourth, V R 50/09, a criminal conviction for fraud is already in hand. The taxpayer’s argument in these cases is that the tax evasion is foreign (not German), so there should be no German penalty. “R” resolves this issue against the taxpayer, and the civil courts now follow suit.

V R 3/10 places the other knowledge pole in the ground. In V R 3/10 there is objective evidence of fraud, however evidence of fraud (without more) is not sufficient. In this case the supplier is honestly deceived by his buyer. The supplier does engage in a transaction that contributes to a fraud, but it is a fraud about which he has no knowledge and no means of knowing anything about. The zero-rate cannot be denied.

V R 46/10 is the case in the middle. V R 46/10 demonstrates the impact of a Member State “impos[ing] other obligations which they deem necessary to ensure the correct collection of VAT” under Article 273. In this case the taxpayer ignores a large number of “other obligations.” It becomes apparent that the taxpayer is not acting as a reasonable businessman. He is negligent. These violations allow the conclusion that he should have known that his contemplated transactions were connected with fraudulent avoidance of VAT. The zero-rate is denied.

The double tax element in the six cases. None of the six cases consider actual or potential double taxation following from the denial of the zero-rate. Double taxation does not seem to be an important issue for the Bundesfinanzhöft. One can imagine that
the foreign tax authorities would not overlook the chance of making an assessment on vehicles that are fraudulently sold VAT-free within their Member State. The assessment will be relatively easy if the vehicle identification number can be secured from the German audit.

In V R 28/10 luxury cars are being delivered to Italian final consumers without VAT. In V R 46/10 expensive cars are being delivered VAT-free to Italy, but to a different (unidentified) buyer. In V R 50/09 is based on criminal confessions. In this case over €1.9 billion in luxury automobiles are sold to Italian consumers without VAT during a four year period. V R 19/10 involves an elaborate multi-corporate structure for securing cars for French and Dutch consumers VAT-free through a Spanish buffer. Both Spanish and French authorities are involved in the investigation, and they most likely have made claims for lost VAT at the time of the German hearing.

The new mutual assistance procedures under Council Directive 2010/24 makes it much easier for jurisdictions where VAT has been lost to identify foreign businesses and individuals who owe or are responsible for tax losses. This was one of the operating premises of the Perfect Storm. Access to information, enforcement cooperation and pursuit of inter-jurisdictional claims are much easier now. The discussion in that paper under the heading “KITTEL STAGE 3 – the search for assets” suggests that just such a dynamic is likely. The six German cases discussed herein indicate that this process is well along its way to fulfillment.

The Perfect Storm proposes that the EU’s fight against missing trader fraud is entering a new phase. Similar arguments are being made in two realms. Arguments based in a trader’s knowledge of supplier (or supply chain) fraud (Kittel/Ricolta and Mahagében/Dávid) are being replicated in arguments based in a trader’s knowledge of customer (or customer chain) fraud (“R” and V R 46/10). The battleground is over how much should a trader know and how much should he be held accountable for. The actual knowledge question is answered. Actual knowledge that supplier or a customer is using a transaction to evade tax will result in the loss of input deductions or the zero-rate on intra-community supplies.

**SUMMARY OF THE SIX GERMAN CASES**

<table>
<thead>
<tr>
<th>No.</th>
<th>Case No.</th>
<th>Trial date</th>
<th>Summary</th>
<th>Type</th>
<th>Knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>VR 28/10</td>
<td>2-17-11</td>
<td>A German resident establishes three Italian trading companies (missing traders), is appointed their agent, and secures luxury cars for Italian individuals.</td>
<td>Chain fraud model</td>
<td>Actual</td>
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</tbody>
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92 Supra note 48, at ¶2.
93 Supra note 66.
95 Id., at 861-62.
96 Supra note 19.
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<th>VR</th>
<th>Date</th>
<th>Description</th>
<th>Type</th>
<th>Notes</th>
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<tr>
<td>2</td>
<td>30/10</td>
<td>2-17-11</td>
<td>Carousel fraud in cell phones moving primarily between Germany and Austria, but with some Italian involvement.</td>
<td>Carousel</td>
<td></td>
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<tr>
<td>3</td>
<td>46/10</td>
<td>5-12-11</td>
<td>Italian business that does not sell cars purchases from German dealer. Numerous documentation problems [receipt on different letterhead, vague destination, invoice does not explain VAT omission].</td>
<td>Fake Purchase Invoice</td>
<td>Should have known</td>
</tr>
<tr>
<td>4</td>
<td>50/09</td>
<td>8-11-11</td>
<td>Prior criminal confession. €1.9m 4 year fraud. Cars invoiced to import traders (missing traders), delivered to Italian businesses.</td>
<td>Chain fraud model</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>3/10</td>
<td>8-11-11</td>
<td>Spanish dealer purchases cars, effects transport, but delivers to French end customers directly. Cars re-sold before pick-up. German dealer unaware.</td>
<td>Fake triangular operation</td>
<td>No knowledge</td>
</tr>
<tr>
<td>6</td>
<td>19/10</td>
<td>8-11-11</td>
<td>Elaborate GmbH, BV and SARL structure secured French &amp; Dutch final consumers for cars bought from GmbH through Spanish dealer on behalf of SARL.</td>
<td>Multiple buffer model</td>
<td></td>
</tr>
</tbody>
</table>

97 Supra note 22.
98 Supra note 20.
99 Supra note 21.