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Reshuffle of supply chains – managing risks regarding excise tax



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**Reshuffle of supply chains - managing risks regarding excise tax**

More and more companies carry out restructurings of their supply chain in order to concentrate all purchasing activities in one central supply unit thus optimizing their cost structure and reducing their tax burden.

To this end the legal ownership of the stocks of the production companies in the respective countries at one cut-off date is transferred to the central purchasing unit whilst the factual possession remains with the local company which continues the production process as before. The central purchasing unit then for all companies in the EU or worldwide closes the purchase contracts with the suppliers and provides the products to the local companies. The local companies now do not purchase any more their raw material and do not sell the finished products as this also is being done by the central purchasing unit as the legal owner also of the finished products.

In case products subject to excise duties like energy products, spirits, tobacco or coffee are involved, such reshuffles according to European excise tax law are prone to risks. In more detail: their tax free status could be at stake. For instance energy products may under certain circumstances be exempted from taxation if they are used for other purposes than as motor or heating fuel like for instance for the production lubricants, coatings and other chemicals. The same is true for spirits, if they are – say – used for the production of pharmaceuticals or beauty care products.

But the tax free use and transport of excise goods according to European excise tax law is allowed only under very strict conditions. If those conditions are not met tax accrues. The operators resorting to those exemptions have to fulfil formalities like applying for a tax warehouse permission or an end user license permission. In case excise goods are to be delivered from other EU-states an application as registered consignee is needed. Apart from that in the process reporting duties to the tax authorities apply and in some cases the use of the special surveillance system Excise Movement and Control System (EMCS) has to be employed in order transport excise goods under tax suspension.

A supply chain reshuffle can endanger the tax free use of those excise products and lead to considerably high amounts of tax risks. As all those permissions mentioned are issued on one special company the fact that after the reshuffle another company - the central purchasing unit - buys the excise goods can lead to problems. The supply chain may be disrupted because the supplier declines to sell to a company which - like the central purchasing unit - is not mentioned in the existing excise tax permission. Apart from that their even is the risk that tax accrues, because the customs office could argue that excise goods are sold to an operator who is not legitimised thus endangering the tax surveillance by the fiscal authorities. In the following the legal situation, potential risks and remedies in selected European States are outlined.



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### General overview

Belgium imposes excise duties on a number of products, including: alcohol and/or alcoholic drinks; energy products and electricity; mineral oils; tobacco; and coffee and non-alcoholic beverages. In general, Belgian excise law is based on EU legislation concerning the so-called European excise products: energy products; tobacco; and alcohol. Coffee and non-alcoholic beverages are subject to specific national excise duties that are not covered by the EU rules.

### Supply chain reshuffles – the effect on excise duties

Companies may reshuffle their supply chain for a variety of reasons. In practice, a reshuffle is often intended to centralize a group's purchases and sales with a single entity that will operate as the group's "central entrepreneur".

Apart from the many practical issues related to a supply chain reshuffle, companies should also be aware of the excise-related implications that such a reshuffle may entail. As supply chain reshuffles very often require a change of ownership of the underlying excise products, they could endanger the excise-free use of certain excise goods and lead to an increase in excise liability. This risk largely arises because all exemption licenses for the tax-free exploitation of excise goods are issued on a nominal basis. In practice, the fact that after a reshuffle another company, e.g. the "central entrepreneur", is the excise goods' legal owner, could give rise to various problems:

- The supply chain might be disrupted because suppliers decline to sell to a company that is not named on the existing license;
- The excise liability could increase as the local excise authorities might impose penalties for those company transactions for which the company does not have the necessary authorisation (for example, the company is not named on the license). Please note that excise errors could easily constitute criminal offenses in Belgium and such errors are

severely punished (with fines of up to 1000% of the duties' value).

### How to cover the effect of a supply chain reshuffle on various excise licenses

We will briefly summarize below the best ways to deal with these issues for some types of (Belgian) licenses that grant excise duty exemptions.

#### Authorized warehouse operator license

In Belgium, the most prominent exemption for excise duties concerns excise warehouses. Excise warehouses are used to receive excise goods from various suppliers under the duty suspension regime (EMCS). This regime implies that these goods, which would otherwise be liable for excise duty, can be stored without the need to pay excise duties for a certain period of time. However, only authorized warehouse operators benefit from this suspension scheme.

Belgian excise law does not require the authorized excise warehouse operator to be the owner of the excise products (see Admin. Instruction 720.04, no. 29). Following the introduction of a new supply chain, the transfer of the ownership of raw materials and finished products should not, therefore, necessarily have an effect on the license-authorized warehouse operator.

Furthermore, under Belgian law the license for operating an excise warehouse can only be granted to companies or persons that are actually established in Belgium. It is assumed that this would not apply to the case of a foreign central entrepreneur. As a result, and following the introduction of a new supply chain, the license should not and cannot be transferred or shifted to a foreign central entrepreneur. Future suppliers should continue to use the original group company's existing excise number.

To cover any possible issues regarding the excise warehouse license, we recommend informing the Belgian excise authorities in advance about the change of flows and invoicing following the supply chain reshuffle.



### **Specific licenses for excise exemptions**

Excise legislation provides for a variety of specific exemptions relating to the use of the excise products (for industrial use). In principle, these exemptions are linked to specific licenses.

Following a supply chain reshuffle, it is not always clear what happens with these individual licenses as they are, in principle, linked to a particular individual company. The goods' change of ownership could have an effect here.

We will now refer to two recent examples from our practice, that of: the license end-user for energy products; and specific licenses for denaturated ethyl alcohol.

#### **Energy products: the license end-user**

A licensed 'end user' for energy products allows companies to purchase energy products without excise liability if these goods are used in an industrial or production process. The impact of a supply chain reshuffle in Belgium on this type of exemption is unclear as Belgian law and the administrative guidelines do not provide any guidance on this particular topic.

In the absence of any legal clarification, one could argue that a supply chain reshuffle should not necessarily affect the existing license nor require the license's transfer. It could be argued that the existing license can still be used after the supply chain reshuffle.

However, recent experience with the Belgian excise authorities has shown that a cautious approach should be adopted. It is recommended that the previous company, that owned the goods, keeps its end-user license and that the new company, which will now act as the "central entrepreneur", also requests such a license to avoid any protracted discussions with the excise authorities.

Again, it is important that the Belgian excise authorities are informed in advance about the reshuffle. In particular, if the central entrepreneur is a foreign company, then it is not easy to quickly request a new end-user license.

#### **Ethyl alcohol: denaturation processes/ industrial productions**

Another exemption covers the use of alcohol products for industrial purposes. Ethyl alcohol is exempted from excise duties when it is 'denatured' and used in a production process, provided that it is used solely to produce specifically-defined end-products.

While the supply chain reshuffle may change the ownership of the underlying excise products (for example, to the central entrepreneur), it is clear that the production process still remains in the hands of the local company/entity in whose name the license was originally acquired. This situation should certainly be the case if this denaturation license is linked to an excise warehouse license.

Accordingly, we see no reason why the license should be withdrawn or changed in the case of a supply chain reshuffle. Again, this situation should be discussed with the excise authorities in advance of the supply chain reshuffle.

#### **Conclusion**

It is important for international groups considering an important supply chain reshuffle to first monitor, in detail, the possible effects on excise duties and existing licenses.

For the Belgian excise issues, we recommend contacting the competent excise authorities about the planned reshuffle and closely collaborating with them to avoid any excise liability arising from the underlying goods' change of ownership.

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**(Hidden) Excise tax issues to be considered when reshuffling the supply chain**

In Germany energy products, electricity, spirits, coffee, tobacco, beer, sparkling wine and nuclear fuel rods are subject to excise taxes whereas energy products and spirits play the most important role in supply chain reshuffles. The most important provisions governing those products are the Energiesteuergesetz (energy tax act), Stromsteuergesetz (electricity tax act), Branntweinmonopolgesetz (spirits tax act) and implementing regulations for the respective legal areas.

A supply chain reshuffle in Germany can endanger the tax free use of excise products and lead to considerably higher tax risks. As all the licences needed for tax free uses are issued to one specific company the fact that, after the reshuffle, another company – the central purchasing unit – buys the excise goods can lead to problems. The supply chain may be disrupted because the supplier declines to sell to a company which – like the central purchasing unit – is not mentioned in the existing excise tax licence. Apart from this, there is also the risk that tax will accrue, because the customs office could argue that excise goods are sold to an operator who is not licensed, thus endangering the tax surveillance by the fiscal authorities.

**Options for eliminating excise tax risks**

In order to eliminate such risks, it is necessary to carry out a thorough examination of the situation according to German excise tax law. One of the issues arising from such reshuffles is the question of whether the role as legal owner of excise products is enough to make the central purchasing unit liable to pay tax, even if this company has no registered offices in Germany and has never had any actual access to the excise products. As German excise tax law builds on the factual access, the possession of the excise goods, it is our understanding that the central purchasing unit under such circumstances is not liable. Therefore, the liability remains with the toll manufacturer who is actually still handling the excise products.

**Three options according to German excise tax law**

There are several legal options under German excise tax law that uphold this interpretation of the law. Firstly, it may make sense to apply for excise licences for the central purchasing unit. While this can serve as safety net in case the tax authorities change their mind, it can also provide legal documentation that can be relied on, to some degree, if the tax authorities reject this licence – which is very likely because they don't consider the central purchasing unit to be liable to pay tax.

A second option – which is also a legal obligation in our view – is to notify the customs office of the changed situation. This has to provide details showing that the company, which has bought excise goods on its own account up to the current date, is now switching to a toll manufacturer. This means that, although it still physically receives the excise goods from the supplier, it is no longer the legal owner of those excise goods because the supplier transfers the legal ownership to the central purchasing unit.

A third option can secure intra German deliveries. In this case tax free delivery simply requires the recipient to hold a simple licence for exempted use. Contrary to reception of goods as registered consignee from other EU States, use of EMCS is not required. In order to improve the tax authorities' surveillance, it may be helpful for the toll manufacturer to apply for a licence for a formal tax warehouse in addition to the licence for exempted use. As the tax authorities operate much stricter control of both tax warehouses and – due to the use of EMCS – transport to tax warehouses, this move makes it much more difficult for the tax authorities to claim tax accrual as a result of removing the excise goods from tax surveillance.

At any rate, close coordination of the reshuffle with the customs offices is recommended.

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### **Excise Tax in Hungary – Scope**

In Hungary, the Act CXXVII of 2003 on Excise Taxes and Special Regulations on the Distribution of Excise Goods (hereinafter referred to as the “Act”) prescribes the list of goods subject to excise duty. Excise tax is levied on items such as mineral oils, alcohol and alcoholic beverages, beers, wines, sparkling wines, intermediate alcoholic products and tobacco products, manufactured within the country or imported into Hungary.

### **Potential excise tax issues in international supply chains**

For the majority of taxpayers who carry out international business and cross-border sale of goods, the question of which VAT rate to apply and whether they need to register for VAT in different countries may also create problems and should be clarified in the very first phase. This results from the complexity of global supply chains, as even if the supply chain is well understood and identified within the group of affiliated companies, several other companies may also be involved in the supply chain, which can impact the obligation to pay Hungarian excise duty.

Adverse tax implication can arise, as described above, as a result of the inappropriate recognition of the correct supply chain effects. Missing VAT registrations can easily be resolved retroactively. However, official excise tax licences cannot be requested after initiating activities. Before starting to sell goods that fall within the scope of the Act in Hungary, there must be an investigation into whether any excise tax licence is needed for the business activity. As an example from 2014, the activity of companies wishing to sell certain lubricating oil by way of export, import and intra-Community trade is subject to official authorisation under the Act. In practice, this means that even if no excise tax is payable upon the sale of certain goods, the sale activity itself is linked to a preliminary licence granted by the Hungarian tax authority. In our experience, several companies that were not explicitly involved solely in the sale of lubricating

oil were actually selling lubricating oil as a component of their own products. In such cases, the need for an excise duty licence also has to be reviewed carefully. This latter problem also reveals the importance of the proper customs code classifications. Improper classification can create excise duty, VAT and also customs duty risks.

### **Administrative and timing issues**

Further to the above, taxpayers should be aware that acquiring such authorisation from the tax authority may be a time-consuming process requiring lengthy administration. It should be noted that in order to receive a licence from the tax authority, they may need to fulfil more prerequisites, for example, existence (rental) of a warehouse, a licence for the warehousing activity from the local tax authorities and filling in a very detailed official form. Taxpayers have to bear in mind that, as a general rule, the business activity cannot be started until this licence has been received. However, if a new administrative burden is introduced from one year to another, taxpayers may be given a transition period. If they initiate licence arrangements with the tax authority within a certain deadline, they can carry on selling the goods requiring this licence even if the authorisation itself has not been granted by the end of the transition period but it is in progress.

### **Company restructurings – hidden tax risks**

In addition to changes in the supply chain, today we are seeing a trend for company restructuring. These are multinational companies, where the local company is transformed into a local (Hungarian) branch through a cross border transformation. If the local company is in possession of an excise duty licence to carry out activities, this raises the question of whether the licence is still applicable after the company restructuring.

The above questions highlight the importance of a thorough excise duty review and our team of experts in Hungary is ready to assist you in handling excise duty challenges.



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**(Hidden) Excise tax issues to be considered when reshuffling the supply chain**

A supply chain reshuffle can lead to a shared service centre, where the main contractor supplies the real estate and fully-working plants, including (for instance) surveillance, maintenance and repair services as well as the electricity necessary for running the plants, as required by each counterpart under a global service agreement.

In these circumstances, excise tax profiles have to be taken into consideration because, as recent case law has demonstrated, the Italian Tax Authorities can bring the related correct application into question.

In similar circumstances to those described above, during a tax assessment, the Italian Tax Authorities can conclude that (i) the main contractor is a taxable person subject to paying excise duties (Art. 53, Excise Tax Regulation) and (ii) the main contractor cannot benefit from the excise duty exemption granted for use of electricity in the same industrial plant over 1,200,000 kWh per month (Art. 52, Para 2, Lett. o-bis, Excise Tax Regulation).

**Options for eliminating excise tax risks**

The application of a global service agreement for excise tax purposes has not yet been discussed in front of the Supreme

Court. However, a main trend is emerging from the first and second level courts. According to recent case law (see, e.g., Judgement of the First Level Court of Milan, Section 3, 9 March 2010 n. 94; Judgement of the Second Level Court of Piedmont, Section 2, 20 December 2010; Judgement of the Second Level Court of Lombardy, Section 7, 13 January 2011), the main contractor providing global services (including electricity) facing a fully-comprehensive consideration (determined on the basis of the space effectively occupied or similar) is not a taxable person subject to pay excise duties. In fact the supply of electricity is merely a part of the fully-comprehensive, complex provision of services rendered.

In addition, according to these court judgements, the main contractor can benefit from the excise duty exemption granted for use of electricity in the same industrial factory over 1,200,000 kWh per month, since the electricity is used in one single factory in order to supply a fully-comprehensive, complex provision of services.

Since the controversy strongly hinges on the underlying factual circumstances, the global service agreement assumes a decisive relevance. In fact, the qualification of the transaction would be determined on the basis of the scope of the agreement and the related processing of excise tax for electricity purposes.

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**(Hidden) Excise tax issues to be considered when reshuffling the supply chain**

In the Netherlands alcoholic products (spirits, wine, beer etc.), tobacco products and mineral oils (gasoline, diesel, LNG etc.) are subject to excise taxes. These excise goods are listed in the Dutch excise code under their Combined Nomenclature (CN) codes as defined by the European Commission. General thought in the Dutch excise legislation is that the actual 'handling' of the goods should be taxed. This means that excise duties should become due when the excise goods are moved or used. There are several specific taxable events and exemptions but for efficiency purposes we will not elaborate on those.

Article 2 of the excise code stipulates that, in general, excise taxes are due from whoever:

1. removes excise goods from a suspension arrangement (i.e. from an excise warehouse).
2. 'holds' excise goods in the Netherlands for which no excise duties are paid in the EU.
3. produces excise goods outside of a suspension arrangement.
4. imports excise goods which are not put into a suspension arrangement directly on import.

Where the suspension arrangement (based on article 2a of the Dutch excise code) can be applied the excise taxes will not be due when certain formalities are met (i.e. when goods are moved from one excise warehouse to another). In order to use the suspension arrangement a company must first acquire a licence (as a warehouse keeper, registered trader or non-registered trader) from the Dutch Customs office. Without such a licence, the suspension arrangement cannot be used. In principle, these licences are not transferable.

When reshuffling the supply chain, the suspension arrangement may be jeopardised as the new central purchasing unit (NewCo) does not automatically acquire new licences from the Dutch Customs office and excise taxes could become due when the excise goods are used in the production process or when the ownership of the goods is transferred to NewCo. Also, the suppliers can no longer use the licences issued in the 'old setup' to supply without excise taxes as the supplies now come from NewCo. Furthermore, Intra-EU supplies could be jeopardised in cases where the EMCS-system is not updated quickly enough.

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**Possibilities to rule out excise tax risks**

In order to avoid or rule out excise tax risks for the existing setup or the NewCo, the following steps should be taken. First, there should be an investigation into what kind of licences already exist and whether NewCo should acquire these licences from the Dutch Customs office itself before the supply chain reshuffle is implemented. The investigation should be done at an early stage as acquiring new licences could take some time. There should also be an investigation into whether the existing licences from the 'old setup' are still accurate. Maybe acquiring new licences could result in tax savings.

When new and/or updated licences are needed the requests should be filed as soon as possible with the Dutch Customs office as they could have additional questions before granting the licences.

When the investigation concludes that no licences are needed, the 'new setup' could consider acquiring a formal ruling from the Dutch Customs office in order to have 100% certainty on the excise consequences. Even though this is not common practice for the Dutch Customs office, they can be approached in the event certainty is required. WTSNL is experienced in acquiring formal rulings from the Dutch Tax Authorities and can assist clients with this procedure.



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