



FINANCE BILL 2011

CLAUSE 74, ZERO-RATING: SPLITTING OF SUPPLIES

Parliamentary briefing submitted at Public Bill Committee stage in June 2011 by ICAEW Tax Faculty setting out concerns that this clause is too widely drafted and potentially contrary to EU law.

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Introduction

This is anti-avoidance legislation designed to counter the provision of zero-rated supplies of printed matter when the supply is connected with services made by another supplier when if they had been made by the same supplier they would have been treated as a single supply taxable at the main VAT rate of 20%.

We understand the policy purpose of the provision although we consider that the same objective could have been achieved by applying the existing VAT law, making the clause unnecessary. As it stands, the draft clause is drafted too widely - it would require many zero-rated supplies to be standard rated where the supplier had no way of knowing that this should be done.

We raised this concern in our response to the draft finance Bill clauses published on 9 December 2010 (published as TAXREP 5/11) but the clause in the Finance Bill is unaltered from the draft clause published on 9 December 2010. Since then, HMRC has helpfully published a document setting out examples of when this new clause is likely to apply and examples of when HMRC believe that it will not apply.

The examples are helpful and we believe set out accurately HMRC's policy intentions. However, we consider HMRC's interpretation to be much narrower than the wording of the clause, which is much more widely drafted and relies on complex UK and European Court of Justice case law to define the hypothetical question posed in the clause on what is, or is not, a single supply.

We, together with other professional bodies, have had extensive and useful discussions with HMRC but have been unable to reach agreement on the extent of the application of the clause. In brief, HMRC have been unable to convince us and others that the clause reflects their narrower intentions.

Similar problems have arisen in the past with wide-ranging legislation, for example with the VAT (Supply of Services) Order 1993. Neither HMRC nor the government can guarantee that a future HMRC officer plus a tribunal/court will take the wider not the narrower view. So if the clause is really considered to be necessary, it seems not unreasonable to have a test similar to that in the VAT (Groups Eligibility) Order 2004 (SI 2004/1931) to ensure that the bookseller etc is not affected because the supplier of the service does not benefit.

We do not believe that it is the intention of this clause to remove zero-rating from a wide range of books and other printed matter and instead subject them to 20% VAT or convert them into exempt supplies. But it risks starting that effect unless the draft is amended to make it more targeted.

The clause is designed to counter perceived tax avoidance of some £50m per year. Whilst this is not at insignificant amount, it does represent only 0.13% of total annual VAT receipts.

Government tax policy requires simplification to the UK's tax law so that both business and HMRC can administer it better. We therefore question whether it is necessary to introduce such uncertainty and complexity for a relatively small amount of money, particularly when any tax avoidance in this area could be countered by existing legislation.

Our comments below reflect those we made in our earlier TAXREP.

The problem with this clause

The Tax Information and Impact Note (TIIN) in relation to this clause states

‘Policy objective

This measure supports the Government’s objective of making the tax system fairer by closing a VAT avoidance scheme that is being used to reduce the amount of VAT due where a business supplies a service together with printed matter that is ancillary to that service.

Proposed revisions

This measure covers, for example, the following situations:

- where the consumer is contractually obliged to purchase the printed matter from one company in order to obtain the service from another; and
- where the price of the printed matter is discounted against the price of the service but if the customer chooses not to take the printed matter they are charged the undiscounted price for the service.”

Summary of impacts

This measure will only impact on the small number of businesses taking part in this VAT avoidance scheme.’

HMRC have advised why they wish to change the law, but the draft legislation amending the zero-rating provisions in Group 3, Sch 8 VAT Act 1994 goes far wider than HMRC’s stated intentions. It states:

“...(2) Items 1 to 6 do not include goods in circumstances where.

- (a) the supply of the goods is connected with a supply of services, and
- (b) those connected supplies are made by different suppliers.

(3) For the purposes of Note (2) a supply of goods is connected with a supply of services if, had those two supplies been made by a single supplier.

- (a) they would have been treated as a single supply of services, and

(b) that single supply would have been a taxable supply (other than a zero-rated supply) or an exempt supply..”

There is no requirement for the two suppliers to be connected (in the sense of under common ownership), nor that they are even aware of the other’s existence. There is not even a requirement on HMRC to demonstrate that there has been any tax advantage or that there has been any artificial value-shifting.

Supplies that on the face of it will be caught by the clause include:

A newspaper promotional coupon offering a 10% reduction on a restaurant meal.

Someone hiring an electrical item from one supplier decides to purchase a book on how to use it from an independent retailer.

Someone having their car serviced decides to buy a servicing manual to check that the job has been done properly.

A tutor gives a reading list to a group of fee-paying students, who then buy the books from various independent booksellers. The booksellers would not necessarily know that the purchase was linked to an exempt supply of education.

Educational course books being purchased by students from a third party distributor. This is a common arrangement which applies to, for example, the supply of ACA and other ICAEW course materials. These are commercial and practical arrangements to make it easier for the distribution of reference material to students. There is no requirement for students to purchase the materials available.

In each case the retailer of the zero-rated printing matter would not know, nor have any means of knowing, that there had been a supply of services by a third party to the same customer. It is even difficult to see how HMRC could discover this without identifying and speaking with the purchaser.

We understand from HMRC's comments that in fact they would not expect that the provision to apply in these circumstances. That is reassuring and welcome but nevertheless taxation by law and relief by concession is not a satisfactory tax policy and in practice is likely to lead to considerable uncertainty and business burdens.

If a retailer were assessed, then it would be difficult for him to contest the assessment properly unless HMRC were to provide him with the information on the third party supplier of services. HMRC would presumably not be prepared to do this because of taxpayer confidentiality. But without that information, how could the third party retailer contest any assessment? He would not know to which supplies of services his sales of books etc HMRC considered were connected?

There is also the question of whether the UK needs a derogation under Art 395 of EC Directive 2006/112/EC before it could introduce this clause.

ICAEW recommendations

We consider that the draft legislation should be amended to require, in each case that both suppliers are connected (in the sense of common ownership); and/or that the values for each supply are artificial and not at arm's length.

Further contact

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APPENDIX 1

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
- 2.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
- 4.
5. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.
- 6.
7. We have set out in Appendix 2 the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

APPENDIX 2

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx>).