

TAXREP 35/09

Finance Bill 2009

Committee stage briefing on Part 4: Value Added Tax

Parliamentary Briefing submitted on 11 June 2009 by the Institute of Chartered Accountants in England and Wales setting out concerns on the VAT measures being introduced in the Finance Bill 2009 to implement the UK's obligations under the EU VAT package.

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Introduction

1 Clauses 75 to 77 and Schedule 36 are the first in a series of changes to the UK VAT rules agreed at EU level and which are scheduled to be implemented over the next decade. The proposals are radical and represent a move by the Commission and the Member States to forge a stronger Single Market with less anomalies and an improved ability of EU member states to combat VAT fraud.

2 There are two key changes in this year's Finance Bill, namely:

- an amendment to the rules for determining the place of supply of services; and
- a complete reform of the provisions covering the cross-border reclaim of VAT for trading entities established within the European Union.

3 The provisions in the Finance Bill implement the first phase of these changes which arise out of the VAT Place of Supply of Services Directive (Directive 2008/08/EC).

The Finance Bill measures

Clause 75 and Schedule 36, Place of supply of services etc Clause 77, information relating to cross-border supplies of services to taxable recipients

4 The changes to the place of supply of services rules are not all being introduced at this stage since the rules attaching to business to consumer supplies remain determined by the place of belonging of the supplier. In due course this will change and shift to the location of the customer.

5 For business to business supplies, the place of supply will be determined where the customer is located and VAT will be collected by the operation of reverse charge provisions. In principle this is little different to the existing arrangement.

6 What has changed is:

-) the introduction of the requirement to include the supplies within European Sales Lists (see clause 77);
-) a very tight period given for compliance;
-) a most unwelcome and we think inoperable change to the rules applicable to the time of supply; and
-) the introduction of joint and several cross-border liability rules applicable in the event of failure to comply.

Clause 75 and Schedule 36, Place of supply of services etc

7 Schedule 36 inserts:

- a new clause 7A into the VAT Act 1994 which sets out the revised Place of Supply of Services rules; and

- new Schedule 4A setting out a number of special rules.

Example

8 Under the current rules a UK firm of chartered accountants provides tax advice to an accounting firm based in France. The supply is treated as made outside the UK but within the EU. There are no further reporting requirements in the UK. The accounting firm in France will account for the supply by way of reverse charge and, assuming it is attributed to a taxable supply it makes, will claim the amount as input tax subject to the rules applicable in France. If the supply was made the other way around, the supply would fall to be treated as a reverse charge supply in the UK and the UK firm would account for UK VAT on the value of the supply, recovering any VAT by reference to its own VAT position in the UK.

9 Under the new rules, there is no fundamental change to the VAT treatment. However the UK supplier is now required to report the supply on a European Sales List. Moreover, the supplier will be jointly and severally liable in the event that the recipient does not account for VAT under the reverse charge rules.

Clause 77, Information relating to cross-border supplies of services to taxable recipients

10 This provision imposes new reporting requirements on the cross border supply of services within the EU. Currently, businesses need to submit lists of supplies of goods but no such requirement exists for services. The basic reporting requirements under the Directive are monthly and electronic and with a month for completion of all compliance by trader and national revenue. However, the UK has decided to take advantage of some options available in the Directive so that:

- entities supplying goods may opt to report quarterly, based on calendar quarters regardless of the VAT return stagger, provided intra-EC supplies are below a threshold which is no more than €100,000 (£70,000) per quarter from 1 January 2010 to 31 December 2011, reducing to €50,000 (£35,000) per quarter from 1 January 2012; and
- entities supplying services may opt to report quarterly and there are no threshold requirements.

From 1 January 2010 the time limit for filing ESLs by traders will be reduced for paper returns to two weeks and for electronic returns to 21 days, which is half of the current time limit of 42 days. This change will be made by statutory instrument.

Time of supply of services

11 Whilst we appreciate that it is not included in this Finance Bill, the proposed changes to the time of supply of services rules are an integral part of these changes. The proposed change to the rules relating to the time of supply of services may appear small but its effect is far-reaching, unwelcome and, we believe, unworkable.

12 Hitherto a service has been deemed supplied at the earliest of three events, namely:

- a) the completion of the service
- b) the raising of an invoice and
- c) the receipt of payment

- 13 It is reasonable to presume that in the vast majority of cases invoice date represented the VAT supply date with many traders familiar with the concept of requests for payment preceding receipt which determined the tax point. Accounting systems from the simplest books to the most sophisticated software package depend on the measured, precise recording of activity so that the invoice is fundamental to accuracy, confidence and certainty.
- 14 Given the fundamental importance of the invoice in accounting and VAT processes, we are completely baffled to find that the Directive removes the date of invoice from the list of events which trigger the time of supply of a service. Under this new system a service is supplied for VAT purposes at the earlier of the receipt of payment or the completion of the service.
- 15 The underlying motive for inclusion of services within the European Sales Lists is as a counter fraud measure and the perceived risk that services fall within the ambit of Missing Trader Fraud. This is why the EU default return position is monthly and there are tight time constraints both on traders and national revenues for collection and dissemination of information.
- 16 Given the propensity of traders to dispute issues relating to the supply of goods which are normally tangible, the ability to disagree as to whether a service has or has not been completed is set to cause huge confusion amongst the revenue authorities of Member States. If you couple this uncertainty together with the requirement for the customer to self supply at the right time and the risk of joint and several liability, the scope for double or no VAT liability is considerable.
- 17 Accounting systems will not be able to cope with the implied requirement, especially where the services supplied are electronic. We think it is essential that the invoice date is used as the main time of supply. Without it, the system is unworkable; cut off points cannot be established and cross border VAT reconciliation will not be possible.

ICAEW concerns

- 18 In our 2009 Budget submission, we expressed a number of concerns about the overall package of proposals, namely:
- the complexity of the changes;
 - the continuing uncertainty as to how certain services will be treated;
 - the complex change to the time of supply for VAT purposes;
 - the onerous extra reporting requirements (due to the need to include lists of intra-EU supplies of services); and
 - the added risk to business of the joint and several liability proposals.
- 19 Having seen the proposals our concern about the changes is significantly increased, not only because the changes taken as a whole will impose onerous new obligations on the supply of services within the European Union, but that it is not possible to adapt accounting systems to deal with them.
- 20 A tax system needs to operate seamlessly and must not act to the detriment of traders, the free flow of business and the growth of trade. The administrative proposals around the place of supply changes, coupled with the time of supply change will:

- deter some UK businesses, particularly SMEs, from making cross-border supplies within the EU; but will
- give those trading outside the borders of the EU a competitive advantage.

21 From 1 January 2010 it will be simpler, cheaper and less risky for UK businesses to trade within the UK and/or with non- EC countries rather than with businesses in other EC Member States.

ICAEW recommendation

22 We are aware of the extensive discussions that have followed the decision of the Council of Ministers to introduce the changes collectively known as the VAT Package. We are also aware of the difficulties encountered in trying to reach agreement within the EU committees negotiating how these rules should be applied cross-border.

23 It is unfortunate that no direct input was possible into those discussions from those directly affected and, whilst there has been keen and clear discussion with HM Treasury and HMRC representatives on these issues, the decisions occurred at a European level and have resulted in provisions which are in practice likely to prove unworkable.

24 In the circumstances we appreciate and acknowledge the statement issued by HMRC designed to help traders dealing with these issues. It is our strongest recommendation, however, that these matters are taken back to the table at the European level, and that representations are made to:

- 1) include the invoice date as one of the indicators of the tax point for the supply of services;
- 2) extend the time limit for the supply of paper ESLs from 14 days to 21 days; and

25 Given that the rules apply from 1 January 2010, we ask that these issues be addressed as a matter of urgency. We would ask further that the proposal inherent in the draft directive issued on 1 December 2008 COM(2008) 807 final at paragraph 3.3.1 for the extension of the joint and several liability to VAT provision to cross border transactions where there has been a failure in accounting compliance be resisted most strongly.

Clause 76, Repayment to those in business in other states

26 Under the EU 8th Directive, a business person located in an EU member state can recover VAT suffered in another EU member state despite not being registered for VAT in that member state. However, the procedures are time consuming, require substantial paper handling skills and an encyclopaedic knowledge of VAT as each member state adopts different rules.

27 Clause 76 implements EU Directive (2008/9/EC) and sets out a completely new and revised EU-wide scheme for VAT recovery. It amends the existing statutory refund provision found in s 39, VATA 1994 and provides a statutory appeal right by amending s 83, VAT Act 1994.

28 The new system applies from 1 January 2010, is wholly electronic and will be operated in each Member State by the Revenue authority of that State as a conduit, not as an agent of the Member State of reclaim.

29 In the UK the electronic claim will be sent to the HMRC web portal being established for the purpose. HMRC will check the authenticity of the claimant and then forward the claim, electronically, to the Member state of claim. HMRC will not be certifying the validity of the claim or any of the information contained therein. Once submitted, the processing of the claim and any enquiries relating to it will be dealt with by the Member State and the trader subject to very specific time limits.

30 Each Member State is obliged to lodge with the Commission details of the rules for deduction of input tax in their State although this will not be seen as definitive or binding.

ICAEW concerns

31 We understand that the EU is determined to ensure that these provisions apply as directed and that there will be a sudden cut off point on 31 December 2009 –ie there will be no transitional rules.

32 Our concern is that with six months to go to the change, we have still not seen the software or the systems that will apply. We believe that there are Member States which are seeking permission to delay (or even resile) from the provisions but which, in any event, are almost certainly not going to be ready to adopt these provisions at the specified time. We are concerned that claims from the other Member States to the UK may be met whilst UK traders will be prejudiced from making claims in some of those countries where the software systems are not yet available – this is disproportionate and not equitable.

33 The provisions applicable to VAT reclaims in respect of traders located *outside* the EU, which arise as a result of the 13th Directive, are not affected by this change. The 8th and 13th Directive systems are practically the same so there will be a continuance of the old system for non-EU reclaims and a new system for EU reclaims.

ICAEW recommendation

34 We ask that consideration is given to a continuance of the old 8th Directive system whilst the new system beds down and other Member States make their systems compliant and available.

FJH
11 June 2009