Tax Representation

TAXREP 8/09

VAT: PLACE OF SUPPLY OF SERVICES: CHANGES REQUIRED TO IMPLEMENT EC LAW

Response made on 13 February 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to a consultation document published on 22 December 2008 by HMRC

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ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ www.icaew.com/taxfac	T +44 (0)20 7920 8646 F +44 (0)20 7920 8780 E tdtf@icaew.com

VAT: PLACE OF SUPPLY OF SERVICES: CHANGES REQUIRED TO IMPLEMENT EC LAW

INTRODUCTION

1. We are pleased to respond to HMRC's consultation document dated 22 December 2008 published at http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_029116.

2. Details about the Tax Faculty and the Institute of Chartered Accountants in England and Wales are set out in Annex A and our Ten Tenets for a Better Tax System which we use as a benchmark is in Annex B.

KEY POINT SUMMARY

3. The changes to the VAT place of supply rules for services are fundamental – and the most major change since the Single Market rules were introduced with effect from 1 January 1993.

4. However,
   - the complexity of the changes,
   - the continuing uncertainty as to how certain services will be treated,
   - the complex change to the time of supply,
   - the onerous reporting requirements, and
   - the added risk to business of the joint and several liability proposals,

   have transformed what should have been a beneficial result for business into an expensive and risky compliance exercise – and that in the middle of an economic downturn which itself is imposing strains on businesses.

5. Probably the most unfortunate aspect of the changes is that by extending the Single Market regime to a wider range of services, the Commission and Member States are increasing the opportunities for cross-border VAT fraud, the existence of which has been a feature of the Single Market System known about since before it was introduced on 1 January 1993, and their collective failure to resolve this has resulted in increasing compliance burdens, and now risks, being imposed on business, with the likely result that many will be deterred from undertaking cross-border trade.

GENERAL COMMENTS

6. These are the most comprehensive changes to the VAT law since the Single Market legislation was introduced with effect from 1 January 1993. These changes to the place of supply rules for cross-border services were developed with the best of intentions by the European Commission and the tax authorities of the Member States. It is clearly beneficial for business to extend the range of services to which the reverse charge applies.

7. However, the complexity of the changes, the continuing uncertainty as to how certain services will be treated, the complex change to the time of supply, the onerous reporting requirements and the added risk to business of the joint and several liability

proposals have transformed what would have been a beneficial result for business into an expensive and risky compliance exercise.

8. The timing of these changes is unfortunate. Many businesses are fighting for survival in the worst financial climate for decades. HMRC are now asking them to divert resources and incur on-going costs in their role as unpaid tax collectors for government, without any commercial benefit whatsoever to the business itself. At best, that demonstrates a lack of understanding of the current business environment by those concerned with VAT matters within the Treasury and HMRC.

9. It must not be forgotten that the problems, particularly those concerning fraud, in cross-border trade have arisen because of a weakness in the VAT system known to the Commission and to Member States since before 1993. It is unfortunate that their collective failure to resolve this has resulted in their imposing increasing compliance burdens, and now risks, on business. By extending the range of services subject to the reverse charge, the Commission and Member States need to recognise that they have also extended the opportunities for cross-border VAT fraud.

10. We do not think it overstates the position to say there is now a real danger that the changes, taken as a whole, will deter some UK businesses, particularly SMEs, from supplying services cross-border within the EU.

The Problem Areas

11. As a result of their own work and the informal consultations, HMRC are well aware of a considerable number of problem areas on place of supply points, the time of supply, ESL reporting and the joint and several liability proposals. The place of supply and ESL reporting points are now listed in various HMRC 'Issues Logs', and we do not repeat them here unless we wish to make further points.

Timetable

12. HMRC need to appreciate the need to act quickly to resolve or clarify these identified problem areas. Undertaking to apply penalties with a light touch is no substitute for HMRC identifying the real issues facing business, dealing with or clarifying them (including making amendments to the law where necessary), and then giving business proper time to implement the IT changes, (re)train their staff and test their systems before going live. Whilst identification of the issues has largely been done, the rest remains outstanding, and time is fast running out.

13. It is important to understand that, for the place of supply issues, UK businesses will need to know not only the HMRC/UK policy, but also the view of the tax authority in the Member State of their customer. HMRC are well ahead of tax authorities in other Member States in publicising the changes and consulting with business, and should be congratulated for their efforts to date. But for the reasons we set out in this response, even that is unlikely to be sufficient to provide business with the information necessary to adapt their systems in time.

14. What is required is a series of EC-wide statements on how business should treat the problem areas. This could be done by the VAT Committee. However, that is unlikely to be achieved within the next couple of months, and after that it will be too late, as businesses will have insufficient time to implement before 1 January 2010.

15. As a result, we consider that many businesses will not be in a position to comply fully with the new rules from 1 January 2010.

KEY POINT - TIME OF SUPPLY CHANGE FOR SERVICES

16. This change has been introduced with no understanding of how business' accounting systems operate, and will be impossible for many businesses to implement.

17. The change removes the invoice date as the main criterion for determining the time of supply. The date of performance will become the main determining factor, but, so far as we are aware, there is no accounting system in existence which tracks that date, since it is neither commercially necessary, nor in many cases feasible, to do so. By contrast, invoice (and payment) dates are tracked in every accounting system.

18. We can understand why the Commission and the Member States, including HMRC, wished to harmonise the time of supply for intra-EC supplies of services, since it makes it easier for different tax authorities to match supplies with acquisitions. But we cannot understand why they decided to harmonise the rules in a way which takes no account of how accounting systems operate and creates the maximum difficulty for those businesses affected.

19. Businesses which make discrete supplies of services and which have automated billing systems should be able to comply with the new rules. But that is only because they will be able to continue to use the invoice date, since that will be the same as the date of performance. Other businesses making supplies of more complex services will be unable to track until after the event when a service has been performed or completed, as can be seen from the following example.

20. Example: A UK firm provides consultancy advice to a business client in another Member State. That advice is contained in a letter and Report sent to the client on 30 January 2010. The letter accompanying the Report asks the client to come back to the UK firm if they have any queries or further questions. The letter and Report are received by the client on 2 February 2010.

21. When is the time of supply for ESL reporting?

22. Does it make any difference if the client considers the letter and Report and comes back with further questions on 24 February 2010? The UK firm responds on 2 March 2010, the client tells the UK firm that they have no further questions on 25 March 2010, and the UK firm issues an invoice on 10 April 2010.

23. What criteria should the UK firm use to decide by 21 February 2010 (the filing date for its January ESL) whether the service has been completed and therefore whether it needs to report the supply in its January 2010 ESL? What value should the UK firm place on the supply at that time, bearing in mind it may have to deal with further questions?

24. If ESL reporting in all three months (January to March 2010) is required, the end result will be that the UK firm will have issued an invoice in April 2010 which relates to supplies reported on its ESLs in January, February and March 2010. For businesses carrying out many tens or hundreds of these supplies, often to the same client in another Member State, it will become extremely difficult to reconcile the invoice with their ESL reporting.

25. If these issues cannot be resolved very quickly, we recommend that this time of supply change be removed from the VAT Package, and that the principal time of supply is harmonised around the invoice date. HMRC may regard this as unrealistic, but the alternative, namely imposing a reporting requirement which both HMRC and business know cannot be implemented, is even worse.

THE CONSULTATION DOCUMENT ITSELF

26. Despite our comments above, this is an excellent Consultation Document, and HMRC should be congratulated on the detail and the thought that has gone into its preparation. It also reflects many of the points that have arisen during other, less formal, consultations over the past few months.

27. Our only general criticism is that it has been produced very late in the day. The main EC Directive making these changes was agreed by the Member States on 12 February 2008, but the Consultation Document was not published until 22 December 2008, and the UK implementing legislation is only in draft form and will not become law until Summer 2009. Business are required to implement the changes by 1 January 2010, and now do not have the necessary time to make the major changes to their IT systems, which will take many months once the final details are known.

ANSWERS TO CONSULTATION DOCUMENT QUESTIONS

DRAFT LEGISLATION Condoc ref 6.1)

General Rule (Condoc para 3.2)

Taxable Person - General

28. As HMRC know, the UK definition of a taxable person does not correspond with that in the VAT Directive. The UK law (s 3 VATA 1994) defines a taxable person as someone who is, or is required to be registered for UK VAT, whereas EC law defines a taxable person as someone who carries on an economic activity.

29. This difference has existed for many years and has not caused that many problems in practice, but it is causing a difficulty with the draft legislation here in the new Section 7A and the revised Section 9.

30. If the UK definition (s 3 VATA 1994) of a taxable person is used, then a foreign business customer for a reverse charge service from a UK supplier would never be a taxable person for the purposes of the UK law, even if they were established and VAT registered in another Member State.

Taxable Person – Specific - Section 7A(2)a (Condoc bottom of page 9)

31. This refers to the recipient being a taxable person. It does not specify in which country that person is a taxable person. Should “taxable person” be extended to something like “taxable person in a country determined by section 9”? (Please see also our general comment above).

32. For example, if supplies of services were made to a person in France, who was a taxable person only in Germany, would the supply be taxable in Germany? Section 9 suggests that it would.

3.2.2 Interpretation Issues – Business status of customer

33. Please see our comments below.

3.5 Hire of Means of Transport

34. In paragraph 13A (page 18), reference should be made to clarify that this section takes effect from 1 January 2013. For B2C long term hires, there presumably need to be some transitional rules for lettings that span that date.

3.8 Restaurant and Catering Services on board Ships, Planes and Trains

35. We consider that the draft UK law does not fully implement the EC law for journeys that begin and end within the EC, but include a stop outside the EC during the course of the journey.

36. An example of this could be a train journey from Italy to Greece, which has a single stop in Bosnia. The EC legislation suggests that any catering between the last stop in Italy and the first stop in Greece would not be taxable in the EC, catering on the part of the journey before the last stop in Italy would be taxable in Italy and it would be taxable in Greece for that after the first stop in Greece. The draft paragraph 6(3) of the UK legislation (page 23) implies that the catering on the whole of this journey would be taxable in Italy, as it makes no mention of the stopover provision.

37. There are likely to be relatively few EC-non EC-EC journeys starting in the UK, but nevertheless the UK law should reflect the Directive.

3.11 Transport of Goods (B2C)

38. Paragraphs 11 and 12 appear to be structured in an unnecessarily complex way. Para 11.1 sets out the rule for non intra-EC transport of goods as if it is the general rule, and then para 11.3 negates it for intra-EC transport. Para 12 then sets out the rule for that intra-EC transport.

39. Would it not be clearer to distinguish at the outset between intra-EC transport and non intra-EC transport, and then have separate sections dealing with each?

40. Is paragraph 11.2 really needed? It seems unnecessarily complex for the UK, and it is difficult in particular to see when para 11.2(b) would apply.

41. We note that paragraph 12 of the draft UK legislation (page 29) does not implement the EC law option to not apply VAT to parts of a journey that take place outside the EC.

3.15 Reverse Charge

42. There does not appear to be a subsection (2), presumably because the old subsection (2) has been removed and largely replaced by the new subsection (4A).

INTERPRETATION ISSUES (Condoc ref 6.2)

Business Status of the Customer (Condoc ref 3.2.2)

43. We agree with HMRC's analysis that there will be difficulties for UK businesses to determine whether their customer is a business for the purposes of applying the reverse charge.

44. We foresee problems of interpretation between Recital 4 of the Directive (Directive 2008/8/EC) and the new Article 43. The new Article 43 was designed to make compliance easier for the supplier, who did not have to investigate whether his customer (VAT registered in another Member State) would use the supply as a taxable person. But Recital 4 introduces a major element of uncertainty for the supplier. Many services can be used for either taxable or for private purposes, and it will be difficult for suppliers to determine which.

45. For example, a German company wishes to second an employee to the UK for two years. A UK firm of accountants provides them with advice on what would be the UK personal tax position of that employee. Would that be advice for the 'personal use' of the employee, and therefore UK VAT should be charged, or a reverse charge supply? Would it make any difference to the VAT treatment of the supply by the UK firm of accountants if the German business was not incorporated, and the owner was considering opening a UK branch and wanted to know if he would become UK tax resident ?

46. What are the criteria that a UK supplier must apply to determine whether their supply will be used for business or for private purposes?

Services connected with immovable property (Condoc ref 3.3.2)

47. We agree that there will be an issue with travel agents and note that HMRC are raising this at EC level. It would be a major additional compliance burden if all UK travel agents were required to register for VAT in all Member States where they sold holidays. The extra cost could well make the business unprofitable for smaller agents.

Hire of means of transport (Condoc ref 3.5.2)

48. We agree with HMRC's analysis, and share HMRC's view (at bullet point 3), that a sensible meaning of 'put at the disposal of' would be where the customer takes physical control of the means of transport.

49. HMRC will also need to provide clarification for business for supplies spanning the dates of change on 1 January 2010 and 2013.

Cultural, Artistic, Sporting etc Services (Condoc ref 3.6.2)

50. Definition of admission. We agree that this should be strictly interpreted. In particular, it is currently unclear whether in-house corporate training should be treated as an educational service (B2B and reverse charge). This affects a large number of multi-national businesses where staff training is carried out cross-border.

The same point of course applies to independent training, for example a tax conference held in the UK which participants from other Member States attend.

Restaurant and Catering Services (Condoc ref 3.7.2)

51. The UK has not implemented in law the ECJ judgment in *Faaborg-Gelting* (Case C-231/94) and a definition of what constitutes catering services will be necessary if businesses are to be able to comply with this provision.

Restaurant and Catering Services on board ships, planes and trains (Condoc ref 3.8.2)

52. Please see our comment on the draft law.

Use and Enjoyment (Condoc ref 3.9.2)

53. There needs to be definitive clarification at EC level as to when Member States should use these provisions, and what the criteria should be. Our view is that they should be confined to cases where individuals or other non-taxable persons are receiving supplies from non-EC suppliers. They should not apply to B2B transactions (where the business customer is outside the EU) at all.

Reverse charge (Condoc ref 3.15.2)

54. Our comments at 1. above on the issue of when a supply of services could be put to private use also apply.

Force of Attraction (Condoc ref 3.16.2)

55. Whilst this is not a term used in UK VAT law, it is nevertheless important for UK businesses, who, when they have a branch in another Member State, will need to decide who should account for the VAT when they make a supply of services.

56. Urgent clarification at EC level is needed on what constitutes 'intervening' in a supply. For example, a business has a marketing and sales office in another Member State, which has contacts with actual and potential customers, and passes those contacts and enquiries on to its head office. The head office contracts with the customer and carries out the whole of the service. Has the branch 'intervened' in the supply, and who should account for VAT on the supply to the customer?

57. HMRC's own interpretation of the establishment 'most closely connected with the supply' will need to be interpreted in line with the EC clarification.

EC SALES LISTS

Goods

58. The requirement to file 12 ESLs per year instead of the current 4, and the halving of the filing time to 21 days are unwelcome extra burdens for UK business, particularly as there is no evidence that either will do anything to counter cross-border fraud.

59. Although at first sight it would appear intuitive that monthly filing and earlier reporting would assist tax authorities, that will depend on the tax authority in the Member State

of the customer reviewing all the ESLs received within a short period. Since tax authorities will not be able to match the supply with the related acquisition by the customer in their Member State without obtaining further information from the customer, it is hard to see how this will, or can, be done within a short period. As a result, UK businesses are being put to additional cost for no useful purpose.

60. We would welcome clarification from HMRC on how quickly they will process ESLs received from other Member States and how this will help them combat carousel fraud.

61. Larger businesses often have world-wide reporting systems based on a 4week/4week/5 week reporting cycle per quarter. They will find it difficult to file ESLs on a strict calendar month basis without introducing major parallel accounting systems. It will then become harder to reconcile the ESL reporting with the VAT reporting, and this further illustrates the additional difficulties being placed in the way of business wishing to trade cross-border within the EC.

Services

62. As we have already said, most businesses, in particular those only supplying services, already face considerable difficulty and significant extra compliance and IT costs in filing these additional ESLs from 2010. The time of supply changes will make that task even harder.

JOINT & SEVERAL LIABILITY

63. We have informed HMRC of our views in a number of informal consultations and at the JVCC, and understand that HMRC are equally concerned about the lack of balance in the Commission's proposals. We urge HMRC to ensure that, if the UK does agree to new joint and several liability provisions, they are balanced and properly respect the rights of taxpayers.

64. In particular, the 1 December 2008 Commission Proposals will allow any of the 26 other EC tax authorities to assess any UK VAT registered businesses for the acquisition VAT (for which his customer should have accounted) where that UK business has:
- made an intra-EC supply of goods, and
- not reported it properly in the correct month/quarter on the ESL, and
- the customer in another Member State has not filed a VAT Return in that Member State including the acquisition.

65. In addition:
- UK taxpayers will have no right of appeal to a UK court against any assessment, but will instead have to appeal to the courts in the Member State of the assessing foreign tax authority.
- There does not even have to be a fraud. The UK taxpayer/supplier can also be assessed and held liable to pay the VAT of his customer where the customer has not filed a VAT Return and cannot pay because of financial difficulties, liquidation or insolvency. In such cases, the UK taxpayer/supplier may not even have been paid for the supply, but will still have to pay the foreign acquisition VAT due.

- Unlike recent ECJ judgments, the foreign tax authority will not have to prove in any way that the UK taxpayer knew of any likely or intended fraud, nor that the failure of the UK taxpayer to file the ESL on time contributed to or assisted in any way in the non-payment of VAT by the customer. Nor is there any requirement for a foreign tax authority to provide the UK taxpayer with any information or proof that the customer has not accounted for the tax, nor of the circumstances in which the non-payment took place.

66. The simple response from tax authorities is that businesses need to file on time. But the filing timetable, together with the change in the time of supply rules for services, makes this increasingly unrealistic, if not impossible.

67. As they stand, the proposals are likely to discriminate against SMEs in favour of larger businesses and multinationals. Larger businesses and multinationals will be able to supply cross-border to fellow subsidiaries, who will make the onward (domestic) supply to a third party customer. They can be expected to refuse to supply third party customers in another Member State directly. SMEs are unlikely to have such a structure, and so, if they decide to trade, will face the risk which their larger competitors will not.

VAT AVOIDANCE

68. As we have stated, we consider the extension of the reverse charge provides more opportunity for cross-border fraud. We are happy to provide further details to HMRC on request.

69. VAT avoidance will be possible if there are differing interpretations by different EC tax authorities. If cross-border supplies can be made which the tax authority in the supplier's Member State consider fall under the reverse charge, but the tax authority in the customer's Member State consider should be taxed in the Member State of the supplier, the result will be no taxation. However, that would only be of advantage where the customer was unable to recover the VAT in full.

70. We consider it rather more likely that there will be instances where both tax authorities claim that tax is due in their Member State, leading to double taxation.

HMRC IMPACT ASSESSMENT (Condoc ref 6.3)

71. We are not able to judge at first hand the accuracy of the impact assessment. However, the view of our members is that it seriously understates the cost to business in making the necessary changes.

JHEA/NG/PCB
13.2.09

ANNEX A

WHO WE ARE

The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

The Tax Faculty is the centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.

Further information is available on the ICAEW website, www.icaew.com .

ANNEX B

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 www.icaew.co.uk/index.cfm?route=128518.