



**Faculty of Taxation**

## **TAXREP 17/03**

### **VAT CONTINUOUS SUPPLIES: TIME OF SUPPLY**

*Memorandum submitted in June 2003 by The Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation paper issued in April 2003 by Customs*

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## **VAT CONTINUOUS SUPPLIES: TIME OF SUPPLY**

### **GENERAL COMMENTS**

1. We welcome the opportunity to comment on the draft legislation in Customs' consultation paper issued in April 2003.
2. We understand that the object of the provisions is to rectify a perceived cash flow loss to the Exchequer where certain continuous supplies are not invoiced until some time after they are provided, or at all.
3. The provision imposes significant burdens on businesses and we have seen no evidence to suggest that this approach is justified by revenue losses. The approach adopted appears to represent a scattergun approach to the perceived problem and it is clear that it will apply to many situations where there can be little or no revenue at stake. If there is a need for legislation in this area, we consider that it should be properly targeted at whatever mischief Customs consider needs to be countered.
4. Our main concern with the regulations is whether commercial situations will be properly catered for by the ability of Customs to extend the time period following a request by the trader. We would welcome reassurance that Customs will operate their discretion reasonably.

### **DETAILED COMMENTS**

#### **Background**

5. The consultation paper contains no estimate of the cost of the "mischief" that the proposed legislative change is intended to rectify. Whilst we recognise that misuse of the VAT time of supply rules for certain ongoing supplies between connected persons might pose a threat to VAT receipts, it seems to us that the revenue loss is likely to be comparatively small. As is made clear by the consultation document, the area of concern can only be in relation to businesses making taxable supplies to associated companies that are not able to recover input VAT in full. If Customs and Excise have evidence that there is significant avoidance in this area, it would have been helpful if that had been mentioned in the consultation document. That would have assisted a judgement of the likely costs and benefits of the proposed new regulation.
6. We understand from Customs that the estimated loss is in the region of £15 million per annum. We have reservations about whether the additional burdens placed on businesses by this new regulation can be justified.

#### **Scope of the proposed changes**

7. The new rules will apply to leases of property treated as supplies of goods, supplies of water, gas and energy and continuous supplies of services in general. This means that it applies to most supplies that are not "one-off" transactions or supplies of goods.
8. The limitation of the measure to transactions between group undertakings means that most arm's-length commercial transactions will not be covered by it. This must be

correct, as it is clearly open to businesses trading at arm's length to determine when and how charges should be made. It is difficult to see how any interference in commercial decisions of this kind could be justified.

9. The measure seems to be predicated on the assumption that the only reason why a business would choose not to impose a charge on an associated entity would be to avoid crystallising a VAT cost for it. Whilst there may be situations where this is the case, we think that there will be far more occasions where the decision not to impose a charge is taken for other reasons. For example, it might be decided by a holding company not to impose management charges on loss-making subsidiaries, or that stewardship costs of the group should be borne centrally rather than recharged to group members, or there may be changes in the group dividend policy.
10. It seems that many transactions where there can be little or no threat to the revenue will be caught by the new regulation 94B. We have in mind situations where any tax charged would be recoverable in full. If the measure is to be implemented at all, it should be more precisely targeted at the perceived mischief. A restriction of its application along the lines of the “wholly or mainly for eligible purposes” test already used in relation to regulation 93 VAT Regulations 1995 and paragraph 2(3AA) Schedule 10 Value Added Tax Act 1994 would seem to address what we believe to be Customs’ area of concern without applying the measure to a wide range of situations where little or no revenue would be at stake.

### **Cost to businesses**

11. In practice, we foresee a number of areas of potential cost to businesses. The first relates to the need for all corporate groups to monitor their activities in order to identify situations where a tax point is deemed to occur under the new regulation. As is recognised by the preamble to the consultation paper, this is particularly difficult in relation to on-going supplies. In the application of the new rules the situation is made even more difficult by the fact that it is the absence of a charge that will bring the new rules into effect.
12. We would anticipate further difficulties in situations where it is decided to impose charges on some, but not all members of a corporate group. Is there to be a “deemed” tax point in relation to an imputed supply to those companies in the group which benefit from the decision not to impose a charge?
13. The consultation paper makes much of the apparent flexibility over timing of invoices and payments. In practice, however, this will be of little or no benefit when the commercial decision is that no charge should be made. In this case, we would welcome confirmation that a nil charge will not affect the ability of the supplying company to reclaim its input tax.
14. Even when a charge is to be made, we are unconvinced that the 6 month period, during which it is proposed that the issue of a VAT invoice or receipt of payment will displace the annual tax point, will be adequate to cover most situations. The proposed annual tax points may not match corporate accounting periods and may not fit the situations where billing occurs after accounts have been drawn up even when management charges are to be billed around the group.

### **Application of the rules**

15. We would welcome clarification of the way in which the rules will be applied. By way of example, loss-making subsidiary A which is supplied electricity by a fellow subsidiary worth £30,000 per annum might not be billed anything in years 1 or 2 but at the end of year 3 is billed £90,000.
16. Various questions arise.
  - Is it the intention that such situations should be caught by the new provision?
  - Will Customs seek to apportion the £90,000 charged to each of the three years and if so, on what basis?
  - Will it make any difference if the recipient is unable to recover input tax in full?
  - Will Customs seek to disallow recovery by the electricity-supplying subsidiary of its input VAT for years 1 and 2 and if so, to what extent and on what grounds?
  - Will this be affected by whether the electricity-supplying company has charged other customers, associated or otherwise?
17. Would the answers be different in the foregoing example if instead of £90,000 the amount charged was say £60,000 or £120,000?
18. We would also welcome clarification in the case of rent-free periods between associated companies which are not able to reclaim input tax in full. If this is a feature of the market-place, how would the provisions be applied?

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