International services and UK VAT law

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Background

The UK was required to introduce a VAT system pursuant to its accession to what is now known as the European Union on 1st April 1973. The system of VAT in the EU is now governed by Council Directive 2006/112/EC of 28th November 2006 on the Common System of Value Added Tax (normally referred to as the Principal Directive). The provisions of the Principal Directive are broadly reflected in UK domestic VAT law. In revenue collection terms, VAT in the UK is a very significant tax indeed. In a survey produced by the Institute of Fiscal Studies in 2014 which looked at the forecast for the sources of UK government revenue for the financial year 2014-15 some 17.1% of all government revenue (equal to GBP 110.7 Billion) was set to come from VAT. This can be compared with a mere 6.2% of revenue (or GBP 40.5 Billion) expected to derive from corporation tax and may (or may not) seem a surprising statistic given the recent frenzied media focus on corporation tax.

Very broadly, VAT is an EU-wide indirect tax which charges VAT at each stage of a supply chain on the supply of goods or services. The tax operates by allowing for recovery of VAT (‘input tax’) incurred by most businesses at each stage of the supply chain. The burden of VAT ultimately falls upon the final non-business consumer of the relevant goods or services. Certain businesses that make what are known as ‘exempt supplies’ (such as banks and insurance companies) cannot recover the VAT that is charged to them on supplies that they receive for the purpose of making exempt supplies. The standard rate of VAT in the UK is 20% with a limited range of items being subject to a reduced rate of 5% (e.g. energy saving materials and energy supplies) or 0% (e.g. food or newly constructed residential property).

VAT was, upon its introduction, described as simple tax. Whilst the complexity of VAT has certainly increased over the last forty years in a purely domestic UK context, most intra-UK supplies of goods or services do not generally give rise to any significant difficulties. However, this is not the case in the context of the supply of international services which, inevitably, have become of increasing significance for many UK businesses in recent years. This article explains in broad outline the current UK VAT rules in this area and the complexities that they give rise to.

Supplies of international services – position prior to 1st January 2010

The key concept for determining the correct VAT liability in relation to a supply of international services is the ‘place of supply’. Under the old basic rules dealing with the supply of services which applied until 31st December 2009 the rule was that for supplies to private or business customers outside the EU the place of supply was where the recipient ‘belongs’ so the transaction was normally (unless related to UK land) outside the scope of UK VAT. However, for intra-EU supplies the place of supplier was where the supplier ‘belongs’ (although there were a number of exceptions relating to this basic rule in certain areas, e.g. services related to land and property, professional services (including legal and consultancy services supplied to a business customer), freight transport and certain intermediary services). This meant that, for example, where a UK business sold services to a customer located in Spain, UK VAT would normally be charged at the standard rate. Conversely, where a French business supplied services to a UK customer then normally the supplier would apply French VAT to his invoice. This French VAT could not be recovered by the UK business through its UK VAT return although it might be able to recover the VAT from the French tax authorities through using what is known as the Eighth Directive refund procedure.

Where a UK business made a supply of services that was not covered by the basic rule and which was deemed to take place in another EU Member State and not in the UK (e.g. services related to land in another Member State), then a liability to register for VAT in that other Member State could arise depending upon the precise local rules.

Supplies of international services – current position

Significant changes were introduced to the place of supply rules for services on 1st January 2010 and 1st January 2011. The focus of the rules has now changed so that the emphasis when determining whether or not UK VAT is charged is on where the customer is located as opposed to the supplier. This has meant that in the case of business to business supplies (B2B) there is now a much greater probability that no UK VAT will be chargeable. In the case of business to consumer supplies of services (B2C) the position is unchanged so that it is still the location of the supplier that is relevant although there are also exceptions to this rule (e.g. in relation to supplies of broadcasting, telecommunications and electronic services that take place on or after 1st January 2015).

The intention behind the new rules is to simplify the VAT procedures in the area of cross-border services. The key concept remains the ‘place of supply’ as it is in the country where a supply takes place that VAT will be chargeable. VAT will not be payable in the UK if the place of supply is deemed to be in another EU Member State but will instead be payable in that other State. If the place of supply is outside the EU entirely, then no EU VAT will be payable (although it is possible that the non-EU country may operate its own VAT system which will require a supplier to register for VAT in that country and charge local VAT on its services).

Under the new rules in a cross-border intra-EU B2B supply of services (eg from a French company to a UK company) then, unless one of the exceptions described below applies, because the supply is deemed to take place in the UK no French VAT will be charged. Instead, the UK
recipient of the services from the French company will be required to apply the ‘reverse charge’ procedure under which it charges itself UK VAT at the appropriate rate (normally 20%). If the UK company itself makes only supplies of goods or services which are subject to UK VAT (that is, it is ‘fully taxable’ in VAT terms), then generally it will be able to recover all of the VAT incurred pursuant to the application of the reverse charge procedure. Normally, recovery of the reverse VAT charge will be through a simple input entry in the VAT return which will effectively cancel out the output entry required by the reverse charge. In other words, in the case of a fully taxable business, the reverse charge will not result in any requirement to pay over any VAT to HMRC so there is not even a cash flow cost for the business concerned. However, the situation is different if, using the same example, the UK business is not fully taxable because it is a bank or an insurance company which makes exempt supplies. In this situation, the UK recipient of the service from the French supplier will only be able to recover a proportion of the VAT charged with the exact proportion normally depending upon the details of the VAT recovery method that it has agreed with HMRC. The effect of the reverse charge, therefore, is that the UK business is in exactly the same position as if it had purchased the supplies from a UK business in terms of the VAT recovery that can be achieved. A level playing field is thereby maintained so that it is not possible for a non-UK supplier of services to a UK business to gain a competitive advantage.

Place of supply – land-related services

The position with services that relate to land is the same under the new rules as that which applied under the old place of supply rules. The VAT liability depends upon where the land in question is situated. If this is in the UK, then UK VAT will be chargeable on the land-related service (although some UK land-related services such as the construction of a new residential building will be zero-rated). On the other hand, if the land is physically located in, for example, Germany, then the supply of services will be deemed to take place in that country. This means that where a UK architect supplies services that relate to a German property, then, in principle, he needs to register for VAT in Germany and charge German VAT on his supplies. Similarly, where a French business supplies land-related services to a UK customer, then, in principle, it will need to register for UK VAT and charge UK VAT on its services. However, where the UK customer is actually VAT registered in the UK, then registration can be avoided if the customer is prepared to apply the reverse charge mechanism under a special extension to this procedure (HMRC Notice 741 A, Paragraph 18).

Land-related services include obvious examples such as construction, reconstruction, demolition, repair and maintenance and also the services of estate agents and architects, engineers and similar. Also included are the services of property lawyers who undertake the conveyancing work on the acquisition of a property by a buyer. However, generic tax advice provided by a UK lawyer to, for example, a Spanish business client on the tax implications of acquiring property in the UK would not be a land related service and the place of supply would be Spain and not the UK so UK VAT would not be chargeable.

Services supplied where physically carried out

In a B2C context, certain services are deemed to be made where the services are carried out, provided that the recipient does not receive the supply for a business purpose. These services include artistic, educational and entertainment services, services relating to conferences and exhibitions, as well as ancillary transport services. This could lead to, for example, a non-UK business supplier which provided educational services in the UK being obliged to register for UK VAT if the value of the services exceeded the current VAT registration threshold (£82,000).

Outside the scope B2C services

Despite the general rule that B2C services are made where the supplier is located there is an exception for certain services made to a recipient who belongs outside the EU if the service is listed in Paragraph 16 of Schedule 4A to the Value Added Tax Act (‘VATA’) 1994. This paragraph lists services such as those of accountants, lawyers and consultants, as well as advertising services. The effect of the rule is that the services of a UK lawyer in a non-UK land related matter will be treated as outside the scope of UK VAT when made to a non-business client based in the US but the same service will be subject to UK VAT at the standard rate when made to a client based in Belgium.

Zero-rated supplies of services and exempt supplies

Certain services are zero-rated for the purposes of UK VAT law under Schedule 8 to the VATA 1994 so that no VAT is actually chargeable even though the supply is made in the UK. Such supplies include the supply of services of work carried out on goods which are imported into the EU for that work, provided that the intention is to export them later to a place outside the EU. Schedule 9 to VATA 1994 exempts certain services from VAT, including insurance and reinsurance.

B2C and B2B Broadcasting, telecommunications and electronic services (digital services) from 1st January 2015

With effect from 1st January 2015 all supplies of digital services to business or consumer customers located in the EU are subject to VAT in the customer’s location, unless the services are effectively used and enjoyed outside the EU.

This change impacts businesses that supply digital services directly to EU consumers. Supplies of digital services that are made to VAT registered business consumers in other EU Member States are still subject to VAT where the customer belongs under the reverse charge procedure.

If a French-based customer cannot supply a French VAT number to its UK supplier of digital services, then the recipient must be treated as a consumer. The UK supplier will either need to register for VAT in France or to use the procedure known as the Mini One Stop Shop (‘MOSS’). The MOSS system enables UK businesses that supply digital services to consumers in other EU member states to avoid registration for VAT in each of the countries where they have customers. Instead, they can register for MOSS with HMRC and make returns quarterly giving details of supplies made to EU customers. VAT due will be paid by the UK business to HMRC and not to each of the Member States where the customers are located.

Click here for a stage-by-stage guide on identifying the correct VAT liability in specific cases.