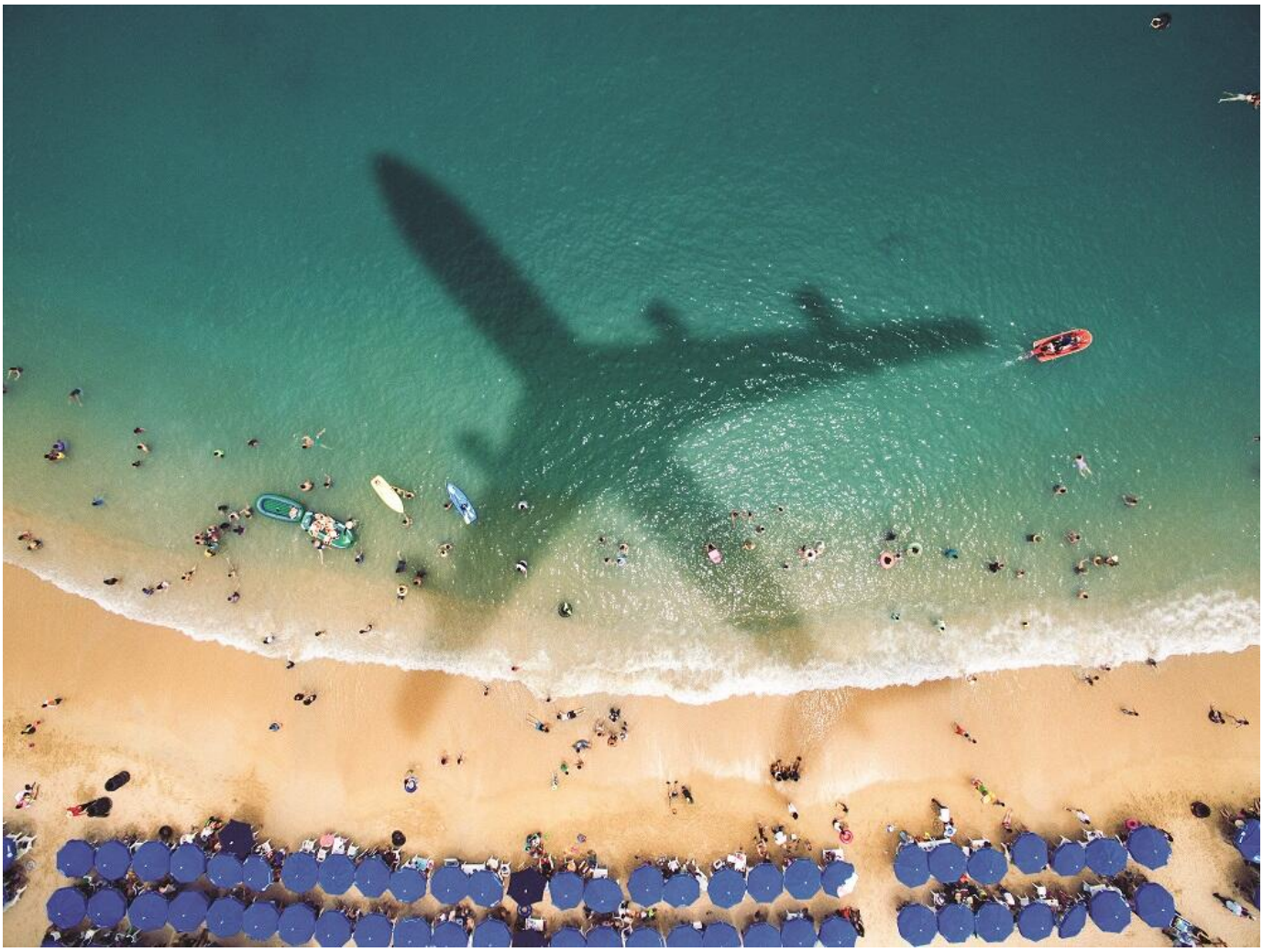
Taxing holidays

Indirect Tax



01 April 2018

Sue Rathmell considers the effect of Brexit on the Tour Operators Margin Scheme

Key Points

What is the issue?

TOMS is a compulsory VAT accounting simplification measure for any supplier who buys in and resells certain (designated) travel services, as a principal or undisclosed agent, without material alteration.

What does it mean to me?

Although the principal of TOMS is reasonably simple, where it gets complicated is in the detail: what goes into the selling price, what can be left out, how to treat insurance, reverse charges, holidays which are part in and part outside the EU, in house supplies, the complexity of the annual calculation and so on.

What can I take away?

At the time of writing, it is still unclear as to how the UK will interact with the EU post Brexit. If there is to be an agreement allowing the UK access to the Single Market then this is likely to come with a requirement that the UK's VAT system mirrors the EU's and thus the UK will still be subject to EU Directives and decisions including any future changes to TOMS.

The Tour Operators' Margin Scheme (TOMS) which is used by tour operators to calculate how much VAT they owe, is an EU scheme, devised by the European Commission and implemented by each of the Member States in varying degrees of compliance with the underlying legislation. This article looks at changes to TOMS and how tour operators and other travel industry operators might be impacted by Brexit.

Background

TOMS is a compulsory VAT accounting simplification measure for any supplier who buys in and resells certain (designated) travel services, as a principal or undisclosed agent, without material alteration. HMRC consider that it applies to sales to consumers only and that wholesale B2B sales are outside TOMS. However this view is not in line with the CJEU and therefore B2B suppliers have a choice as to whether to apply TOMS to their supplies or not.

Designated travel services are accommodation, passenger transport, trips or excursions, hire of a means of transport and the use of airport lounges or tour guides. TOMS can apply to the sale of a single designated travel service as well as a

package. Some other types of supply, theatre/attraction/sports event tickets and catering will be in TOMS if these are sold with a designated travel service. It also applies to any business or organisation selling designated travel services and not just tour operators and travel agents. This means that for example, conference organisers are often within TOMS.

VAT is payable where the supplier is established (so a UK supplier will account for UK VAT) rather than where the service is consumed. This brings a significant benefit to tour operators because without it, under the normal EU VAT rules, suppliers could have a liability to register and account for VAT in every EU member state where any travel service is consumed.

VAT is due on the margin (the difference between the VAT inclusive selling price and the VAT inclusive cost of the relevant travel service). Standard rated VAT is due on the margin generated on holidays in the EU and zero rated VAT applies to the margin on holidays outside the EU. Input VAT recovery is not allowed on margin scheme costs but relief is effectively given in the calculation.

The TOMS VAT liability is calculated on an annual financial year basis but suppliers are required to pay an estimated (provisional) amount of anticipated VAT during the financial year itself.

As an aside, TOMS is an EC scheme which undoubtedly shoots itself in the foot – holidays outside the EU are more attractive from a VAT point of view being VAT free, than holidays inside the EU. It surely does not make sense to have an EU tax system which encourages EU citizens to holiday outside the EU?

Although the principal of TOMS is reasonably simple, where it gets complicated is in the detail: what goes into the selling price, what can be left out, how to treat insurance, reverse charges, holidays which are part in and part outside the EU, in house supplies, the complexity of the annual calculation and so on.

Non EU tour operators

One area which some tour operators have exploited in recent years is that suppliers established outside the EU are not subject to TOMS and therefore not liable to pay any EU VAT even if the customer is in the EU and the service is consumed in the EU. The EU Commission has said that this is under review but there has not yet been any attempt to correct this apparent anomaly.

European Commission

Over the last few years, we have seen the Commission focus on the disparities in implementation of TOMS by attacking countries which have not implemented the scheme strictly according to the EU rules. In 2013 the Commission commenced infraction proceedings against eight EU countries, including Spain, in two areas – how B2B supplies should be treated and how the TOMS VAT should actually be calculated. The Commission won in the Court of Justice of the European Union (CJEU) and Spain and other countries had to change their TOMS rules.

But what of the UK? Interestingly the UK was not subjected to infraction proceedings even though we also do not operate TOMS strictly according to the rules in the VAT Directives. After the CJEU issued its judgment in the case against Spain and others, UK HMRC issued Business Brief 5/14 in January 2014 saying that they recognised the UK was not in compliance but proposed not to make any changes whilst the Commission undertook a review of TOMS. UK tour operators breathed a sigh of relief. In particular, a requirement to operate TOMS on a transaction by transaction basis rather than a global basis, would have lead not only to an accounting system nightmare trying to change existing systems to capture costs by holiday but, on an ongoing basis, to a potentially significant increase in VAT to pay. Without the ability to offset loss making holidays against profit making ones, VAT would have been payable on the full margin of all profitable holidays increasing the VAT costs substantially.

HMRC’s decision not to make changes also allows tour operators to continue using the transport company scheme, a B2B arrangement allowing UK tour operators to get the benefit of UK zero rating on the transport elements of holidays. A subsidiary buys in the passenger travel and sells it on to the tour operator at a marked up price. Passenger transport is zero rated in the UK and so this arrangement allows UK tour operators to avoid paying VAT on the margin on passenger transport.

Next steps by the Commission

In June 2016 the Commission published an Invitation to Tender for a study into TOMS including considering whether travel services need a special VAT scheme or whether the normal rules could apply. The Commission also wanted the study to consider the disparities of treatment between EU and non EU suppliers of travel services.

The study reported in December 2017 and recommended retaining TOMS but modernising it to cope better with the changes in the travel industry in the 40 years since TOMS was introduced. The report highlights the many differences in how member states have implemented the EU legislation and recommends harmonisation of the rules. The report also recommends changing the place of supply for travel services from where the tour operator belongs to where the customer resides or is established. It claims that this would enable equal treatment of EU and non EU tour operators. Another recommendation which is to be welcomed by UK tour operators is to allow the margin to be calculated on a global basis with an option to calculate it on a transaction by transaction basis.

The report will now be considered by the Commission but the chances of rapid change to the legislation for tour operators is unlikely because all EU member states would have to agree on new rules and that is not going to happen quickly.

Brexit

In the meantime, of course, in June 2016 the UK voted to leave the EU and will do so on 29 March 2019. What does this mean for tour operators and their special VAT scheme? In the short term, HMRC have said that VAT will continue to operate post Brexit as it does under the current rules and legislation is in place ready to make this happen.

At the time of writing, it is still unclear as to how the UK will interact with the EU post Brexit. If there is to be an agreement allowing the UK access to the Single Market then this is likely to come with a requirement that the UK's VAT system mirrors the EU's and thus the UK will still be subject to EU Directives and decisions including any future changes to TOMS.

If there is not to be such a close relationship between the UK and the EU then the UK can make its own decisions regarding VAT and we can expect that over time, there will be more and more divergence between the UK and the EU VAT systems.

From the viewpoint of UK tour operators, can they be hopeful that HMRC would do whatever they can to keep a TOMS system which has in built advantages? I think so, at least in the short term. HMRC listened to tour operators when they made representations at the time of the infraction proceedings and took the major step of standing out against the Commission's wishes, admitting that the UK had not

properly implemented the rules but taking a ‘wait and see’ type approach which massively benefited UK tour operators.

For the time being at least, tour operators can be relieved that there is little chance of major changes to TOMS in the near future particularly when the drop in the value of the pound has meant that many tour operators are struggling with big losses on foreign exchange.

Other travel industry businesses

Businesses which sell online accommodation as agent for the hotel continue to be under attack from HMRC who are keen to categorise them as selling as principal and therefore subject to TOMS rather than acting as agents, accounting for VAT only on their commission.

In 2014 the case of *HMRC v Secret Hotels2 Ltd (formerly Med Hotels Limited) [2014] UKSC 16* was eventually decided in the appellant’s favour in the Supreme Court. The contract between Secret Hotels and the accommodation owner stated that the former was acting as agent for the latter but HMRC argued that the commercial and economic reality of the arrangements between the parties was not consistent with an agency relationship and that in fact Secret Hotels was acting with customers in its own name. The Supreme Court held that the contract was determinative unless it was clearly a sham.

Despite this decision, HMRC are continuing to take online hotel accommodation agents to the VAT Tribunal in an attempt to secure a different outcome than that of Secret Hotels. So far however, they have not been successful. Hotels4U.com, Opodo, HotelConnect and Alpharooms were all won by the appellant.

It is interesting times in the world of VAT and not just for the travel industry. Uncertainty is not good for business so we can only hope that the way forward for the UK is agreed as soon as possible so that businesses can plan for the future.