Changes to the VAT treatment for retained payments and deposits on 1 March 2019

Indirect Tax

01 February 2019

On 1 March 2019, the VAT accounting treatment for part and full payments for supplies that are retained/non-refundable where a customer does not take up the supply, changes from VAT free compensation to taxable consideration. Where a service is not used or goods are not collected by the customer, these are known as ‘unfulfilled supplies’.

Background

In the Budget 2018, the government announced measures in the Budget Resolutions to tackle ‘tax avoidance, evasion and unfair outcomes’, which included changes to the VAT position on retained payments and deposits for unfulfilled supplies, estimated to raise £425 million per year in additional VAT receipts. HMRC published Business Brief 13 /18 on 21 December 2018, which sets out its policy on the new VAT treatment for affected supplies.

The change in policy arises as a result of the Court of Justice of the European Union (CJEU) judgment in the joined cases of *Air France-KLM C-250 /14* and *Hop!-Brit Air SAS C-289 /14*, where it was decided that the retained income for unused non-refundable air tickets was in connection to a supply rather than being compensation, so there could be no subsequent VAT adjustment where the supply was later unfulfilled. The business brief also refers to the CJEU judgment in *Firin OOD Case C-107 /13*, which looks at the VAT treatment of advance payments for a Bulgarian business with a bulk order of flour. Please note that domestic passenger transport and food are subject to positive VAT rates in many EU member states, whereas they are generally zero-rated in the UK (subject to exceptions), so HMRC have considered

the legal principles arising from these cases rather than their specific VAT liabilities.

VAT treatment under the current rules to 28 February 2019

When a customer makes an advance payment or part payment for a future supply that is taxable, VAT becomes due at the time these stage payments/deposits are received. If the supply is later unfulfilled and it was initially agreed by both parties that the deposit or advance payment is non-refundable (known as ‘forfeited deposits’ in HMRC’s guidance), the business may treat the income as compensation and the previously declared VAT can be adjusted in the next VAT return.

VAT treatment from 1 March 2019

Where an advance payment or part payment is made by the customer, the business accounts for VAT in the same way as the current rules. However, if that supply is subsequently unfulfilled, the business is no longer able to make a VAT adjustment. Note that HMRC states in the business brief that businesses that have not been making VAT adjustments to date will not be able to make retrospective adjustments, as HMRC considers the new rules to have always been the correct position. HMRC will updates its VAT guidance prior to 1 March 2019.

Earlier case law on deposits

The above cases were distinguished from an earlier CJEU case specifically relating to non-refundable hotel deposits for a French business, *Société thermale d’Eugénie-les-Bains C-277/05*, where the judgment in that case allowed the cancellation fees to be treated as compensation. In French national law at that time, both the Consumer Code and the Civil Code required that where a consumer would lose its deposit for cancellation of the intended supply, should the cancellation be effected by the business instead, the business must refund double the initial deposit. As these rules formed part of the contractual arrangements, it supported the position that there was a compensatory arrangement in place for both parties.

UK businesses that consider this case to be still applicable to their specific contractual arrangements rather than the new rules should either contact HMRC or seek professional advice.