Deduction of VAT relating to foreign branches – update

Indirect Tax

01 September 2015

An update following our response to the HMRC consultation April

We submitted a response to HMRC in April on the proposals to restrict the deduction of VAT incurred in the UK but relating to foreign branches or establishments on 1 April 2015. Details can be found on the CIOT website and in the May 2015 issue of *Tax Adviser*.

Later, we met HMRC officials to discuss our position to provide more detail on the practical aspects of the proposal and, in particular, its adverse impact on UK business. While not conceding the issue, members will be aware that HMRC have now decided not to press ahead with immediate implementation of the draft statutory instrument but instead to consider the matter further.

Part of HMRC's concerns with the existing legislation centred on the department's perception that 'some businesses are able to deduct more VAT than they are entitled to'. In our discussions with HMRC we pointed out that HMRC already had other tools that should be considered (for example, method overrides) and that in fact there was an even greater potential for VAT avoidance if input VAT deduction were to ignore entirely the use of the tax outside the UK.

We noted that, since a used-based method has to be a more precise means of determining the VAT deduction, any perceived problem lies rather in how the method of dealing with the deduction of VAT is applied in practice – not in the fact that there are foreign branches per se.

Further points raised were accounting complexity and the fact that the proposals create a disincentive to support overseas branches from the UK with consequences for inward investment into the country. Far from a simplification measure, we

pointed out that apportioning VAT on the basis of UK use only would complicate the accounting system and audit trails since the apportionment would be done otherwise than by reference to the actual costing.

There will of course be other issues, such as how you deal with VAT relating to a foreign branch that is treated as part of another taxable person in accordance with the Skandia judgment. We encouraged HMRC to give fuller thought to such interactions before implementing any changes.

This is a continuing issue and members should feel free to email any thoughts they have on the issues to indirecttax@ciot.org.uk.