Location, location

Indirect Tax



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Alex Hale explains the place of supply rules for VAT on services

Key Points

What is the issue?

Businesses with overseas customers need to identify the country in which their income is subject to VAT and the associated implications from an indirect tax perspective

What does it mean to me?

A supply of ‘services’ is defined as anything that is not a ‘good’. The format and delivery methods of many products are moving into the services category, particularly those delivered through the internet, such as ebooks, music downloads and content streaming. The VAT treatment of this specific sub-category of services – electronically supplied services – has been subject to much change and coverage over the past year, particularly in respect of the MOSS scheme, but it is helpful to understand where these services fit within the broader place of supply rules.

What can I take away?

Every supply of services must be analysed in the light of the place of supply rules to ensure that the correct VAT is accounted for by the correct entity in the correct jurisdiction. This is particularly important given the extent of VAT compliance obligations that can be created by making global sales, and the place of supply rules are the starting point for this

For UK VAT purposes, the starting point is the ‘basic rule’ for determining the place of supply of services. This is dictated by the business status of the customer and applies unless the services fall into any of the ‘exceptions’ set out in VATA 1994 Sch 4A.

B2B

If the customer is ‘in business’ for VAT purposes (see below under Customer status), a business-to-business (B2B) supply occurs and the place of supply is the location of the customer. As such, if the supplier and the customer are both in the same EU country, a domestic supply takes place, which is subject to domestic VAT. The supplier would account for VAT (output tax) on its supply to the local tax authority.

To the extent a B2B supply of services takes place cross-border, the transaction is subject to VAT in the customer’s territory and any VAT accounting responsibilities

are transferred to the customer. If, say, the supplier is in the UK and the customer is in Germany, the supply is outside the scope of UK VAT. It is, however, within the scope of German VAT, and it is expected that the customer self-accounts for German VAT on the supply under the 'reverse charge' mechanism.

If the customer is 'fully taxable' for VAT purposes – thus entitled to full VAT recovery on costs – the reverse charge is a simple administrative entry with no net effect. However, partly exempt businesses that suffer a restriction on input tax recovery will bear a net loss as a consequence, just as they would had they bought the services locally and incurred local VAT.

B2C

To the extent a customer is not 'in business', a business-to-consumer (B2C) supply takes place. For these, the basic rule is that the place of supply is the location of the supplier. As such, supplies of basic rule services made B2C are subject to the local rate of VAT in the supplier's territory, regardless of where the customer is located.

If a supplier is in the UK, a supply of basic rule services made B2C is subject to UK VAT, regardless of whether the customer is in a relatively low VAT rate territory such as Luxembourg (where the standard rate is 17%) or in one that is relatively high such as Hungary (27%). The supplier will account for output tax to its local tax authority accordingly.

Customer status

The simplest and most reliable way to determine whether a supply is made B2B or B2C is to obtain a local VAT registration number from the customer. To the extent a customer is registered for VAT in the UK or elsewhere in the EU, it will be a 'taxable person' for VAT purposes and the supply is B2B. Suppliers can verify their customers' registration numbers using the VAT information exchange system (VIES) website.

For EU VAT purposes, a customer is 'in business' and is a taxable person if they conduct any economic activity, in any place, whatever its purpose or results. Technically, a supply of basic rule services can be treated as B2B, even without a VAT registration number – albeit this does not extend to electronically supplied

services, for which a VAT number is essential.

HMRC’s guidance on this states that a supplier can accept other evidence of its customer’s business status, such as a link to the customer’s business website or other commercial documents. If the supplier chooses to accept this, it risks taking on the associated VAT liability in the event that the customer is found not to be in business. The prudent approach is to treat such supplies as B2C and to charge VAT accordingly.

Exceptions

There are exceptions to the basic rule for which the place of supply will differ. The UK VAT legislation splits these exceptions into three categories. Those which:

- apply regardless of the customer’s status (‘general exceptions’);
- apply to B2B supplies only; and
- apply to B2C supplies only.

The general exceptions include, among others, supplies such as land-related services, which are subject to tax where the land is situated, passenger transport, which is taxed where the transport takes place, and telecommunications and broadcasting services, which are subject to the ‘*use and enjoyment*’ provisions (see below). There are also exceptions that either apply to B2B only (such as ancillary transport services), or to B2C transactions (for example, work on goods). Any provision of services must be analysed carefully with reference to the Schedule.

One key sub-category of services that has recently been subject to fundamental changes is electronically supplied services (ESS). These are essentially automated services usually delivered over the internet and provided with minimal human intervention.

Electronically supplied services

B2B

The place of supply rules for B2B supplies of ESS initially mirror the general rule, and the place of taxation is determined by reference to the location of the customer as a starting point. Again, a cross-border supply made by a UK supplier would be outside

the scope of UK VAT and an EU customer would self-account for the tax under the reverse charge mechanism.

B2B supplies of ESS are, however, subject to the ‘use and enjoyment’ provisions.

Use and enjoyment

Effective use and enjoyment overrides the basic place of supply rule, when either:

- the place of supply is within the EU, but the services are consumed outside the EU; or
- the place of supply is outside the EU, but the services are consumed within the EU.

Effective use and enjoyment takes place when the customer actually consumes the services irrespective of the contractual arrangements, payment or beneficial interest, and the place of supply moves accordingly.

The provisions exist only to bring within, or exclude, supplies from the EU VAT net, therefore only affecting the VAT treatment when application of the provisions would take the supply in or out of the EU. As such, when the place of supply is a given EU country and the services are used and enjoyed in a different member state, the provisions do not take effect.

The provisions also apply to broadcasting and telecoms services, although this is a general exception and therefore affects both B2B and B2C supplies. The hiring of means of transport is also covered and summer Budget 2015 indicated that the provisions may be extended to include all UK repairs made under UK insurance contracts from 2016. That Budget also stated that a wider review was being considered. This could extend the provisions from the following year to include services such as advertising, potentially as a response to the Upper Tribunal’s recent decision in the *Newey (t/a Ocean Finance) v RCC* [2015] UKUT 300 (TCC) litigation.

B2C

Before 1 January 2015, the basic place of supply rules for B2C services also applied to ESS. However, wholesale EU changes have led to a markedly different rule from that date. Now, the relevant place of supply is where the customer is located.

Whereas before 2015 suppliers could charge the same VAT rate on B2C sales of ESS regardless of the customer’s location, now suppliers must apply the local VAT rate. This has had a material effect on pricing margins, given the 10% differential between the highest and lowest EU VAT rates.

Importantly, the key effect of this legislative amendment is that suppliers affected will be making taxable supplies in each EU country to which they supply. No registration threshold has been set, so supplies of B2C ESS made in any EU country will crystallise an obligation to register and account for VAT locally. For many businesses, this can lead to a legal requirement to register separately for VAT in every applicable EU country; and it is for this reason that the mini one-stop shop (MOSS) scheme was created to allow compliance in multiple member states through a single electronic declaration to the local tax authority.