Where on earth?

The place of supply rules are critical to determining VAT liability. Mike Thexton explains how they apply to goods.


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The VAT Act 1994 begins, at s 1, with the basic charging provision: 'Value added tax shall be charged, in accordance with the provisions of this Act, on the supply of goods or services in the United Kingdom (including anything treated as such a supply).'

The law goes into more detail after that, of course, but this starting point highlights an important distinction: UK VAT is charged on supplies that are treated as made in the UK, and UK VAT is not charged on supplies that are treated as made somewhere else. Such 'outside the scope supplies' may have other VAT consequences in the UK and elsewhere, but they will not incur a liability to UK output tax or to UK VAT registration.

The devil, as the saying might go, is in the brackets. The rules on 'place of supply' (POS) are critical, but they are complicated. They are very different for supplies of goods and supplies of services and are full of extra details that have been bolted on over the years since VAT was introduced. International trade 50 years ago was something that a minority of businesses did with each other, whereas now many businesses and also consumers engage in it regularly, probably sometimes without even realising that they are doing so. This article examines the nuts and bolts of the POS rules as they apply to goods, and a future article will do the same for services.

Brexit will bring significant changes to the way UK businesses account for international transactions, but those changes are as yet not finally determined. These articles will deal with the present rules, which continue to apply while we are in the transitional period, and will point out some of the ways in which the rules are likely to change in 2021.

Key points

- UK VAT is charged on supplies of goods that are treated as made in the UK.
- Is a supply outside the scope, zero rated or exempt?
- Take care at the borderline between goods and services.
- Since 2012, different registration rules apply depending on whether there is a UK establishment.
- A supply may not be complete until installation is made.
- In general, distance sales should be subject to local VAT where the consumption takes place.
- Movement of own goods, chains and triangular transactions.
- From 1 January 2020, new rules apply to call-off stock.

Place and liability

It is important to distinguish between two different reasons for not accounting for output tax on a supply:

- it may be 'outside the scope' because the POS is 'outside the UK'; or
- it may be a UK supply but zero rated or exempt.

This distinction is particularly important in the area of international transactions because supplies can be of either type. The conditions for zero rating an export of goods are specific and mandatory and largely dependent on holding the correct paperwork. If a business applies the wrong rule, it may find that it owes HMRC VAT that has not been collected from the customer.

To illustrate the complications in this area, consider the example of ***Children's clothes***.

Goods and services

Transaction taxes on goods have been imposed by governments for centuries. Generally, they have depended on following the goods around, attaching pieces of paper to them, and recording (and taxing) them as they cross borders. Imposing a transaction tax on services as well, in the form of a single comprehensive system such as VAT, could not replicate the same mechanisms because of the fundamentally different nature of the subject matter.

As a general rule, goods are physical items and services are not; however, there are rules of definition in VATA 1994, Sch 4 and borderline items that have been considered by the courts. For example, a leading case on mixed and compound supplies concerned whether the rules for goods or services should

Children's clothes

X Ltd sells children's clothes by mail order to private customers in EU countries. As long as the values stay below the distance selling threshold in each country (which varies from state to state), the POS is the UK and the supplies are zero-rated as UK sales of children's clothing. The sale is recorded in box 6 of the UK VAT return.

If the distance selling threshold is exceeded, the POS shifts to the destination country. X Ltd will be required to register there and account for output tax at the local rate. The sale is recorded in boxes 6 and 8 of the UK VAT return, but there is no entry on the EC sales list (*Notice 725*, section 6 – tinyurl.com/y96299eq).

Y Ltd sells clothing for adults to business customers in the EU and beyond. The POS of all these sales is the UK, but they are zero-rated supplies as long as the conditions of *Notice 703* (exports) and *Notice 725* (despatches to the EU) are met. Entries will be required in box 6 for all the supplies; entries are required in box 8 and on the EC sales list for supplies to EU customers.

apply to an import of computer software on a disk. Because the software had been customised, the physical medium on which it arrived was so insignificant that it should be ignored. There was a single supply of services (see *Levob Verzekeringen BV v Staatssecretaris van Financiën* CJEU case C-41/04). See also ***Undersea cable***.

Registration liability

The POS of goods has nothing to do with a business having 'its establishment' or 'another fixed establishment' in the UK. Those are rules that are mainly relevant to POS of services. However, since 2012 the registration rules have applied differently to businesses supplying goods depending on whether or not they have a UK establishment.

VATA 1994, Sch 1 applies to UK established businesses, and allows those with taxable supplies below £85,000 a year to choose not to register. The turnover test in Sch 1 para 1 refers to 'taxable supplies', which are those defined in VATA 1994, s 1 – supplies made, or treated as made, in the UK. As a general rule – and subject to the complications described further in this article – supplies of goods are made where the goods are when they are supplied; if they move across a border, they are supplied where the movement starts. So a UK-based exporter is making supplies in the UK and is liable to notify HMRC under Sch 1 para 1 if the threshold is exceeded. If all the supplies are zero rated, the exporter would be eligible for exemption from registration under Sch 1 para 14 (but would have to satisfy HMRC that the conditions were met).

On the other hand, a UK-based business that trades exclusively in goods that are situated outside the UK at the time they are supplied is not liable to register under Sch 1 para 1, because it makes no taxable supplies at all. Such a business is entitled to register in the UK under Sch 1 para 10 if, and only if, it has an establishment or fixed establishment here, and the 'outside the scope' supplies would be taxable (rather than exempt) if made in the UK. The business would then be able to claim input tax on UK expenses on a UK VAT return, even though all its supplies are outside the scope – as long as they would be taxable if made in the UK, they confer the right to credit.

Undersea cable

In *Aktiebolaget NN v Skatteverket* CJEU case C-111/05, a company laid an undersea cable from Sweden across the Baltic Sea. The CJEU ruled that this was, in effect, a supply of goods, chargeable to VAT in proportion to the amount of cable which was laid in the territory of each member state that it ran through (including their territorial waters). It would not be chargeable to VAT anywhere on the proportion of the cable that ended up outside the member states.

If it had been a supply of services, it would all have been taxable in Sweden (under the rules for POS then in force), where the cable-laying company was based.

A foreign-based business that owns goods that are situated in the UK when they are supplied is liable to registration under Sch 1A without the benefit of the normal registration threshold. This poses enforcement problems for the authorities: it is easier to find and assess businesses that are based in the UK than those with no physical presence here beyond some moveable trading stock. In recent years rules have been brought in to impose requirements, and sometimes liabilities, on 'fulfilment houses' – UK-based businesses that store and deliver goods for foreign-based suppliers. There are also simplifications to avoid foreign businesses having to register in the UK if a UK business customer could account for the tax instead – see 'call-off stock' below.

Basic rule

The UK law on POS of goods is set out in VATA 1994, s 7. This is one of those legal provisions that would make a great deal more sense if it came with an explanation. It is arranged in the form 'rule 1 applies to X; if rule 1 does not apply, rule 2 applies to Y; if rule 2 does not apply...' and so on, with a 'catch-all' at the end that applies if none of the other rules does. By that time, it is hard to remember what has already been covered.

The basic rule, however, is the simplest: s 7(2) provides that 'if the supply of any goods does not involve their removal from or to the United Kingdom they shall be treated as supplied in the United Kingdom if they are in the United Kingdom and otherwise shall be treated as supplied outside the United Kingdom.' Goods that are not supplied internationally are relatively easy.

Bear in mind, however, that this covers goods that have been moved to the UK before they are supplied – the fulfilment house and call-off stock situations noted above. The movement happened before the supply, so the supply 'does not involve their removal'. It is important to identify the point in time when goods are supplied, and where they are when that happens.

Installed or assembled

The next provision, s 7(3), applies to a particular type of supply: goods whose supply involves their installation or assembly. The POS is in the UK if they are installed or assembled here, and outside the UK otherwise. This is a recognition in the law of a general principle: if the supply involves installation, then the supply is not complete until the installation is done. If the supply happens once the installation is done, it is logical to conclude that the POS is where the goods are at that time.

This means that a foreign business that installs fixed plant in the UK has a liability to register here. There is a simplification allowed under EU rules – VATA 1994, s 14(2) permits a UK VAT-registered customer to treat the supply as an acquisition, and the supplier from another member state can therefore treat it as an exempt despatch from its home registration. This presumably ends when the transitional period does, and whether it will be replaced by some other easement remains to be seen.

Distance sales

The next two rules (s 7(4) and (5)) are the most in need of explanation. They relate to 'distance sales' – supplies of goods that are despatched to consumers (as opposed to taxable persons) in other member states by or at the direction of the supplier (in effect, mail order).

The idea is that such sales should be subject to local VAT where the consumption takes place, but relatively small amounts are allowed to be dealt with in the supplier's country as a simplification.

VATA 1994, Sch 2 imposes a registration liability on a foreign business making such supplies to UK consumers if the value exceeds £70,000 in a calendar year. There are corresponding provisions in other member states, where the threshold is generally either €35,000 or €100,000 (or equivalent figures in those countries that have not adopted the euro).

The law then says that:

- if a foreign trader makes such a supply to a customer in the UK and is liable to be registered under Sch 2 or is already registered under Sch 1, the POS of those goods is the UK;
- if a UK trader makes such a supply to a customer in another member state and is liable to be registered there under corresponding local provisions, the POS is outside the UK.

This seems a little backward: the registration liability determines the POS rather than the POS determining a registration liability (as it does with stock held in fulfilment houses). It is easier to understand once the reader has made it all the way to s 7(7) and realised that the distance selling rules are exceptions to the general rule for supplies that involve goods crossing borders.

Imports

VATA 1994, s 7(6) provides that the POS of imported goods (in other words, those from outside the EU) is the UK if their supply involves the importation and they are supplied by the person by whom, or under whose directions, they are so imported.

In effect, this is the distance selling rule applied to imports, as illustrated by ***Mail order***.

Mail order

A German mail order company supplies £100,000 of goods a year to UK consumers. Because there is a registration liability under Sch 2, the POS is deemed to be the UK under s 7(4), and UK output tax is due.

A Chinese mail order company supplies £10,000 of goods a year to UK consumers. Schedule 2 does not apply, but s 7(6) provides that the POS is the UK; this triggers a liability to register under Sch 1A and UK output tax is due.

Exports and despatches

The catch-all rule (s 7(7)) starts:

> 'Goods whose place of supply is not determined under any of the preceding provisions of this section but whose supply involves their removal to or from the United Kingdom.'

The transactions that remain after the preceding provisions are cross-border supplies that do not involve installation or assembly, and that do not involve a registration liability in respect of distance selling – routine imports and exports, acquisitions and despatches, and EU distance sales to consumers that do not breach the registration threshold in the destination country.

The rule is that the goods are 'supplied in the United Kingdom where their supply involves their removal from the United Kingdom without also involving their previous removal to the United Kingdom' and 'supplied outside the United Kingdom in any other case'. So an export or despatch has a POS in the UK, even though the goods leave the UK.

This is a paraphrase of the EU rule in the Principal VAT Directive, art 32, which states:

> 'Where goods are dispatched or transported by the supplier, or by the customer, or by a third person, the place of supply shall be deemed to be the place where the goods are located at the time when dispatch or transport of the goods to the customer begins.'

This rule avoids the need to consult the contract in detail to determine where the goods are when title passes – it does not matter if the contract is ex-works, CIF (cost, insurance, and freight) or anything else. The POS is where the journey starts, and the liability of the supply will generally be zero rated ('exempt with credit for input tax' in EU-speak) as long as the paperwork is in order. Contrast that with the situation where the movement is clearly separate from the supply, and the goods continue to belong to the supplier after they have arrived in the destination country – a later sale will be within s 7(2).

Paperwork

The zero rating of despatches and exports depends on meeting the evidential conditions of *Notice 725* and *Notice 703*, both of which contain numerous requirements that have the force of law. The law was tightened from 1 January 2020 – one of the last VAT changes the UK complied with before Brexit – to make it clear that specific requirements such as showing the customer's VAT number and filing a sales list afterwards are 'substantive conditions' for zero rating, rather than mere formal record-keeping.

Movement of own goods

If a business moves its own goods to an EU member state without supplying them, this is deemed to be a supply subject to the same rules as a sale – the POS is the UK and zero rating depends on the paperwork. The business will probably have to register in the other country to account for acquisition tax, and for output tax if, subsequently, it sells the goods once they are situated there. The reporting requirements are set out in *Notice 725* at section 9.

French supplies

A UK business M has purchased goods from a French business N that bought them from another French business O. M sells the goods to a UK customer P; M arranges for the transport of the goods from O's premises to P's premises.

The default position is that N's supply to M is the despatch; M accounts for acquisition tax and input tax on its UK VAT return, and UK output tax on the sale to P.

If M is also registered for VAT in France, M and N can agree that N's supply to M is a domestic French supply (on which M recovers input tax on a French VAT return); M's supply to P is then a despatch with POS in France.

Chains

The European Commission required all member states to introduce new uniform rules to deal with 'chain transactions' from 1 January 2020 and, as we were still a member state on that day, we duly complied – although the statutory instrument was only laid before parliament on 20 December 2019, so it was a last-minute thing. There is some very good guidance on the problems and the rules at tinyurl.com/y9azznrn.

A chain arises when there are several supplies of goods and one movement across a border. If A sells to B who sells to C who sells to D, and then the goods are moved from A to D, it is important to know who has made an intra-community despatch. That business must hold all the relevant paperwork and do the reporting to justify zero rating; the others are making and receiving domestic supplies in their respective countries.

The problem has been considered several times by the CJEU, which has confirmed that only one of the parties can make an intra-community supply. The new chain rules were discussed by Angela Lang-Horgan in 'A quick fix' (*Taxation*, 27 February 2020, page 12), and I include only a brief summary here for completeness. The 'simplification' includes the complexity of a choice:

- the default position is that the trader who arranges the transport of the goods is treated as receiving the intra-community supply; but
- if that person is registered in the same state as their supplier, they can choose to be treated as making the intra-community supply.

The example of ***French supplies above*** illustrates this.

It seems a little counter-intuitive that it is the person who arranges the transport who receives the intra-community supply, because they are likely to have all the necessary paperwork for zero rating, rather than the person who is making that supply. However, the rules have to determine that one of the supplies is the despatch, and that is the one they have gone for.

Planning point

For triangular supplies, where there are VAT-registered three parties in different member states with goods being transferred directly from the first to the third, the supply by the trader in the middle of the transaction is treated as outside the scope of VAT in any country.

Triangles

There have been specific rules for one type of chain since the 1990s – where there are just three parties and they are all registered for VAT in different member states, and the goods are transferred directly from the first to the third.

As long as various paperwork requirements are observed, the supply by the trader in the middle is treated as outside the scope of VAT in any country – it is reported on the intermediate supplier's sales list, and the customer will account for acquisition tax, but there is no need for an extra VAT registration.

Call-off stocks

Another rule taking effect on 1 January 2020, but not introduced until Finance Bill 2020 and therefore only applicable retrospectively, implements the commission's solution to the problem of 'call-off stock'. This is where a trader moves goods to another country to be on hand when a customer needs them, but the supply is not made until the goods are 'called off'.

As set out above, the basic rules would require a deemed supply on the movement of the goods, the supplier to be registered in the destination state, and a domestic supply in that state when the goods are sold to the customer.

The simplification that is now supposed to apply throughout the EU is to regard the call-off stock as still situated in the member state of origin until it is supplied. The movement has to be recorded in the paperwork, but the sale is treated as a despatch at the time the goods are called off. The POS of that supply is therefore in the origin state, not the destination state, and no registration liability arises.

This reverses the old UK treatment of call-off stocks, which up to now have been treated as supplied when the movement happened – rather than moving when the supply happens. These rules are also discussed in Angela Lang-Horgan's article, and there is detailed guidance from HMRC at tinyurl.com/y96z59ju.

Second instalment

This article has concentrated on goods. The rules for services are necessarily different, and they will be described in a second article. I will also consider how the place of supply rules will be affected by the 'proper' departure from the EU that is expected at the end of the transitional period on 31 December 2020. ●

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