Where on earth – 2

Mike Thexton explains the VAT place of supply rules as they apply to services.

My article 'Where on earth' (*Taxation*, 18 June 2020, page 17) explained the rules that determine the place of supply (POS) of goods for VAT purposes. This article examines the rules that apply to the POS of services.

A significant reason for the difference between the rules for goods and services is that traditional transaction taxes have depended on the physical nature and physical movement of goods. Services do not move around in boxes that can have pieces of paper attached, capable of inspection and recording as they cross borders. The POS of goods focuses on the subject matter of the supply, the goods themselves, and where they are during the course of the supply; the POS of services has to depend on the location of something else that can be determined with more certainty.

The basic rules

The basic rules (which are subject to a long list of exceptions) are found in VATA 1994, s 7A and the Principal VAT Directive (PVD), art 44 and art 45. They draw a distinction between supplies made to business customers (B2B) and to consumers (B2C), but they are both based on the place of belonging of a business involved in the supply. That is easier to pin down than the intangible service itself.

B2B supplies are made in the country where the customer belongs. In general, a business customer will be able to recover VAT on supplies received, so in many cases the VAT charge should net to zero on a B2B supply. It is more convenient for the customer to deal with the VAT using the reverse charge procedure (see below) than having to pay 'foreign' output tax to the supplier, which would be due if the POS was the supplier's country. Foreign VAT cannot be recovered as input tax on a VAT return, but has to be claimed directly from the local tax authorities using the electronic refund procedure (Directive 2008/9/EC).

Key points

- The basic rule for place of supply of services depends on the location of the supplier and customer.
- For a B2B supply in another member state, the business customer may have to account for the output tax as a reverse charge.
- Where a business 'belongs' is critical to the basic place of supply rules.
- There are many exceptions to the basic rule.
- Special rules may apply depending on the use and enjoyment of the supply.
- Changes at the end of the Brexit transitional period.

B2C supplies are made in the country where the supplier belongs. This is contrary to the general principle that VAT should be charged on consumption, rather than on production. The rule dates from a time when international B2C supplies of services were relatively rare and therefore insignificant; many of the exceptions to the basic rule represent attempts to relate the charge to the place of consumption.

Reverse charge

If the POS of a B2B supply is in another member state under the basic rule, there is no liability – or entitlement – to register there as a result, regardless of the values involved. The business customer is required to account for the output tax as a reverse charge on their VAT return, and then recover it as input tax to the extent that they are entitled to credit. For a fully taxable trader, the net result is always zero. If the business cannot recover VAT in part or in full, the irrecoverable VAT will be collected by the member state in which the service is consumed, in line with the general objectives of the tax.

Contrast this to the rule for goods, where a trader making supplies of goods in another country has a liability to register there without the benefit of any threshold (subject to some simplifications such as for 'call off stock'). Contrast it also to the situation in which the POS of a service is in another member state under one of the exceptional rules described below, where there may be a registration liability. Some countries (including the UK) allow a simplification if the customer is registered, but the local rules should be checked.

Of course, a consumer customer will not be able to account for a reverse charge on the purchase of a service: it is possible

(although difficult) to collect import VAT from private customers on goods when they are physically delivered, but services are much harder to track and trace. Imposing a charge on the seller in the 'wrong' country on general services, and creating exceptions to charge the 'right' VAT on specific services, is a compromise solution.

Belonging

The place a business 'belongs' is critical to the basic POS rules. It is defined in VATA 1994, s 9, which refers to 'a business establishment' and 'some other fixed establishment'. The original UK wording has never been changed to reflect developments in EU law: the Implementing Regulation 282/2011 makes it clear that there can be only one 'establishment' – 'the place where the functions of the business's central administration are carried out' (Implementing Regulation, art 10). That is therefore the starting point for the POS of a business customer receiving B2B supplies, and a supplier making B2C supplies.

The POS may be shifted if the business has 'another fixed establishment' in a different country. The first step is to consider whether a presence in a particular country has the characteristics of a fixed establishment; the second step is to consider whether that establishment is more concerned with receiving a B2B supply, or making a B2C supply, than the main establishment.

The minimum characteristics of a fixed establishment have been considered in numerous CJEU cases, and they are now set out in Implementing Regulation, art 11: it is any establishment, other than the main one, which is characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to:

- receive and use the services supplied to it for its own needs (B2B): or
- provide the services which it supplies (B2C).

The most recent case to consider the fixed establishment rules is *Dong Yang Electronics* (Case C-547/18). There, a Korean holding company imported goods into Poland, where it traded through more than one subsidiary. The holding company continued to own the goods, and was therefore registered for VAT in Poland in its own name. However, it did not consider that it had a fixed establishment in the country – it owned goods and it owned subsidiaries, but the subsidiaries were independent companies registered for VAT in their own right. It contracted with an independent Polish company to carry out some work on the goods. Because the goods belonged to the Korean holding company, the supplier invoiced Korea – a 'basic rule B2B service' treated as outside the scope of Polish VAT because it was treated as made in Korea.

The Polish tax authorities argued that there should be a tax charge in Poland (even though it would have been immediately recoverable as input tax on the Korean company's Polish VAT return). For that to be correct, the Korean company would have to have a fixed establishment in the country. The stock could not be a fixed establishment on its own; that left the subsidiaries. The CJEU confirmed that the mere existence of a subsidiary in a country is not enough to show that the holding company has a fixed establishment there, and in general a supplier is entitled to accept the assurance that the supply is being made to the foreign establishment without investigating the contractual relationships within the group.

The Polish authorities relied on an old decision, *DFDS A/S* (Case C-260/95), in which the UK subsidiary of a Danish holding company was held to be a fixed establishment which rendered the holding company liable to registration in the UK in its own capacity (rather than the subsidiary being separately registrable). The CJEU considered that it was acting as a 'mere auxiliary organ' of the holding company, because it only sold the holding company's holidays to UK consumers and had no independent business of its own. In the *Dong Yang* case, Advocate-General Kokott explained that this was an exceptional situation that arose from the potential avoidance of VAT that DFDS's arrangements would have achieved. In the absence of abusive avoidance, separate companies are treated as individual taxable persons in their own right, and they are not to be regarded as fixed establishments of other group companies.

See the example of ***Moving abroad*** for other case decisions.

Natural persons

The language of the Implementing Regulation and case decisions on 'establishment' and 'fixed establishment' appear mainly to deal with large businesses and companies. Although it is possible for a sole trader to establish a fixed establishment in another country, it is more likely that the rule in VATA 1994, s 9(3)(c) will apply: 'the country in which the person's usual place of residence or permanent address is'.

Exceptions

The basic rule identifies 'the business' – customer or supplier – as a good geographical location to which to pin the supply. There are numerous exceptions to the basic rule, and they are far from exceptional – they are attempts by the lawmakers to achieve the objective of charging VAT in the member state where the services are consumed, and the following services are thought to have closer connections with something other than the business establishments.

The list is long and the arguments are numerous, so only a brief summary of some of the problem areas is included here. The rules are in VATA 1994, Sch 4A and PVD, art 47 to art 59, and they are described in *Notice 741A: Place of supply of services*.

Moving abroad

In *Newey* (Case C-653/11), a UK financial business established a company in Jersey to shift the place of supply of advertising services out of the UK and thereby avoid irrecoverable input tax. The CJEU held that the scheme would work if the advertising services were genuinely supplied to the Jersey company 'in accordance with commercial and economic reality'. The Court of Appeal has remitted the case back to the First-tier Tribunal for reconsideration of this question (more than 20 years after the disputed transactions).

In *Hastings Insurance Services Ltd* (TC6306), a UK company provided services to a Gibraltar insurance company. HMRC argued that UK VAT was due. This could only be correct if the Gibraltar company had a fixed establishment in the UK, and that could only be Hastings, the company that supplied the services. The First-tier Tribunal did not agree that it met the conditions of the Implementing Regulation 282/2011, art 11 with respect to the insurer.

Services relating to land

Services that are closely related to land are supplied where the land is situated, regardless of whether the supply is B2B or B2C. The main problem is determining what is sufficiently 'close' and what is only loosely related (when the basic rule will normally apply).

This has been clarified since January 2017 by the insertion of art 31a and art 31b into the Implementing Regulation. Supplies are subject to this rule only if they have a close connection with particular land, for example legal services concerned with the transfer of the land, and construction or repair services. Design services for a particular plot of land will be included, but generic design services will not.

This means that tax advisory and accountancy work is almost certainly too far removed from the land itself, even if it relates to income or gains derived from the land; but legal services related to land transactions will usually be chargeable where the land is.

Cultural services

In relation to cultural, artistic, sporting, scientific, educational, entertainment or similar events, such as fairs and exhibitions, there is a division between B2B and B2C services. B2C services have a POS where the event takes place; B2B services are 'basic rule' unless they are 'in respect of admission' or 'ancillary services related to the admission'.

See ***Conference*** for an example.

Work on goods

Carrying out work on goods, such as repairs or valuation, is a basic rule service if supplied to a business customer (as in the *Dong Yang Electronics* case described above). The POS of such services if supplied B2C is where the work is physically carried out. If a French private customer sends something to a specialist repairer in the UK, UK VAT must be charged. If the repairer goes to France to do the work, strictly the repairer incurs a liability to register there and charge French output tax.

Restaurant and catering services

Restaurant and catering services are supplied where they are physically carried out, whether B2B or B2C. This is naturally in line with the principle of taxing consumption where it takes place. Someone on a business trip abroad will have to pay the local VAT and may then be able to claim it back using the electronic refunds procedure.

Hiring of means of transport

Short-term hiring of means of transport (Sch 4A, para 3) is treated as made in the country where the transport is put at the disposal of the hirer, whether B2B or B2C. Long-term hiring of means of transport (Sch 4A, para 13A) is treated as made where the recipient belongs if B2C. It is 'basic rule' if B2B, which gives the same result (in other words, it is the B2C rule that is exceptional – based on customer rather than supplier). What is short and long term is defined in the law.

Recipients outside the EU

Schedule 4A, para 16 contains a list of services that are treated as outside the scope of UK VAT if they are supplied to a consumer who belongs outside the EU. The list includes accountancy and legal services, as well as the services of consultants and the provision of information. The question of where someone 'belongs' for this purpose has been considered in the context of legal services supplied to a person who was ordinarily resident in India (*Razzak* VTD15240) and foreign exchange services to travellers who spent up to 18 months in the UK (*1st Contact Ltd* (TC1780)).

The question of what are 'services of consultants' was considered recently in the context of an international matchmaking business (*Gray & Farrar International LLP* (TC7457)). The First-tier Tribunal judge held that a 'consultant' did not have to give specialist advice or hold a formal qualification – all that was required was expertise or experience that people relied on. However, the judge also considered that the service of the matchmaking business went beyond what he accepted was consultancy (giving advice on who would be a suitable match). There was a more complex service that included coaching, administration and other support provided by the consultant's staff, and the package as a whole did not fall within para 16. The basic rule applied, so UK VAT was due even if the client belonged outside the EU.

The same point was recently argued, with partial success for the company, in *Mandarin Consulting Ltd* (TC7714). The company helped Chinese students studying in the UK to apply for jobs here; the service was usually paid for by the parents from China. The First-tier Tribunal held that this was consultancy, not education (which would be supplied where physically performed); after July 2016, when contracts were made with the parents, the recipients of the supply belonged outside the EU. The judge disagreed 'with respect' with the decision in *1st Contact Ltd* – in his view, the only test of where an individual 'belongs' is where they 'have their permanent address or usually reside'. The terms of a visa, or direct tax principles, are irrelevant.

There is a prospective amendment to the legislation shown below para 16: the UK intends to apply this rule to supplies of this type to anyone belonging outside the UK and Isle of Man when the transitional period ends. If that is the case, it will be possible to charge no VAT on legal, consultancy, accountancy and advertising services supplied to non-business residents of France or Ireland. The EU's Brexit negotiators may push back against this.

Use and enjoyment

Some supplies are subject to special rules if:

- the normal POS rules would place the supply in the UK, but the use and enjoyment of the supply is outside the EU; or
- the normal POS rules would place the supply outside the EU, but the use and enjoyment of the supply is in the UK.

Conference

Kim is a UK-based lecturer who is engaged by a German company to present a course in Germany. This is B2B so it is 'basic rule'; the place of supply is Germany, and the customer will account for a reverse charge.

Events Ltd is a promoter of business conferences. It organises an event in France and sells tickets to business and private customers. These are rights of admission; the place of supply is France in all cases, and Events Ltd is liable to account for French output tax.

In these cases, the POS is shifted to the place where the supply is used and enjoyed. Note that this only moves the charge across the EU border, not just the UK border – if something is used and enjoyed in France, the rule will not apply. How this will change after Brexit, now that the UK border has become the EU border (from the other side), is not yet finalised.

The supplies affected include:

- short-term hiring of means of transport, and hiring of other goods;
- radio or television broadcasting services; and
- B2B telecommunications and digitally-supplied services.

This used to apply to B2C telecommunications services as well, which were much more likely to be subject to the rule. There have been arguments about how it should reduce the VAT charge if, for example, a person with a monthly mobile phone contract visited the USA and made some calls. It seems that the government decided the relief was open to abuse, so it was removed in 2017.

Digital services

Since 2015, B2C supplies of 'electronically supplied services' have been made where the recipient belongs. Because consumer recipients cannot account for a reverse charge on a VAT return, an international supplier has to register to account for output tax in the country where the customer belongs. Because this could require someone operating a website selling downloaded music, information or pictures to register separately in every member state, the mini one-stop shop (MOSS) system was established to enable traders to register with their home tax authority and to make a single return and payment each quarter. Nevertheless, the system requires people selling digital services to collect and retain a great deal of information about their customers to show that they have accounted for the right VAT to the right country.

From 1 January 2019, a de minimis threshold of total sales to all other EU countries of €10,000 (£8,818) was introduced: anyone below that level can ignore MOSS and account for their home country output tax on international sales. Unless the trader's *total* digital sales are below that level, it is still necessary to collect the information to be able to prove that the threshold for *cross-border* supplies has not been breached.

Both simplifications will go when the transitional Brexit period ends. Unless there is a special provision in the deal to cover them, anyone selling digital products from the UK to the EU will have to register under the non-union MOSS scheme in a different country after 1 January 2021.

Consequences

The article on the POS of goods made the point that an exporter of goods makes supplies in the UK that are zero rated. If it exceeds the registration threshold, it is required to notify HMRC.

Planning point

A €10,000 de minimis threshold of total sales applies to all other EU countries. Persons below that level can ignore MOSS and account for their home country output tax on international sales. Unless a special provision is introduced, this simplification will end with the transitional Brexit period.

A business that makes supplies of services that are treated as made outside the UK does not make taxable supplies in the UK, and such sales do not count towards the registration threshold. If such a business is established in the UK or has a fixed establishment here, it is entitled to register and to recover UK input tax on a VAT return, as long as the foreign supplies would be taxable (as opposed to exempt) if they were made in the UK.

A business that does not make supplies here and has no establishment here is not entitled to register – if it incurs VAT on costs in the UK, it can only claim it back using the electronic refunds procedure (for EU businesses) or the 13th Directive (if not established anywhere in the EU).

The distinction between 'UK, zero rated' and 'outside the scope' is particularly important for traders using the flat rate scheme (FRS) for small businesses. VAT will not be added to either type of supply when charged to the customer; however, FRS VAT at the trader's appropriate rate will have to be accounted for to HMRC on the zero-rated supplies (export of goods). No FRS VAT is due on the outside the scope supplies of services.

Paperwork

To determine the POS of services, it is necessary to establish the customer's status ('B' or 'C'), location (place of belonging) and capacity (business acting as such, or for private purposes).

Normally, a foreign business customer will volunteer evidence to avoid being charged UK VAT. In general, the Implementing Regulation provides that a foreign VAT number can be accepted as evidence of all three factors, unless the supplier has reason to consider that the POS should not be governed by the basic B2B rule. However, a foreign VAT number is not an absolute requirement, as it is for zero rating a despatch of goods; nor is there any equivalent of the requirement for evidence of movement. Other evidence of the three factors can justify charging no VAT.

Supplies that have been treated as outside the scope of B2B supplies to EU VAT-registered businesses must be reported on a quarterly sales list. They are not identified separately on the VAT return – they are included in box 6, but not in box 8, which is only used for goods.

Conclusion

With regard to the POS of services, I have always considered the rules to be the equivalent of a Zoom background – I may be sitting at my desk looking out at British rain, but if I am advising a foreign client, the VAT Act transports me to a different place. In the middle of lockdown, that is perhaps the closest I will get to foreign travel for a while.

Author details

Mike Thexton MA FCA CTA is a director of Thexton Training Ltd and author of the *LexisNexis Online Quarterly VAT Update*.

FIND OUT MORE
On Taxation.co.uk

- VAT place of supply rules for goods: tinyurl.com/yb5whg3c
- EU VAT changes affecting cross-border transactions: tinyurl.com/ybpn3ha7
- VAT on UK business selling overseas: tinyurl.com/yxq4xlpl