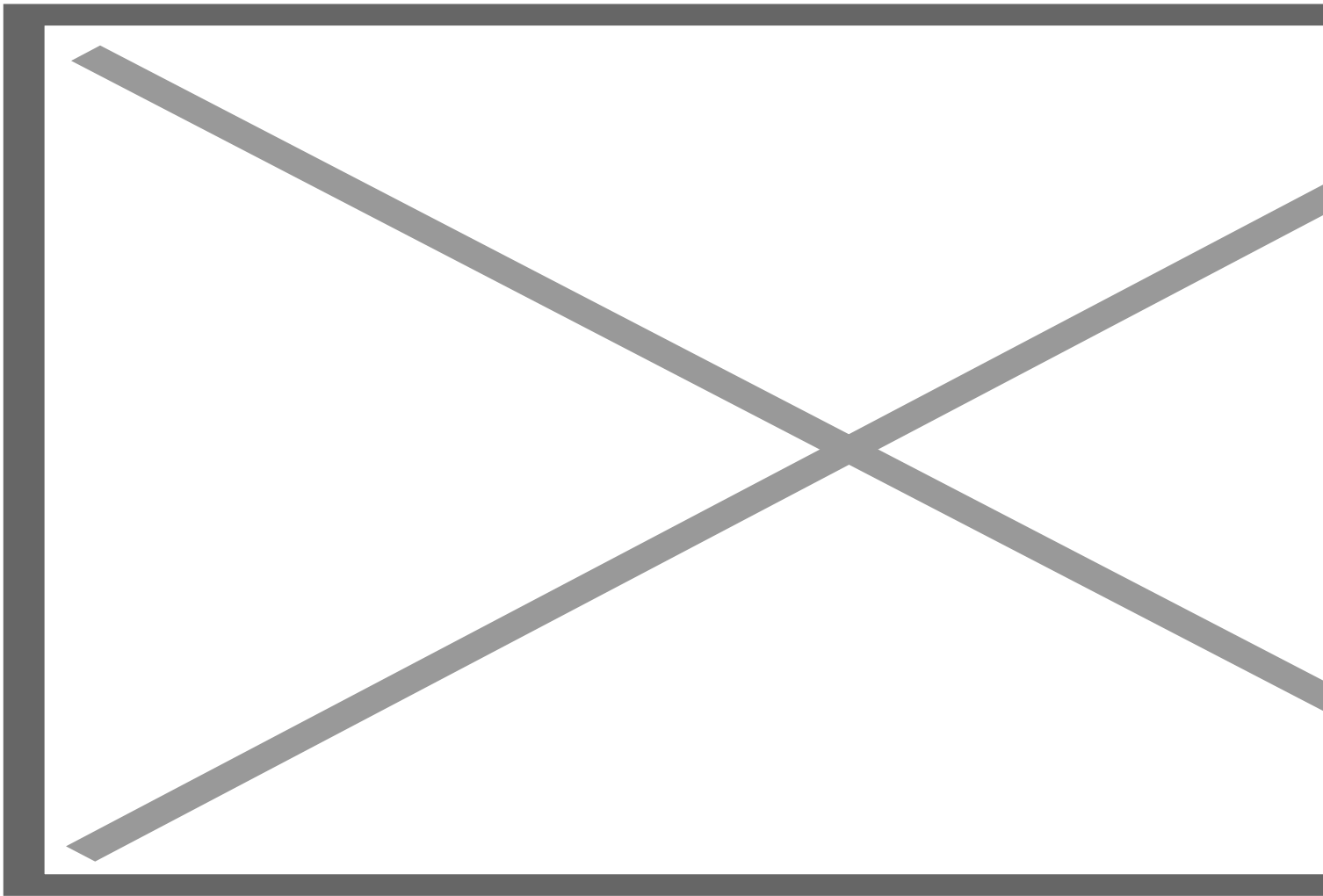


Word games

Indirect Tax



30 September 2021

Neil Warren considers ten common phrases that are used in the VAT legislation and HMRC's public notices, and seeks to simplify them with practical examples about what they actually mean

Key Points

What is the issue?

Complicated VAT phrases need to be understood so that you don't give confusing advice to clients.

The same VAT meaning can sometimes be described in two different ways; e.g. 'economic activity' and 'business activity' basically mean the same thing.

What does it mean for me?

It is important that written advice to clients uses the simplest possible phrase to avoid confusion and, in areas of doubt, should be supported by a practical example or simple analysis. For example, many clients might think that a 'taxable sale' is one that is only subject to 20% VAT.

What can I take away?

An understanding of VAT phrases and their meaning might help to save tax for clients. For example, a business can register in some cases and claim input tax, even if it does not have taxable UK sales with the principle of 'outside the scope with recovery'.

I enjoyed the comment of the judge in the recent Court of Appeal decision in the VAT case of Royal Opera House Covent Garden Foundation v HMRC [2021] EWCA Civ 910):

'The principles of VAT law can appear more obscure than they need, partly because some of the most important terms are unfamiliar to all but the specialists.'

I agree with what he says and have always tried to use simple words and phrases where possible, not easy in the complex world of the nation's favourite tax. So, in this article, I will quote ten commonly used VAT phrases and try to simplify them with practical examples. Wish me luck!

1. Place of supply

The phrase 'place of supply' means the country where VAT is payable. If the place of supply is the UK, it is subject to UK VAT rules; if it is outside the UK, it is not. In the latter case, it is outside the scope of UK VAT. So, for example, the sale of goods that start in China and go directly to America is outside the scope of UK VAT.

Some advisers wrongly think that the 'place of supply' for services is always the country where work is being carried out. But this is not correct: for 99% of B2B services, the place of supply is where the customer is based. So, for example, if a computer consultant in Manchester is sitting at his desk and doing work for a business in France, the place of supply is France. It is irrelevant where the work is being performed. This is known as the general B2B rule for services.

For B2C services, the default position is that the place of supply is where the supplier is based (see VAT Notice 741A paras 6.2 and 6.3). This leads to another important phrase...

2. General rule exceptions

The place of supply rules quoted above do not always apply and we have 'general rule exceptions'. Here are three common examples:

- **Land services:** The key issue is where the land or building is located. If a UK builder fits a new bathroom suite in a property that I own in Spain, the place of supply is Spain. The work is only liable to Spanish VAT.
- **Performance services B2C:** It is where the service is performed that counts (see VAT Notice 741A s 9 for a list of qualifying services). So, for example, a UK based opera singer performing in Berlin at a

private birthday party will need to charge German VAT, either by registering for VAT in Germany or, since 1 July 2021, registering for the One Stop Shop (OSS) scheme in an EU country of her choice. Professional services: The place of supply for many B2C professional services (e.g. accountancy fees) depends on where the customer is based rather than the supplier (see VAT Notice 741A s 12).

3. Outside the scope with recovery

The computer consultant mentioned above has earned fees from his French business customer which are outside the scope of UK VAT; the place of supply is France. However, he can still claim input tax on any UK expenses he incurs, assuming he is registered for VAT, because the service he has supplied (computer consultancy) would be subject to VAT if invoiced to a UK customer; i.e. subject to either 0%, 5% or 20% VAT.

If all of his work is for overseas business customers, with no output tax charged, then his VAT returns will always be net repayments; i.e. input tax exceeds output tax. This is known as ‘outside the scope with recovery’.

Here is a question for the Christmas tax quiz at your office party: is it possible to register for VAT if you don’t make any UK taxable supplies? The answer is ‘yes’ due to the outside the scope with recovery rules. The registration will be voluntary and can be backdated up to four years.

4. Taxable supply

There was a well-publicised situation some years ago when an HMRC officer misled a business owner about whether he needed to register for VAT. The business partly sold goods in the UK and exported others to America. The total sales figure exceeded the annual VAT registration threshold but the UK sales alone did not. The question was whether the business had to register for VAT. The officer’s answer was allegedly: ‘No, the registration threshold only includes taxable sales. You can ignore exports because they’re zero-rated.’

A ‘taxable sale’ is one that is subject to 0%, 5% or 20% VAT under UK law. If the sale is exempt from VAT, or outside the scope of UK VAT, then it is ignored for registration purposes and is not a taxable sale. So, for example, if the business had sold consultancy services to American business customers (outside the scope), rather than goods (zero-rated), the income would have been excluded from the registration test.

5. Taxable person

True or false? A taxable person is a business or entity that is registered for VAT. The answer is ‘false’ – it is a business or entity that is either registered for VAT or should be registered. A business earning annual taxable sales of, say, £100,000, but which has failed to register for VAT on time, is still a taxable person from the date it should have registered.

Don’t forget that it is a ‘person’ who is registered for VAT and not a business. The VAT system works on legal entities. So, for example, a sole trader hairdresser who is registered for VAT and earns extra income renting out a property she owns on Airbnb must account for VAT on both sources of income. But if she owned the property in joint names, say with her husband or civil partner, this would be a partnership for VAT purposes, a separate legal entity to her hairdressing business.

6. Economic activity

The phrase ‘economic activity’ is an EU phrase. UK law refers to ‘business activity’. An entity can only register for VAT if it is making or intending to make taxable sales ‘in the course or furtherance of any business carried on by him’ (see Value Added Tax Act 1994 s 4). There have been many disputes over the years about what is

classed as a business. Here are three tips:

- An activity does not need to make a profit to be classed as ‘business’.
- A one-off sale can still be business. For example, if I buy a plot of land with the purpose of building a house to sell at a profit, this is clearly a business venture, even though I will only make a single sale.
- It is still good practice to consider the six business tests of the landmark VAT case Lord Fisher [1981] STC 238, which have stood the test of time. (See HMRC’s VAT manual VBNB22000.)

7. Elect to waive exemption

This phrase relates to land and property, and the decision of a landlord or tenant with an interest in a building to charge VAT on future income. I think it is much easier to say ‘opt to tax’ rather than ‘elect to waive exemption’. Consider the following two sentences:

- John purchased a commercial property and made an election with HMRC to waive exemption on supplies connected to the building.
- John purchased a commercial property and opted to tax it with HMRC so he will charge VAT on the future income earned from the building.

The two sentences are saying the same thing but the first is confirming that income earned from the building will ‘not be exempt’; whereas the second is saying that it ‘will be standard rated’.

8. Multiple supply

I prefer the phrase ‘mixed supply’ – in other words, a business is making a supply of goods or services for a single price that contains two or more elements and which have different VAT rates.

Think of a gift item that consists of a standard rated pen and a zero-rated book, being sold for a single price of £19.99. How much output tax must the seller declare? The main challenge is to consider whether one of the supplies is ‘incidental’ and can be ignored – the VAT liability in such cases is wholly based on the main supply. If there is more than one supply, output tax must be apportioned in a fair and reasonable manner.

9. Reverse charge

The ‘reverse charge’ procedure means that the customer makes VAT return entries that would normally be made by the supplier. On 1 March 2021, the reverse charge principle was extended to many construction industry supplies, an anti-fraud measure to prevent a builder from charging 20% VAT to another builder on a sales invoice and disappearing with the VAT money. The builder receiving the services is no longer charged VAT by his supplier, doing the reverse charge on his VAT return instead.

The reverse charge extends to the purchase of services from abroad – note the word ‘abroad’ and not ‘EU’. So, for example, a UK accountancy firm paying £10,000 to a bookkeeping business in India will account for output tax of £2,000 in Box 1 of its VAT return, claiming the same amount as input tax in Box 4. The net value of the payment will be included in the inputs and outputs boxes of the same return; i.e. £10,000 in Boxes 6 and 7.

10. Partial exemption

Last but not least – partial exemption, which was the key issue in the Royal Opera case I mentioned at the beginning of this article. Most advisers are aware of the principles of partial exemption and its input tax challenges, so I won’t repeat them here. But to finish with a word scenario, input tax on expenses that relate to both taxable and exempt supplies (mixed costs and general overheads) can have three different descriptions,

depending on your reference point: residual input tax; non-attributable input tax; or 'the pot'. As someone who likes simple words, I prefer the last phrase!