Goods or services?

Indirect Tax

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Are we always clear on the difference between goods and services? Neil Warren explores

Key Points

What is the issue?

The amount of tax payable on a sale can be different in some cases, depending on whether a supply of goods or services is taking place

What does it mean for me?

If the correct VAT treatment is applied, there is less risk of a business making costly errors or getting queries from HMRC

What can I take away?

It is always important to be clear about the VAT liability of all goods and services, eg to establish the correct date of registration

In my article ‘Avoiding a trip up’ in February’s Tax Adviser, I highlighted how, when completing a VAT return relating to an overseas transaction, different boxes are checked depending on whether it is goods or services that are being bought or sold. This invites some follow up questions. Are we always clear on the difference between goods and services? And why is this difference important in the VAT world, apart from when it comes to completing the correct boxes on a return?

I’ll consider these important questions in this article, and their practical relevance when it comes to dealing with the nation’s favourite tax.

Goods or services

The HMRC definition of a supply of services is ‘something other than supplying goods’ (VAT Notice 700, para 4.5) – which is a very long list!

However, the definition is extended to include the phrase ‘done for a consideration’. This is good news, because it means there is no VAT to worry about on a free supply of services, such as an accountant doing the year-end accounts for a local charity without making a fee charge.

The difference between goods and services is clear in most cases, because goods are usually tangible and can be seen by the customer. To give some everyday examples, a chair, a computer and a cricket bat are obviously goods; while builders, barristers and beauticians are supplying services because the customer is paying for the skills of the individuals in question.

However, there are a number of borderline situations, usually when computer supplies are involved (see ***Example 1***).

Example 1

Mike is VAT registered and is an expert on marketing. He produces a monthly newsletter for UK subscribers, providing advice and tips on marketing. The newsletter has always been posted to subscribers in paper format, but with effect from 1 January 2015 it was emailed to subscribers instead.

What is the VAT position?

The paper copy qualifies as a supply of goods, eligible for zero rating because it is printed matter under VATA 1994 Sch 8 Grp 3. However, the email newsletter means that the customer is receiving a supply of services – and the supply is therefore standard rated.

Note: the recent CJEU cases of Commission v France (C-479/13) and Commission v Luxembourg (C-502/13) confirmed that any reductions in the standard rate of VAT for reading material can only apply to printed books and not ebooks. The court ruled that, on the basis that ebooks are downloaded from a website, they are considered to be ‘electronically supplied services’, and not ‘books on a physical means of support’. As such, they are explicitly excluded from the VAT reduced rate provisions. This was a bad result for publishers in both countries, where domestic legislation allowed them to account for lower rates of VAT (3% in Luxembourg and 5.5% in France).

Computer software supplies

What is the situation regarding computer software supplies?

For example, if I go into my local store and buy a copy of a standard accounting software package off the shelf, such as Sage Line 50, this is a supply of goods. This is because the software is a mass produced item that is freely available to all customers. In effect, boxed sales of personal and home computer software, game packages, etc are all classed as a supply of goods.

In contrast, if I order a ‘specific’ software product for my own requirements (ie instructing a programmer to create a unique program just for me), this is a supply of services. The expertise of the person(s) producing the package means I have paid for his or her services.

As another practical example of the importance of deciding whether supplies relate to goods or services, think of an importer's predicament when he buys the latest technology product from the US. Does he have to declare his product as an import of goods (in which case, he must pay VAT at the time of import into the UK and reclaim this amount as input tax on his VAT return)? Or is he making an import of services (in which case, he can import the product VAT free, as a B2B purchase, and deal with the VAT on his next return using the reverse charge system – whereby output tax is declared in Box 1 and input tax is reclaimed in Box 4, subject to normal rules)?

The rules in the above situation are helpfully clarified by HMRC in Notice 702, para 7.5. These state that 'normalised software' (such as Sage Line 50) is treated as an import of goods, but 'specific software' represents a supply of services.

The same approach about whether a supply is a mass produced or a specific software product applies to computer supplies sold abroad (see ***Example 2***).

Example 2

Mary is UK based and has designed a software package about stock control for a clothes wholesaler in France, charging £20,000 for her services. The package is hand delivered to the customer on a disk.

Mary is making a supply of services (a bespoke software product designed for the customer) to a business customer outside the UK; and her fee is outside the scope of VAT under the general B2B rule. The fact that the software is supplied on a disk is irrelevant – the disk has no monetary value.

The decision about whether the supply is of goods or services is important for Mary's VAT compliance procedures. If she is making a supply of goods (which is not the case in this example), she must retain evidence that the goods have left the UK (proof of export); otherwise HMRC could treat the goods as being supplied in the UK and raise a VAT assessment.

Transfer of ownership – HP or lease?

A supply of 'goods' takes place when there is either:

- any transfer of the whole property in goods; and
- the transfer of possession of goods.

So how do the above situations apply to hire purchase (HP) and leasing agreements?

The key point with a HP agreement is that the intention is for the ownership of the goods to pass to the hirer at some point in the future, usually when the final payment has been made. The transaction therefore relates to a supply of goods.

The first instalment paid to the HP company usually includes a deposit on the asset and full payment of VAT based on the value of the goods. The hirer can reclaim input tax (subject to normal rules), even though he is paying for the goods over a longer period of time.

Contrast the above situation with the common lease hire arrangement for a car in ***Example 3***.

Example 3

John is a VAT registered management consultant. He pays £400 each month to lease a car for three years and will then return it to the leasing company at the end of the period. In this situation, there is neither a transfer in the property of the goods, nor in the possession of the goods.

The monthly instalments of £400 therefore relate to a supply of services and VAT should be charged at 20% (£80). As long as the vehicle has some business use, John can claim 50% input tax recovery on each instalment (£40), again subject to normal rules (see HMRC Notice 700/64 s 4 concerning the 50% claim procedures).

Note: the best approach is to study the written agreement between the buyer and seller, and the intention as far as ownership is concerned. To give an EU legislative reference, Article 14(2)(b) of Directive 2006/112/EC rules that there is a supply of goods where ‘in the normal course of events’ ownership will pass at the latest upon payment of the final instalment.

Flat rate scheme and VAT registration

Think of the implications for both the flat rate scheme (FRS) calculations and the date a business needs to VAT register, with regard to computer software supplies and when deciding whether goods or services are being sold.

Going back to Mary in Example 2, if she is selling computer services to an EU business customer outside the UK (or to any customer outside the EU), this income is ignored as far as the VAT registration thresholds are concerned; it is outside the scope of VAT, and therefore not taxable. Therefore, if a UK business sells software to French business customers (£30,000 a year), to American non-business customers (£20,000 a year) and to UK customers (£60,000 a year), then it does not need to register (unless it wants to on a voluntary basis). This is because annual taxable sales of £60,000 are less than the registration threshold of £82,000 that took effect on 1 April 2015.

So what are the implications for a FRS user? This is where there is good and bad news to report:

- any sales that are outside the scope of VAT are ignored as far as the scheme is concerned – no tax is payable in Box 1 and the fees are also excluded from Box 6 (outputs); and
- tax is payable, however, on zero rated and exempt sales, even though no tax is charged to the customer.

As a final example, let us imagine that Mary has made two sales to Pierre, who is VAT registered in France:

- the sale of a computer for £1,000; and
- the sale of a piece of specific computer software that she has designed for him, for a charge of £2,000.

The sale of goods to a VAT registered business in another EU country is zero rated, as long as the goods leave the UK and proof of shipment is retained by the supplier. And as explained earlier, the £2,000 software sale is outside the scope of VAT under the general B2B rule, and so is excluded from the scheme. However, FRS tax is payable on the computer sale, based on £1,000 multiplied by Mary’s relevant FRS percentage. *C’est la vie*.