

PLACE OF SUPPLY AND REVERSE CHARGE CHANGES 2010

The issue

VAT is a tax on both goods and services. Where the supplier and recipient are located within the same country it is relatively easy to determine the jurisdiction in which a supply of goods or services should be taxed, - even if it is less straightforward to determine whether it should be taxed. Where a supply is originated in one country for the benefit of a recipient in another, there is a need for a framework of rules to decide whether the supply should be taxed in one or other of the countries concerned and if it should, in which one.

This framework is known as the 'place of supply' rules and important changes are being introduced from 1 January 2010 to the rules for determining the place of supply of services. The changes will affect the determination of the place of supply and the arrangements to be made for the assessment of VAT on services.

These changes may have a very significant impact on the VAT costs suffered by charities - including many not currently registered for VAT - and the remainder of this briefing considers that potential impact.

We make grants or work in partnership - we don't receive 'services'

For some organisations - those that are clearly purchasing services from

overseas - the relevance of this change will be clear. For many others there may be a significant problem that has not been recognised. The problem will be because the organisation does not describe the relationships it has with other organisations outside the UK in commercial language such as 'supplies of services'.

If the interpretation of what constitutes a supply of services between UK and overseas bodies can be assumed to follow that which has been upheld in UK cases, a 'supply of services' might include, for example, the administrative retention passed to a partner organisation as part of a donor funded project or the portion of donations retained by a network's country programmes to cover 'core costs'.

Such round sum elements of a funding agreement 'even where a common sense reading of the relationship is passing on donations or donor funds to a partner organisation' can be interpreted by HMRC as a payment for a supply of 'management services'.

Place of Supply Rules

The place of supply of services is determined with reference to the nature of the supply and where the supplier and recipient of the services are deemed to have either a fixed or business establishment. Identifying where an organisation is established, or where it belongs, is sometimes a matter of

interpretation, but broadly both require an element of human and technical resource to be deployed in a country for a recipient to be recognised as having a presence for VAT purposes.

Historic Position

For many services, the place of supply has been established specifically in long standing rules and will not change. This includes those services known as Schedule 5 services which are deemed to be supplied where the recipient belongs. (Schedule 5 services include advertising, services of consultants which include research services, supplies by accountants and solicitors.) It also includes specified services which are deemed to take place where they are physically performed and a number of land related services which are supplied where the land is situated.

For a large number of other services including 'management services', the fall back position (known as the basic rule) has deemed the place of supply to be where the supplier was established.

It is this basic rule that is being changed.

Changes being introduced from 1st January 2010

In January 2010 the basic rule for the place of supply will alter so that the place of supply of services to a 'relevant business person' (1) will now be deemed

to be the place where the recipient of those services is established. Under the previous rule (based upon the location of the supplier) the onus fell on the supplier to charge VAT in accordance with the law of the relevant country. Where the supplier does not charge VAT and there is no movement of physical goods, it falls on the recipient to account for the VAT in their own jurisdiction - the 'reverse charge'.

Where the supply is received as part of an activity which is a taxable business supply, the 'reverse charge' has a neutral effect, it is declared as due to HMRC arising from the supply received but recoverable as input VAT by the charity. However, where the supply is received for exempt or non business activity, the charity will be required to declare VAT on the supply received but be unable to recover that VAT. As the VAT chargeable in this way counts towards the registration threshold, it is likely that many charities not currently registered may be faced with registration only to pay over this newly arising VAT.

(1) A relevant business person is a person which is:

- A taxable person within the scope of Article 9 of the Principal VAT directive (this means anyone who has an economic activity whatever the purpose or result of that activity).
- Registered for VAT in the UK.
- Registered for VAT in another Member State.
- Registered for VAT in the Isle of Man.

A charity will be in business (for VAT purposes) if it runs fundraising events (which are exempt from VAT) even though it may not be VAT registered.

Supplies to non business persons (for VAT purposes) will still be taxed where the supplier belongs.

Changes to the application of rules for 'Non Business' activities

From 1 January 2010, if the customer is engaged in both business and non business activities then any supplies to them will be treated as a supply to a relevant business person and the new place of supply rules will apply.

In addition, HMRC has changed its view (largely as a result of cases brought in European Courts) on the need to account for VAT, under the reverse charge procedure, where the supply is used for a non business purpose. Historically, HMRC did not expect that the supply should be included in the reverse charge procedure. However, from 1 January 2010 all services received, whether for a business or non business reason, will fall under the reverse charge procedure.

This means that where a UK charity receives supplies of services from a non UK supplier, even if it is for a non business purpose, the supply will be caught under the reverse charge rules and incur a VAT cost unless the charity carries out no 'economic activity' whatsoever.

The implications

HMRC has confirmed that the change of rules could bring items such as the administration allowance in funds paid to overseas organisations into the scope of the reverse charge rules for supply of services. Whether this is the case will depend upon the terms of the agreement between the UK charity and its partner(s). Where arrangements such as this or more straightforward receipts of services supplied from overseas exist charities should consider:

- Are the services 'received' in the UK? If the charity has no establishment outside the UK the answer will almost certainly be 'yes'.
- Is the charity a 'relevant business person'? If the charity undertakes fundraising trading, organises fundraising events, or is engaged in primary purpose trading then the answer is 'yes' even if these are occasional and very minor in the scope of the charity's overall activity.

There are steps that can be taken to clarify the arrangements in place and to ensure that determination of the place of supply will not be unfavourable. Equally there are temporary measures that can give the charity time to consider the matter fully before any tax becomes due. We recommend charities act quickly.

EXTRACT FROM EUROPEAN LEGISLATION

ART 9 - Taxable Persons

9(1) 'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.