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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

Regular readers of the Indirect Tax Update will be aware that, last year, HMRC issued a Revenue & Customs Brief concerning the VAT treatment of termination and similar payments. Following Court of Justice judgments in two Portuguese cases (MEO Telecoms and Vodafone Portugal) – which concerned the termination of mobile phone contracts by consumers, HMRC considered that it was necessary to change its policy.

Revenue & Customs Brief 12/2020 - published 2 September 2020 – set out HMRC's new policy on early termination payments. However, it was not limited to just consumer contracts (as in MEO and Vodafone) but HMRC considered that the new policy should also apply to all situations where a supplier charges their customers to withdraw from agreements to supply goods or services or receives compensation for early termination. HMRC also indicated that this new policy would be implemented retrospectively and businesses would be obliged to correct any VAT accounting errors in the previous four years.

Having considered representations by many concerned taxpayers and advisors (including Grant Thornton UK LLP), we understand that HMRC is to withdraw R&C Brief 12/2020 and is to implement the change in policy from 1 February 2021. HMRC has also provided further clarification on the scope of the charge and has issued draft guidance for comment.

Following Brexit, HMRC has also updated its guidance on how businesses should account for VAT on the movement of goods between GB and NI from 1 January 2021.

Finally, we take a look at the EU VAT changes that are to come into force in July 2021 in relation to e-commerce. These changes were, initially, intended to come into force in January 2021 but have been delayed across the EU due to the impact of the global Coronavirus pandemic. More VAT changes are on the way and UK businesses need to prepare.

Early termination and compensation payments

HMRC to withdraw Revenue & Customs Brief 12/2020

In September 2020, following earlier judgments from the Court of Justice, HMRC issued Revenue & Customs Brief 12/2020. The issue covered by the Brief was the VAT treatment of early termination and similar compensation payments. The Brief stated that, following the Court of Justice judgments in MEO Telecoms and Vodafone Portugal, the UK's treatment of such payments needed to change. That in itself was not really surprising as policy often changes as a result of case law developments. However, in this case, what was surprising was that firstly, HMRC stated in the Brief that the policy change would be implemented retrospectively and, secondly, that it would apply to a far wider set of circumstances than just the early termination of consumer contracts.

The MEO and Vodafone Portugal cases concerned the early termination of mobile phone contracts by consumers. The Court of Justice ruled that, in circumstances where a payment is received by the supplier in a situation where the consumer terminates a contract early and that payment is required as a term of the original contract agreed with the consumer, then the payment is to be regarded as further consideration for the original supply of telecoms services and liable to VAT. In other words, where the supplier, in effect, receives what would have been due under the original contract and the customer knew in advance that he would be required to make a payment on early termination then the payment must be regarded as payment for the supply of telecoms services.

When issuing R&C Brief 12/2020, HMRC considered that the new policy did not just apply to the early termination of consumer contracts but should also apply to other situations where a termination or compensation payment is stipulated in the contract. This, according to HMRC would include such payments as liquidated damages and dilapidation payments. However, it was not the change in VAT treatment that caused concern, but it was HMRC's statement in the Brief that the new policy simply confirmed what the law should have always said and would, therefore, be imposed retrospectively. Businesses that had received early termination or compensation payments in the previous four years were required to make corrections to their previous VAT returns despite the fact that HMRC's published guidance at the time stipulated that such compensation payments were outside the scope of VAT. This retrospective implementation was the catalyst for many businesses and their advisors (including Grant Thornton UK LLP) to make representations to HMRC. There was concern that HMRC's new policy widened the impact of the Court of Justice judgments beyond what was required and that the retrospective implementation of it offended established principles of legitimate expectation.

Having listened to these representations, HMRC has announced that it is to withdraw Revenue & Customs Brief 12/2020 in its entirety. It has received advice from tax Counsel that it has an arguable case to not apply the changes retrospectively and will not now do so. Instead the policy change will come into effect on 1 February 2021. In situations where HMRC and a taxpayer are already in litigation in relation to this issue, HMRC is to consider the specific facts of the case and, if necessary, it will alter the line it has taken to date. HMRC has also undertaken to provide draft guidance for comment (which it has done) and will issue a new Revenue & Customs Brief covering the issue in early February 2021. HMRC has stated that early termination and similar payments will be treated as consideration for the underlying supply if they form a cost component to the supplier of making the intended supply available or they are broadly equivalent to what would have been charged for that supply. However, where a charge is made which is provided for in a contract, but which is not directly linked to the intended supply, it will continue to remain outside the scope of VAT. HMRC's draft guidance also covers early termination of contracts (similar to the MEO and Vodafone cases) and cases concerning compensation payments such as liquidated damages. Look out for our more detailed Briefing Paper on this subject.

Comment – It is good that HMRC has listened to the representations that have been made. However, had it consulted more widely at the outset, there would have been no need to withdraw the Revenue & Customs Brief. Businesses that receive termination or compensation payments should take note of the revised policy.

Moving goods between GB and Northern Ireland post Brexit

HMRC updates Brexit guidance

HMRC has updated its guidance on the VAT treatment of goods moving between Great Britain (GB) and Northern Ireland (NI) (GB being the UK minus NI).

As NI remains part of the UK, but also part of the EU Single Market, businesses in NI are, in essence, governed by two sets of VAT rules. However, HMRC has stated that to all intents and purposes, VAT on supplies made between NI and GB (and vice versa) will continue to be treated under the existing UK VAT system. This means that VAT will be charged in the normal way and accounted for through the UK VAT returns. However, there are special rules that will apply where supplies of goods are made by a GB business but the goods are transported via NI to an EU Member State (such as the Republic of Ireland). For these movements, the VAT treatment will depend on the specific circumstances or arrangements agreed between the seller and customer. Broadly, it will depend upon where the goods are situated at the point at which the transfer of rights to the goods takes place.

Under the new rules, where goods are located in GB at the time of supply but are then subsequently moved to a Member State via NI, the GB supply will be treated as a zero-rated export. However, the movement will trigger an import VAT liability and, in the circumstances, the GB seller will be required to include the import VAT charge in its price to the customer. The seller will account for the import VAT as if it were output tax due and the customer will then reclaim that import VAT through the EU's VAT refund system.

If the goods are moved to NI from GB before they are supplied, there will be two VAT events. Firstly, the supplier will be deemed to have moved his own goods and must account for and reclaim any VAT due through his UK VAT return. The second movement (from NI to a Member State) will be treated under the EU VAT rules for acquisitions and despatches.

Comment

These new rules are a consequence of the UK's departure from the EU and the terms of both the Withdrawal Agreement and the Northern Ireland Protocol.

Businesses that trade goods involving movements to NI need to consider these new rules in detail especially in relation to movements that begin in GB and are shipped to an EU Member State (including but not limited to the Republic of Ireland) via NI.

Suppliers will need to ensure that any import VAT due is accounted for in the correct way and, more importantly, charged to and recovered from their customers. HMRC will expect businesses to account for such import VAT regardless of whether the VAT has been passed onto the supplier's customer.

Get ready for more EU VAT changes

New EU 'B2C' VAT rules to come into effect 1 July 2021

From 1 July 2021, a number of amendments to EU VAT law will start to apply affecting the VAT rules applicable to cross-border business-to-consumer (B2C) e-commerce activities. According to the EU Commission, the rationale for these changes is to overcome the barriers to cross-border online sales. In particular, the changes will address challenges arising from the VAT regimes for distance sales of goods and from the importation of low value consignments. Presently, there is a significant administrative burden placed on traders which impedes the development of intra-EU online trade. In addition, many non-EU suppliers do not comply with the EU's VAT rules which puts EU businesses at a significant disadvantage. The new rules are intended to level the playing field and to simplify VAT obligations for businesses engaged in cross-border e-commerce.

The main changes coming into affect on 1 July 2021 will be the adoption of a One Stop Shop system (similar to the existing MOSS scheme for digital services etc). This system is to be extended to other B2C services (ie not just digital), to intra-Community distance sales of goods as well as to certain domestic supplies of goods. As from 1 July 2021, businesses not established in the EU supplying services to non-taxable persons (consumers) in the EU do not need to register for VAT in each Member State in which their supplies of services take place. Instead, the VAT due on these supplies can be declared and paid in one single Member State (the so-called Member State of identification) via the One Stop Shop (OSS, non-Union scheme).

The new rules do not change the place of supply of those services, but only offer a simplified procedure to declare the VAT due in the EU Member States where the supply takes place.

Comment

The extension of the Mini One Stop Shop into an all-encompassing One Stop Shop will mean that UK suppliers will be required to register under the Non-union scheme for all supplies of goods or services supplied to EU consumers after 1 July 2021.

The changes are far reaching and comprehensive and affected businesses need to familiarise themselves with the new regime as soon as possible.

The changes were intended to be introduced on 1 January 2021 but were delayed due to the impact of the global Coronavirus pandemic.

Look out for our guide on "B2C EU trade" which is to be published shortly.

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