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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

Unless HMRC decides to delay implementation for a third time, the construction services domestic reverse charge (DRC) is set to come into force on 1 March 2021.

Given that businesses in the UK have been affected by the introduction of Making Tax Digital, extensive changes to the VAT regime in the UK brought about by Brexit and massive economic disruption as a result of Covid-19, HMRC may consider a further delay. There have been no hints of this but, given that the pandemic was the reason for the 2nd delay and the UK is now in a much worse position vis a vis the pandemic, it seems sensible for implementation to be delayed further.

Assuming, however, that no further delay is announced, businesses must prepare for its introduction. The new measure shifts the responsibility for accounting for VAT to the customer. This is done by applying a 'reverse charge' to affected supplies. Essentially, the customer must account on his own VAT return for the output tax that, ordinarily, would be accounted for by the supplier. The customer then, if eligible, reclaims that VAT as input tax on the same VAT return.

This is an anti-fraud measure which should prevent unscrupulous suppliers from charging and collecting VAT from their customer and then disappearing without paying it over to HMRC.

The Advocate General of the Court of Justice has also issued an opinion this week that will have a major impact on self-employed lorry drivers who are engaged to transport Excise goods (beers, wines, spirits and tobacco etc). The AG considers that drivers are liable for any Excise duty that is found to be due in respect of their load.

Finally, we look at a Court of Justice judgment in a case concerning the provision of a car to an employee. The issue was whether a supply of the vehicle for no consideration should be regarded as "the letting on hire of a means of transport".

Construction: Domestic Reverse Charge (DRC)

DRC due to come into force 1 March 2021

It seems a long time ago since HMRC announced that it was to introduce a DRC in the construction sector. The idea was first mooted in the Autumn Budget of 2017 and was, initially, intended to be introduced in October 2019. However, despite a long lead time, businesses were not prepared for the initial implementation date and it was deferred by a year to October 2020. Then, along came Coronavirus and HMRC took a manifestly sensible and pragmatic view that implementation should be further delayed. Accordingly, the date was shifted once again to March 2021. In light of the resurgence of the pandemic and the third lockdown, it does seem equally sensible and pragmatic for the implementation to be delayed further. However, at the time of writing (late January 2021), there is no hint from HMRC that this will happen. So, unless there is a last-minute change of heart, the new rules will come into force in just over eight weeks' time.

This new measure essentially shifts the responsibility for accounting for VAT on affected supplies from the supplier to the customer. It does not change the VAT liability of any supplies, nor does it change the VAT registration liabilities of any entities. It does, however, substantially change the VAT reporting obligations, and crucially the cash flow position, of those affected. When the implementation date was delayed, HMRC also took the opportunity to amend the legislation and guidance. In particular, the new regime will now not apply if the recipient of the construction service is an 'end user' or a 'relevant intermediary' and the recipient has notified the supplier in writing or has a written agreement with the supplier which confirms that status.

Similarly, in previous guidance, parties could look across all contracts, and if DRC supplies exceeded 5%, they could opt to apply DRC to all supplies. This was not within the original legislation, only the guidance, but this has now seemingly been removed. The new guidance also includes an additional 'concession' (but again, not within the legislation) which states that if the value of supplies within DRC equate to 5% or less, the DRC does not need to be applied to that element, and the normal rules can (i.e. optionally) be used for the entire supply.

In a VAT context, the introduction of DRC coincides with both the requirement to start settling VAT payments that were deferred under COVID measures, the mandating of the 'digital links' requirement under the Making Tax Digital regime and significant changes brought about by Brexit. If DRC does come into force in March, it will need some careful thought and preparation. In addition to the VAT contexts, it also coincides with two other related tax measures that are due to take effect on 6 April 2021. Firstly, there are proposed changes to the CIS regime, which include changes as to how a 'deemed contractor' is defined for CIS registration purposes. Since DRC affects only those that are CIS registered, the scope of these new measures will need to be carefully considered. The new CIS rules for registration will be based on a 'rolling' threshold which requires businesses to track construction spend on a 'real time' basis. This may lead to an increased administration burden for businesses and also an increased risk of breaching the rules, which could result in significant penalties.

There are also changes to the off-payroll working rules (IR35). If the contractor falls within IR35, this removes the requirement to operate CIS (as the contractor will be considered a 'deemed employee' for tax purposes), and therefore also from the scope of the DRC - and so the interaction of all these measures will need to be considered.

Comment – the new domestic reverse charge rules will have a significant impact on businesses in the construction sector. Coupled with everything else that is going on, it would seem sensible for HMRC to delay implementation again. However, with only eight weeks to go before implementation date, a further delay looks unlikely.

Court of Justice of the European Union – Advocate General's Opinion

HMRC v WR

It is not often that we focus on Excise Duty cases. However, this case concerns a referral from the UK's Court of Appeal on a point of EU law of great significance to self employed lorry drivers. In simple terms, WR was the driver of a lorry load of excisable goods (in this case beer) that arrived in the UK with documents that were incorrect. (The load was declared with an ECMS number that had already been used). HMRC took the view that as WR was in physical possession of the goods at the time when they became liable to duty, he should be liable to pay that duty.

The First-tier Tax Tribunal ruled against HMRC considering that, in the circumstances, and based on the facts, WR was an 'innocent agent' and could not be held liable. HMRC appealed to the Upper Tribunal but had its appeal dismissed. The Upper Tribunal considered that the FTT had reached the correct conclusion. HMRC then appealed to the Court of Appeal which decided to refer the matter to the Court of Justice for assistance in determining the exact meaning of the EU Excise Directive. The Court of Appeal asked the Court of Justice whether a person (such as WR) who has no legal or beneficial interest in the goods, was transporting the goods on behalf of others for a fee and knew that the goods were excise goods (but was not aware and had no reason to be aware that the goods had become chargeable to excise duty) could be held liable for the duty under the terms of the Directive.

Advocate General Tanchev issued his opinion on 21 January. In his view, the answer to that question is an emphatic "yes". The word 'holding' (as used in the Directive) is to be interpreted as including simple physical possession such as the situation of WR. The AG also considers that same conclusion must also apply where excise duty is due from 'any person who participated in the irregularity'. A person such as WR who transports goods and is in possession of them at the time when the irregularity takes place may be considered to 'participate' in the irregularity, even if only in a passive and inadvertent manner.

Comment

In this case, the driver worked for cash and had no knowledge of the excise status of the load he was carrying. He was, as the FTT and Upper Tribunals concluded, an 'innocent' agent.

However, he was also in possession of the excisable goods at the point when duty became payable and in the absence of anyone else, the Advocate General considers that WR became the person liable to pay. Assuming that the full court agrees with the AG, the mere act of transporting the goods means that drivers such as WR will be regarded as participating in an irregularity concerning the movement of the goods. As such, the driver can be held liable by the relevant tax authority.

Such a liability should make drivers think twice about accepting contracts for the movement of excise goods.

Court of Justice – Judgment - QM

Place of supply

This was a referral to the Court of Justice by the German courts concerning the place of supply rules in relation to the 'letting on hire of a means of transport'.

QM is a business established in Luxembourg. It made cars available to two employees both of which were resident in Germany. One of the employees paid nothing for the use of the vehicle while the other employee contributed an amount from his salary. The questions to resolve were firstly, whether, in those circumstances, QM made a supply of the vehicles for VAT purposes and, secondly, if that were the case, what was the place of supply.

The Court of Justice has issued its judgment and has confirmed that, for employee 'A', (who paid nothing for the use of the vehicle) there was no supply of a letting on hire of a means of transport and, as such, no VAT was due. However, as far as employee 'B' was concerned, there was a hire of the vehicle for a specific period and in return for a 'rent'. That constituted a supply for VAT purposes and, in particular, a supply of the letting on hire of a means of transport.

Under Article 56(2) of the VAT Directive, as the hire was for a period in excess of 30 days and, as the hire was to a non-taxable person (employee 'B'), the place of supply was the country where the customer had his usual place of residence. In the circumstances, therefore, the place of supply of the letting on hire of a means of transport was Germany. Accordingly, the Court considers that QM made taxable supplies in Germany and German VAT was therefore due on the supply to employee 'B'.

Comment

Whilst the UK is now out of the EU and is no longer subject to the VAT Directive, this case demonstrates how a UK business could fall foul of EU VAT law.

It is clearly possible for a UK business to provide a means of transport to an employee based in a different tax jurisdiction and to deduct the cost of providing the vehicle to the employee in question.

In such circumstances, the Court of Justice considers the charge to the employee to be consideration for a taxable supply of the letting on hire of a means of transport taxable in the country where the employee is normally resident.

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