Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

This week's edition of Indirect Tax Update is the last edition before a summer break. Generally, the Courts and Tribunals do not issue judgments or decision during the summer months so we will also take a break and will return with ITU 29/2020 in early September.

Obviously, if there are any major developments that require reporting during the break, we will issue an appropriate alert.

The main topic on the agenda for many businesses in the remaining half of 2020 will be the preparation for Brexit and in this week's edition of Indirect Tax Update we take a look at some of the changes that will take place as a result of the UK leaving the EU.

In particular, businesses involved with 'distance selling' to customers in the remaining EU countries will need to familiarise themselves with the new VAT rules from 1 January 2021. Businesses moving goods between Northern Ireland, Great Britain (ie England / Scotland and Wales) and the EU will, effectively, have two VAT systems to deal with and will need to ensure that they are compliant with the new rules.

The Upper Tribunal has issued a judgment this week in the case of Milton Keynes Hospitals NHS Foundation Trust v HMRC. This appeal concerned the recovery of VAT incurred by the Trust. The Trust claimed and recovered VAT under the Contracted Out Services directions in respect of expenditure on IT equipment. HMRC subsequently took the view that the Trust was not entitled to that refund, and assessed it for the amount which (according to HMRC) had been overclaimed.

Finally, this week, HMRC has issued guidance in connection with the introduction of 'postponed accounting' – the system to be introduced from 1 January 2021 to deal with import VAT. The guidance covers when businesses can and cannot use postponed accounting.

So, that's it – the ITU now goes on a summer break and we will be back in early September. If you are going on holiday, we hope you all have a relaxing break.

Preparing for Brexit

Distance selling and Northern Ireland

We make no apology for covering Brexit issues again in this week's ITU. There are now only 154 days left to the end of 2020 and businesses must start preparing for the major changes to VAT and customs that will come into force on 1 January 2021.

Distance Sales
Business involved with distance sales to consumers belonging in the EU and businesses involved in trading goods that move to or from Northern Ireland will, in particular, need to understand the complex new rules.

Distance sales are those which involve the supplier sending goods directly to a customer where the transport of the goods is arranged by the seller. Under the current rules, a business is required to account for VAT on the sale in the country where it is established. However, once the level of turnover from such sales exceeds a certain threshold, the supplier is then required to register for VAT in the member state where the customer is located and account for VAT in that country. A supplier can, however, volunteer to register in the Member State of his customer before the threshold is breached.

As a result of the Covid pandemic, the EU has deferred the implementation of a system known as the 'One-Stop-Shop' (or OSS) whereby suppliers will be able to register for VAT in a single Member State and account for VAT through the OSS system for all supplies to customers throughout the whole of the EU. As a result of that announcement after 1 January 2021, UK businesses will be required to import goods into the customer's Member State and account for VAT there through a VAT registration. Alternatively, businesses could import goods into a single Member State and then use the EU's distance selling rules for onward supplies to other Member States.

Northern Ireland
There are also some major changes coming into effect in relation to the trading of goods with Northern Ireland. Whilst Northern Ireland is clearly still part of the United Kingdom, from 1 January 2021, as part of the Withdrawal Agreement negotiated between the UK and the EU, Northern Ireland will exist as if it were still a Member State of the EU and a dual VAT system will exist in relation to the trading of goods which involve movements to or from Northern Ireland.

From 1 January 2021, goods arriving from the EU will continue to be treated for VAT purposes as intra-community acquisitions and will not require import declarations or any customs formalities. Goods being sent from Northern Ireland to a Member State of the EU will continue to be regarded as intra-community supplies (to other businesses) or distance sales (to consumers) and no export formalities will be required.

By contrast, despite being a part of the United Kingdom, under the terms of the Withdrawal Agreement the movement of goods between Northern Ireland and Great Britain (for these purposes the United Kingdom less Northern Ireland), and vice versa, will be regarded as imports and exports and will require customs declarations.

For goods moving between Northern Ireland and the rest of the world, normal import and export formalities will ensue.

Under the provisions of the Northern Ireland / Ireland protocol negotiated as part of the withdrawal of the UK from the EU, this dual system will prevail in relation to Northern Ireland for an initial period of four years and will be subject to periodic consent from the Northern Ireland Executive and Assembly thereafter. The Protocol prevents the need for a hard border between Northern Ireland and the Republic of Ireland and is, therefore, likely to prevail for the foreseeable future.

Comment – Businesses involved with the distance selling of goods into the EU after 31 December and involved with the trading of goods to or from Northern Ireland need to understand the new VAT and customs rules that will apply. There are many things to contemplate such as the appointment of fiscal representatives / VAT registrations within the EU, the appointment of customs agents etc. To ensure a smooth transition from the existing arrangements to the new rules, businesses need to consider the issues sooner rather than later.

Upper Tribunal – Milton Keynes Hospitals NHS Foundation Trust v HMRC

Whether Trust entitled to input VAT recovery and whether HMRC is entitled to assess?

The issue in this case is whether HMRC is entitled to assess the NHS Trust under section 73 of the VAT Act for VAT that the Trust had, in HMRC's view, reclaimed incorrectly on the purchase of certain IT equipment.

Under special arrangements (section 41 of the VAT Act), certain public bodies (including NHS Trusts) are entitled to reclaim VAT that they incur and pay to suppliers even though they are not regarded as "taxable persons" in relation to their core activities. In this case the Trust, which is an NHS Foundation Trust, used the special arrangements to reclaim VAT incurred on the purchase of IT equipment. HMRC rejected the claim and the Trust appealed to the First-tier Tax Tribunal (FTT) against that decision. That appeal (the substantive issue) has yet to be heard by the FTT. However, as a preliminary issue, the Trust also claimed that, as it was not a taxable person in relation to its core activities, HMRC was not entitled to raise an assessment against the Trust under section 73. It argued that that provision could only be utilised against taxable persons and, clearly, as it was not a taxable person, that precluded HMRC from raising an assessment.

The FTT dismissed the Trusts appeal in relation to that preliminary issue and the Trust appealed to the Upper Tribunal. It argued that, as EU VAT law did not permit the recovery of VAT by non-taxable persons, the VAT claimed under the UK's special arrangements was, somehow, not VAT and could not, therefore, be assessed under section 73. The Trust argued that the FTT was wrong to find otherwise.

The Upper Tribunal disagrees and has dismissed the Trust's appeal on this preliminary issue. Section 73 is clear. It refers to VAT credited to a person that should not have been credited as being assessable regardless of whether the person is a taxable person or otherwise. The use of the word 'person' as opposed to 'taxable person' is deliberate and allows HMRC to assess 'any' person where they consider that VAT has been overclaimed or credited to them.

Comment

This is quite a novel argument. In essence, the Trust argued that it was not a taxable person and that, as a result, the provisions of s73 of the VAT Act (which give powers of assessment to HMRC) could not be applied to it.

Both the FTT and now the Upper Tribunal have rejected the arguments and, presumably, the point will now either be appealed further to the Court of Appeal or will be dropped.

The FTT will then consider the merits or otherwise of the Trusts substantive case (ie whether or not it was entitled to claim the VAT it had incurred on the purchase of the IT equipment.

Under general VAT rules, VAT can only be reclaimed by taxable persons acting as such so, ordinarily, an NHS foundation trust would not be entitled to reclaim any VAT incurred in carrying out that core activity. The reason for the existence of the special arrangement for public bodies is to allow such bodies to outsource where necessary without incurring irrecoverable VAT. Section 41 allows for the recovery of VAT incurred where the activity of the body is not regarded as an economic activity for VAT purposes.

HMRC guidance

Postponed Accounting – from 1 January 2021

For those with long memories, before the advent of the Single Market in 1993, the UK used to operate a system of VAT accounting on imports known as postponed accounting. Under this regime, there is no requirement to account for import VAT at the border (when the goods arrive) but an importer can declare the import VAT (and reclaim it where appropriate) through his VAT return.

That system is to return for all imports arriving in the UK from 1 January 2021. With Brexit, the number of imports into the UK is likely to rise by a factor of five. This is due to the fact that(with a few exceptions) goods arriving from the EU after 31 December 2020 will no longer be dealt with as intra-community supplies and acquisitions but will be treated as exports from the EU and imports into the UK. All imports into the UK will, therefore require a customs entry and import VAT will be payable if the goods in question would be liable to VAT if the goods had been supplied in the UK. In light of this, UK business would have been faced with cash-flow problems. In recognition of that, the Government has agreed to revert back to the old system of Postponed Accounting.

HMRC has published guidance this week on how Postponed Accounting will work. In essence, the arrangement will be available for all imports (not just those arriving from the EU as a result of Brexit). Any importer will be entitled to use Postponed Accounting and does not require prior authorisation. There are a number of conditions however. The goods being imported must be for use within the importer's business and the importer must declare his GB EORI and VAT registration numbers on the import declaration.

As a facilitation measure to help businesses through the coronavirus pandemic, the Treasury announced that businesses would be able to defer customs declarations for certain goods arriving in the UK for a period of 6 months. However, this deferral does not apply to import VAT. Any VAT due in relation to an import must be declared (and reclaimed) via the importer's VAT return for the relevant period under the Postponed Accounting procedure. The payment of import VAT cannot, therefore, be deferred.

Comment

When the Brexit transitional period comes to an end at 11pm (UK time) on 31 December 2020, the current system of dealing with the movement of goods between EU Member States will cease as far as the UK is concerned. From 1 January 2021, goods arriving from the EU will require a customs declaration and the payment of import VAT where necessary.

The Government has recognised that this sudden flux of customs entries and the requirement to pay import VAT would have had a significant impact on the cash-flows of all importers. Accordingly, it has decided to introduce a system of accounting for import VAT that was used in the UK before the Single Market came into effect in 1993. This system is to be adopted for all imports and not just those arriving from the European Union

Under this system, the importer pays import VAT through making an entry in his VAT return (a bit like acquisitions are handled under the current system). The importer will declare the VAT due in box 2 of the relevant VAT return and, if appropriate, will be entitled to claim back the VAT so declared in box 4 of the same VAT return. For a fully taxable business, the net effect of these two entries is nil.

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