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VAT alert

HMRC's proposed changes to VAT groups will be costly!

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Summary

HMRC has recently published a revised draft version of Public Notice 700/2 relating to VAT Group and Divisional Registration and has asked for feedback in relation to the revised text.

The principal change relates to the valuation of 'bought in' services and, if adopted, will have a major impact on businesses in the financial services sector.

Businesses in the sector commonly have international structures with companies and branches established in different tax jurisdictions. Where services are provided from an overseas jurisdiction to a UK VAT group, there is a rule in force in the UK which applies a 'reverse charge' (ie VAT is accounted for in the UK by the recipient VAT group). Historically, where the UK VAT group has been unable to value the supply received, the reverse charge requirement was ignored and no VAT was accounted for.

The new approach means that where values cannot be established, the whole value of the service will become liable to the reverse charge. This will have a major financial impact on businesses within the financial services sector.

HMRC publishes draft Notice 700/2: Group and Divisional Registration

HMRC has published a revised draft of Public Notice 700/2 which is intended to replace the current version of the Notice published in 2014. At the 2018 Budget, the government announced its intention to counter what it considered to be VAT avoidance by UK VAT groups. The details of the measure are set out in the new Notice and HMRC has invited affected businesses and other stakeholders for feedback before the new policy is adopted. The measure does not require a change of UK VAT law.

Generally, supplies of goods or services between members of the same VAT group are disregarded for VAT purposes. This is because, whilst a VAT group is made up of two or more separate entities, it is regarded as a single taxable person. As such, it cannot, therefore, make a supply of goods or services to itself. However, there is an exception to that rule which is intended to prevent distortion of competition between entities within a VAT group and entities where no such VAT group exists. Without this exception, a member of a VAT group could receive services from its overseas branch (on a VAT free basis), and then re-supply those services to another entity within the VAT group where that re-supply would be disregarded and no VAT accounted for. If certain conditions are met, the exception imposes a requirement for the VAT group to account for VAT on receipt of the bought in service under the 'reverse charge' mechanism. Businesses that can reclaim that VAT as input tax do so on the same VAT return, but businesses that are partially exempt (such as banks and other financial institutions) cannot reclaim all of the VAT charged in this way. This mechanism puts them in the position that they would have been in if they had purchased the services in question from a UK supplier.

The proposed policy in the revised notice is intended to prevent an anomaly. Hitherto, businesses required to account for VAT under this reverse charge procedure could escape the VAT charge if they were unable to separately identify and quantify the value of a particular bought in service when making an intra-group supply. The revised policy will require an affected business to identify and calculate the value of each bought in supply and to account for VAT under the reverse charge but, where a bought in service element of an intra-group supply cannot be identified or quantified, the value of the reverse charge will be the whole of the intra-group supply and not just the value of the bought in element. This will have a major impact on banks and other financial institutions. Such entities are heavily partially exempt and are unable to reclaim the majority of VAT incurred either on supplies of goods or services made to them by third parties or under the reverse charge mechanism.

Comment – Banks and other financial institutions often establish companies and branches in different tax jurisdictions and are also often members of VAT groups. This new approach to valuation of bought in services is likely to have a substantial financial impact on entities within the sector. The draft notice has been circulated by HMRC for comment and feedback by those likely to be affected by the proposed changes, their advisors and other stakeholders.

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