



ASSOCIATION OF FINANCIAL MUTUALS
Indirect Taxes: Nick Warner & Mustafa Sikandary
Training Day, 28 June 2018

Topics



- Fixed establishments and place of supply
 - Principles do not just apply to insurers
 - Case Law
 - Hastings Insurance Services
 - Impact
- IPT - Hybrids
- Making Tax Digital

Legal Provisions & Case Law



- VAT Act 1994, s.7A, s. 9
- ART. 44, Dir 2006/112
- Implementing Regulation 282/2011
 - ART. 10, ART. 11, ART. 21, ART. 22
- Berkholz (1984)
- DFDS (1997)
- RAL (Channel Islands) (2005)
- ARO Leasing (1997)
- Welmory (2015)

Legal References



- s. 7A – place of supply in country where recipient belongs
- s. 9 – relevant establishment is one “most directly concerned with the supply”
- ART. 44 – place of supply is where the recipient has established his business (BE) or to a fixed establishment (FE)

Business Establishment (BE)



- Place where the functions of the business's central administration are carried out
 - Place where essential decisions are taken
 - Where the registered office of the business is located
 - Place where management meets
- If the above do not allow establishment to be determined with certainty, place where essential decisions concerning the general management of the business are taken shall take precedence
- Presence of a postal address may not be taken to be the place of establishment of a business of a taxable person

Fixed Establishment (FE)



- ‘fixed establishment’ shall be any establishment, other than the place of establishment of a business (the BE), characterised by:-
- sufficient degree of permanence
- suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs
- same tests in order to provide a service

Suppliers – which establishment?



- To identify the customer's fixed establishment to which the service is provided, the supplier shall examine the nature and use of the service provided.
- Supplier to consider contract, order form, customer's VAT Number, whether FE is paying for the service
- If establishment cannot be determined from the above, then a contract covering one or more services used in an unidentifiable and non-quantifiable manner, the supplier may legitimately consider that the services have been supplied at the place where the customer has established his business (BE)

Previous cases



- ***Berkholz*** -BE in Hamburg
- Operating gaming machines on ferry boats between Germany and Denmark
- Technical resource but no permanent staff
- BE is primary point of reference – only necessary to look at alternatives if the result is irrational for tax or would lead to distortion with other Member States
- ***RAL (Channel Islands)*** – BE in Channel Islands
- Gaming machines in UK arcades
- Human resource ancillary; gaming machines the key
- FE in UK, VAT applied

Previous cases



- **DFDS** - Danish tour operator using its UK subsidiary as its sales agent, marketing package tours on behalf of Danish head office (BE)
- No independence of UK subsidiary - functions carried out determined by HO; no financial risk
- Economic activities were pursued for an indefinite period, making it a fixed establishment of the BE
- Unfair to Tour Operators established in the UK = distortion
- **ARO Leasing** - Car leasing by Dutch company to customers in Belgium - human resource = independent intermediaries
- No staff nor structure with sufficient degree of permanence in Belgium to create framework for drawing up and signing leases

Welmory



- Advocate General - service provider must have legal certainty as to the existence of a FE and cannot be expected to carry out extensive investigations to determine the place of supply
- Each set of supplies by Poland to Cyprus had to be assessed separately

Hastings Insurance Services



- Advantage, regulated in Gibraltar, but permitted under the EU financial services passport, to write UK insurance
- Under a contract, Hastings provided nearly all customer-facing services in return for commission
- Commission charged to Advantage, a specified supply in (non-EU) Gibraltar, allowing Hastings to reclaim input tax
- Does the contract with Hastings mean that Advantage has a FE in the UK?
- Does Advantage receive supplies in the UK?
- Does it make supplies of insurance from the UK?

Key points



- Correct order of analysis
 - Is there an alternative FE to the BE in Gibraltar?
 - If so does the FE make insurance supplies in the UK?
 - Does the UK FE or Gibraltar BE receive Hastings supplies?
- If there is no FE, Berkholz irrationality test does not arise
- The Irrationality Test (HMRC) - Indicators
 - Non-taxation
 - Distortion of competition
 - Double taxation
 - Head office involvement is minimal or non-existent
- “Does reference to the preferred establishment lead to a more appropriate or rational result for tax purposes”

FE – Hastings Arguments



- Resources must be permanently present with a minimum degree of stability necessary for the establishment to receive and use the relevant supplies for its own needs
- FE only if Advantage controlled the relevant resources of Hastings as if they were its own
- The two companies operated as separate commercial enterprises
- Hastings resources in the UK did not provide Advantage with all that was necessary for it to make insurance supplies in the UK – it had to rely on its own resources to provide some of the core functions
- Within parameters of the contract, Hastings operated its functions autonomously with its own commercial objectives
- Contract is at arms length
- Presumption in favour of BE

HMRC's arguments



- Through the contract, Advantage had sufficient control over Hastings resources:-
 - set the price
 - decided what to cover
 - set policy wording
 - ultimate control over claims handling
- Above, combined with common ownership, meant a FE
- Advantage does not have to control the relevant resources as if they were its own; rather they just had to be available to it under the contract and Advantage require Hastings to conduct its business in ways approved by Advantage

Key facts in decision



- Tribunal – no FE
- Composite supply of services – if separate, then each would have to be considered independently
 - a FE for some and not others?
 - consumed in making of local supplies (Welmorey unanswered)
- Hastings set gross premium
- Advantage driven by loss ratios
- Tax advantage
 - due to unique position of Gibraltar
 - Outside EU for VAT; within EU for pass-porting

Impact



- Mixed response from UK insurers; HMRC has appealed
- Issue due to Gibraltar's unique status re pass-porting and VAT
- FE can usually VAT group
- Registration threshold is £85k if FE
- Post-Brexit concerns
 - Carrier BE in EU, with UK FE
 - Service Co with BE in UK and FE in EU
 - UK – UK likely to be exempt
 - UK – EU : potentially a reverse charge in EU?

Hybrid products - IPT

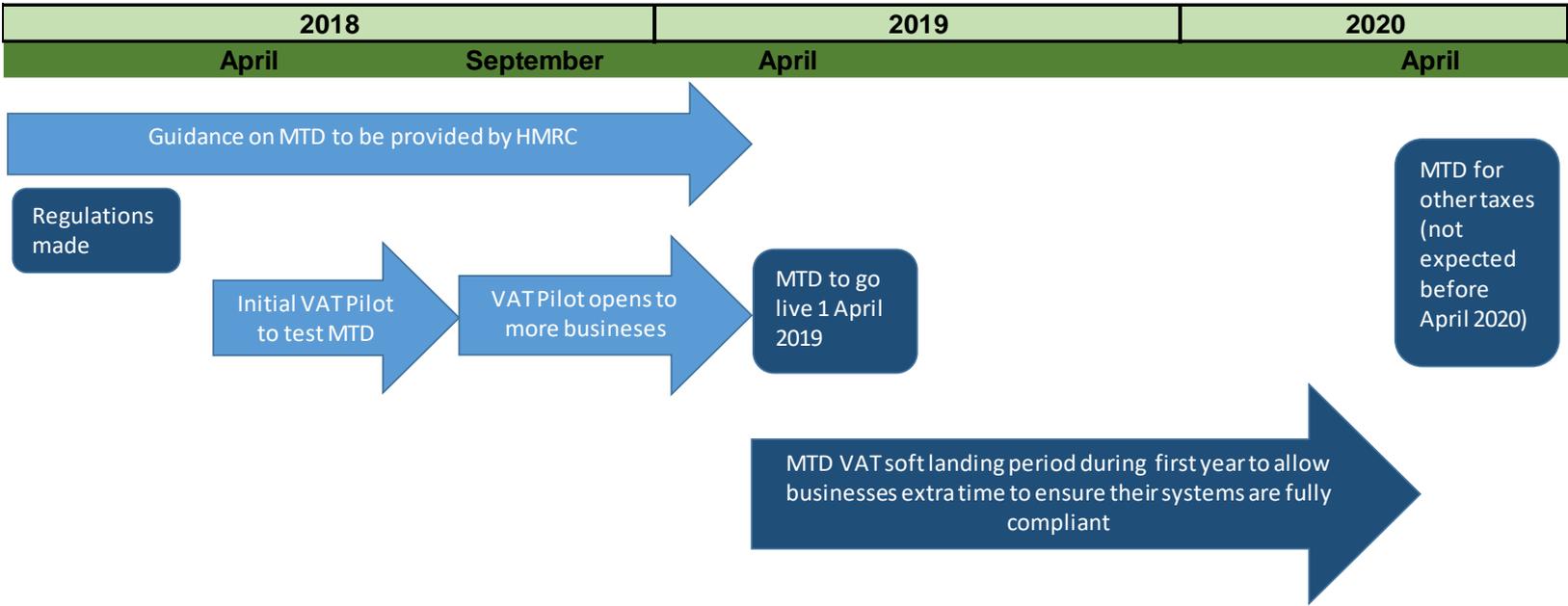


- Single policies including insurance under both Part I and Part II of Regulated Activities Order 2001
- Accidental Death Benefit (ADB) In Life policy
- More hybrid products developed in the market
- Medical insurance excluded from the exemption for Long Term business
- Policies need apportionment (unless taxable element less than 10% and premium under £500,000)
- How to apportion
- Tax sign-off for all new products



Making Tax Digital – VAT

Making Tax Digital (MTD) - VAT Timeline



HMRC Four Foundations



**Better use
of
Information**



**Tax in Real
Time**



**Single
Financial
Account**



**Interacting
Digitally
with
Customers**

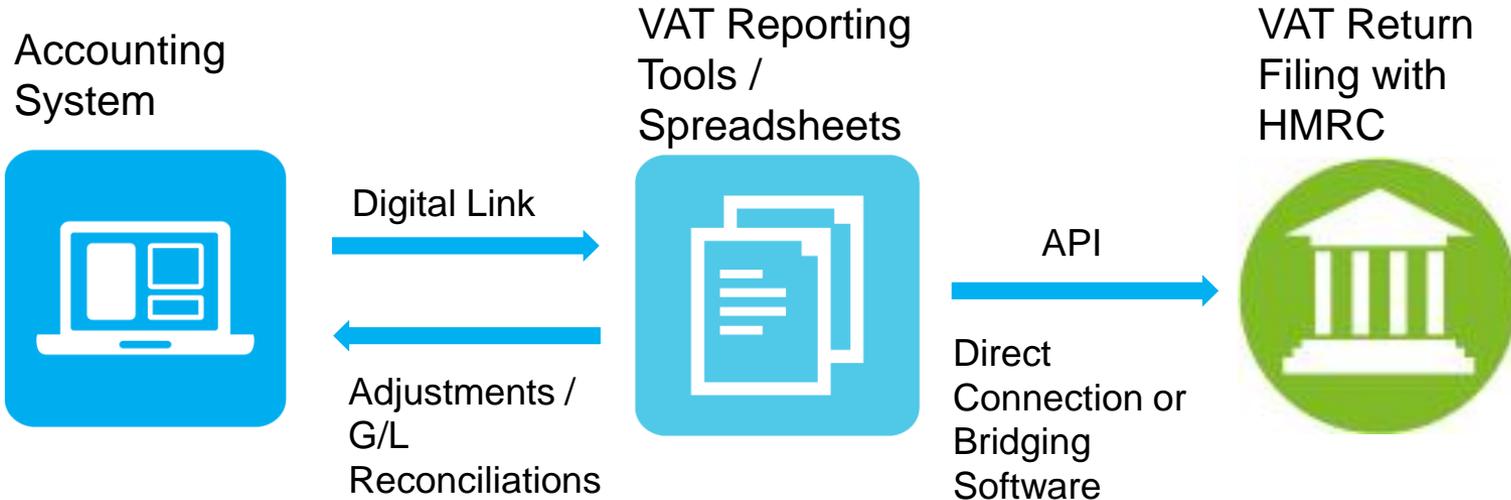


What is MTD?



- Other European countries have already or are planning similar systems
- In the UK, MTD regulations will require businesses to keep digital records and file their VAT returns via one or more **'functional compatible software'**
- This is the first step in a long term goal of requiring **'real time filing'** of individual transactions with the tax authority
- MTD for direct taxes has been deferred until at least 2020
- MTD for VAT will be introduced from 1 April 2019
- MTD will be compulsory for all organisations with a turnover above the VAT registration threshold (currently, £85,000)
- Exceptions to this obligation will be extremely limited

'Functional Compatible Software'



Maintain digital records

Digital links between systems, records and VAT return workings

Digital submission of VAT returns via an API

Functional Compatible Software



A software programme or set of programmes which can:

- Record and preserve records in electronic form;
- Provide VAT return information in electronic form via an application programme interface; and
- Receive information from HMRC.

Where a suite of software programmes are used, these must be linked digitally.

For instance, where spreadsheets are used to prepare VAT returns, there need to be 'digital links' between spreadsheet and source system(s), as well as the subsequent transmission to HMRC.

Digital Records (Examples)



The following information must be kept using functional compatible software approved by HMRC:

'Designatory data'

- The taxable person's name, principal place of business address and VAT number, plus any VAT accounting schemes used

Sales

- The time and value of each supply made and the VAT rate charged
- The VAT exclusive value of each of the following outputs: standard rated, reduced rated, zero-rated, exempt or outside the scope
- The amount of any adjustment or corrections

Purchases

- The time and value of each supply received, plus the amount of input tax to be recovered
- The amount of any adjustment or corrections

Digital Links (Examples)



- Transfer of data between software must be electronic (e.g. between accounting system and spreadsheet used for VAT return workings)
- HMRC refer to the ‘digital journey’, which starts at the point a record is created in the source system, and ends where the VAT return is transmitted to HMRC; there must be a clear digital audit trail
- Manually typing data from one system / report to another, or using copy and paste will not qualify as a ‘digital link’ for instance
- Examples of acceptable digital links:
 - Download of accounting system data into a spreadsheet format
 - Transfer of data via an application program interface (API) from the accounting system
 - Formulas, hyperlinks and direct linked cells within a spreadsheet
 - Transmission of electronic data files by email either internally in the business, or externally to Agents

Digital Submission of VAT Return



- There will be no changes in the frequency of VAT returns, deadlines for submission, or when payment of VAT needs to be made to HMRC
- HMRC is not asking businesses to supply more information than at present
- However, HMRC would encourage businesses to provide ‘supplementary’ information (e.g. VAT return workings) via the MTD-compliant software
- Post-April 2019, VAT returns can no longer be submitted as they are now (i.e. keying in the figures manually on HMRC’s VAT portal)
- Businesses must submit their nine box VAT return through MTD-compliant software

Penalties



- Initial 'soft landing' period
- Points based penalty system proposed
- Taxpayers will receive a point every time they fail to submit on time
- A penalty will be charged at a certain threshold after the threshold has been reached, a penalty will be charged for every subsequent submission failure
- 2 points for annual submissions, 4 points for quarterly submissions and 5 points for monthly submissions.
- Penalty points will have a 'shelf-life' and would expire after a period of good compliance.
- Periods of good compliance 2 submissions for annual submissions, 4 for quarterly, and 6 for monthly.

What do you need to do next?



- How close are you to being MTD-compliant come April 2019?
- Assessment of accounting system(s), current VAT processes and reports, as well as how financial records are held at present
 - Are records held digitally in the business?
 - How many financial systems are operated?
 - What reports are used to compile the VAT return? Are these digitally linked between source system(s) and the VAT return workings?
 - Is your accounting system ready to transmit VAT returns digitally to HMRC?
 - Do you need a bespoke solution (e.g. to create an API-enabled spreadsheet, or use bridging software to link VAT return to HMRC's API for transmission)?

What do you need to do next?



- This assessment will help inform how much work is required in order to be MTD-compliant and thereby, plan where to target process improvements
- Optimise current processes vs. wholesale transformational change
- Optimise current processes
 - Likely to be cheaper in the short run, and simpler to achieve
 - However, overtime inefficiencies and risks can creep in
 - Risk of being left behind the curve as MTD is introduced for other taxes
- Transformational change
 - An opportunity to re-assess the tax function in general, processes and tax reporting to make compliance more efficient
 - Strategically plan use of technology in the organisation as MTD reshapes tax reporting towards increasingly real-time tax data sharing with HMRC (and overseas tax authorities)
 - Rationalisation of financial systems

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