AFM Tax Training Day
VAT & IPT

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pwc

Introductions

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Agenda

1. Topical VAT Issues
2. Common Pitfalls
3. Retained EU Law (Revocation and Reform) Act 2023
4. Case Law Update & HMRC Consultations
5. IPT Practical Issues

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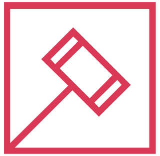
Topical VAT issues - PESMs, HMRC enquiries, MTD

When to think about partial exemption

Have you recently acquired a business?



Have there been any policy / case law updates that could impact your VAT recovery position?

Have you recently implemented a new product line?

Does your existing approach to partial exemption give you a fair and reasonable outcome?

VAT recovery - back to basics

Overview

Businesses will be able to recover the VAT they incur on the cost of making their supplies depending upon the type of supplies made, this is shown below:

Partial Exemption

- Required for taxpayers making both taxable and exempt supplies
- How much input tax is recoverable?

Direct attribution

- Input tax which is used exclusively to make taxable supplies - recoverable
- Input tax which is used exclusively to make exempt supplies - wholly irrecoverable

Residual input tax

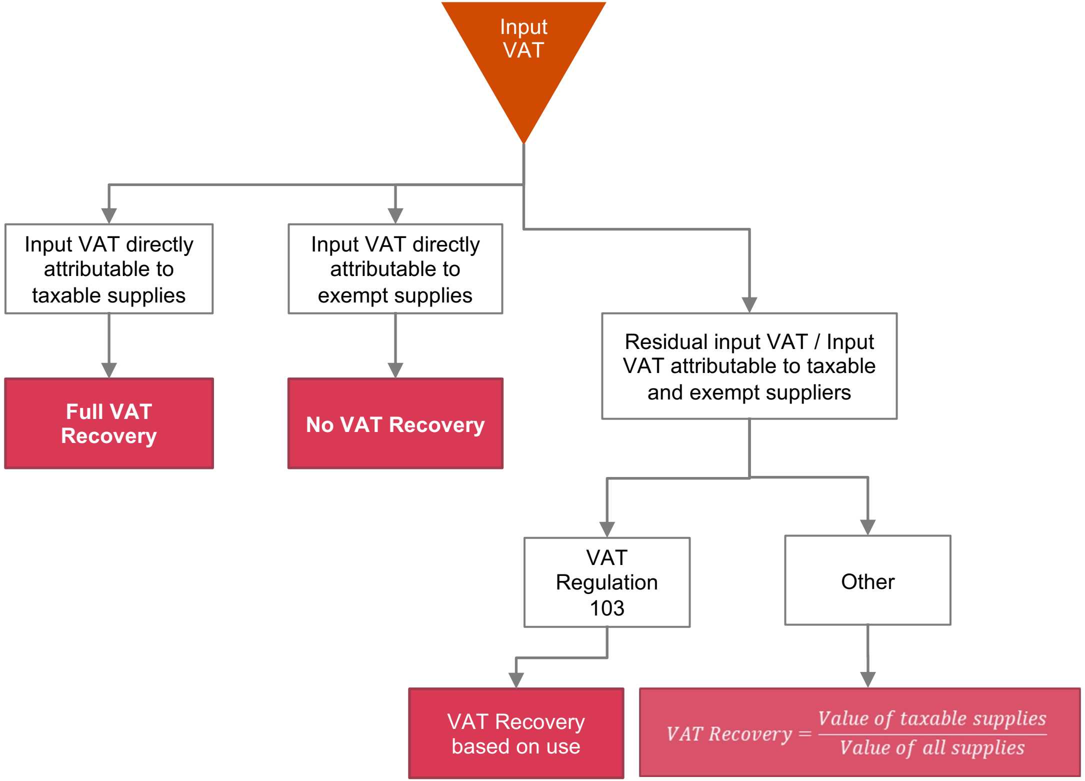
- Input tax which not used exclusively either to make taxable or exempt supplies
- Proportional recovery of input tax

VAT recovery methods

- Standard method
- Partial Exemption Special method

Outputs	**Inputs**
Only taxable supplies	Full input VAT recovery
Only exempt supplies	No input VAT recovery
Both taxable and exempt supplies	Some input VAT recovery
Outside the scope supplies	Potential input VAT recovery

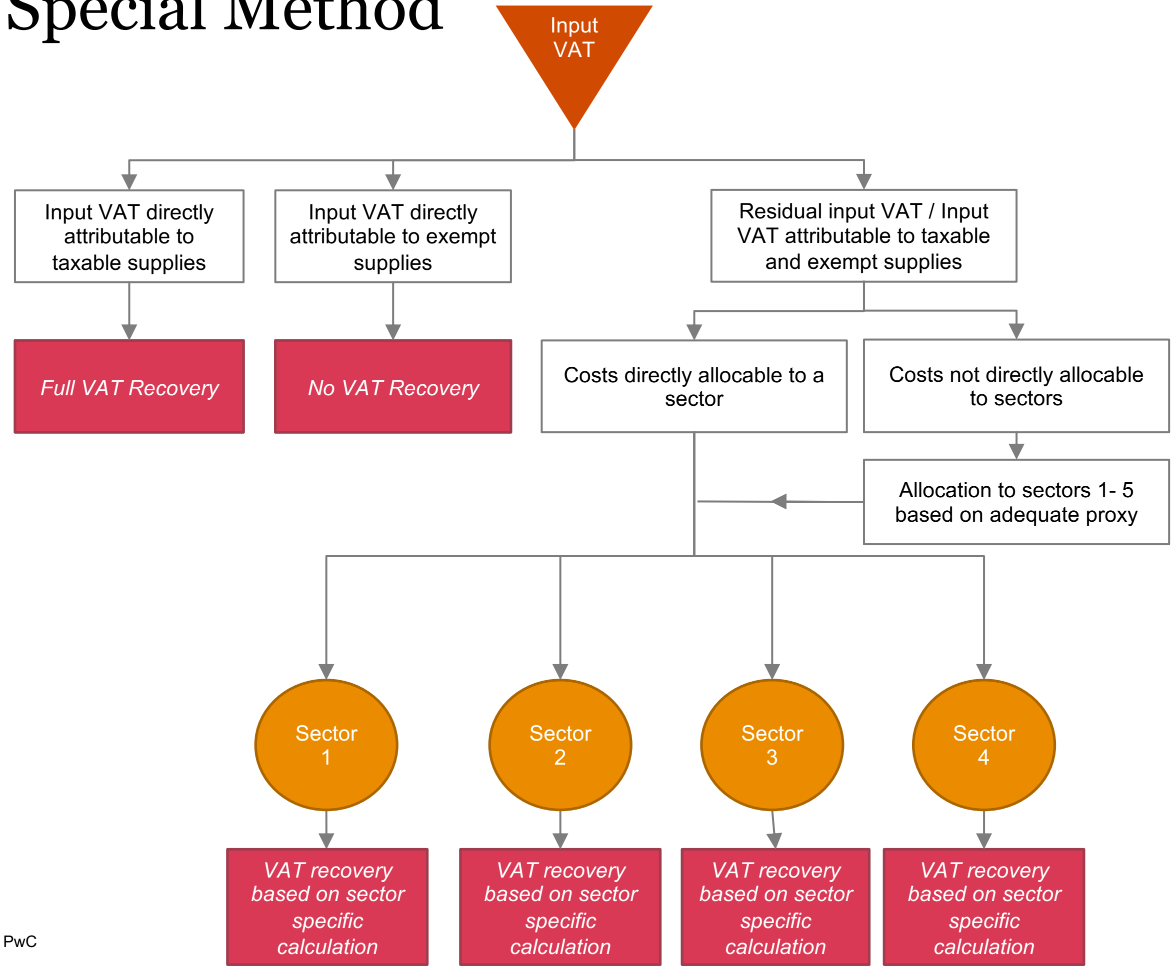
Standard Method



Explanatory notes:

- The standard method must be applied unless HMRC has given approval to operate a special method.
- The standard method is acceptable if it results in a fair and reasonable recovery of input VAT.
- On the basis that the business makes supplies falling within Group 2 or Items 1 to 6 or Item 8, Group 5, Schedule 9, VATA 1994, there is a requirement to ring fence input VAT relating to those supplies and recover them on a “use-basis”.

Special Method



Explanatory notes

- The special method is any VAT recovery method other than the standard method. Typically a special method requires agreement from HMRC, however, where a method has not been operated and the standard method would give rise to an outcome which is not consistent with how costs are used, there is an opportunity to apply a “use-based” methodology.
- The starting point is that a special method should mirror how a business is organised and how costs are reported internally as the primary purpose is to reflect the extent to which input VAT on purchases is used to make taxable supplies now or in the future.
- Whilst a special method is unique to each business, there a number of common themes:
  - Sectorisation (to reflect business activities or legal entities)
  - Direct attribution to reflect where VAT is used in making only taxable or exempt supplies
  - Direct allocation to reflect costs which are using in making both taxable and exempt supplies but which relates only to a sector
  - Allocation of residual input VAT to each sector - which can be based on a number of possible metrics
  - Attribution to taxable supplies i.e. final level input VAT recovery (typically the ratio of taxable to total supplies for VAT purposes

Basic principles - VAT recovery

Partial exemption - adjustments

Annual adjustment

- Compare quarterly calculations to annual calculation
- Similar if not the same calculation as the quarterly returns, however the year's numbers are merged together
- Annual, quarterly and monthly de minimis limit of £7,500, £1,875 and £625 respectively.
- Any adjustment will be posted in the first VAT return of the new VAT year.
- The intention of the annual adjustment is to smoothing out quarterly variations in input tax and output numbers/values

Capital Goods Scheme

- Longer term adjustments apply to certain capital assets:
  - Land, building or civil engineering work (total spend in excess of £250,000)
  - A computer or item of computer equipment (total spend in excess of £50,000)
- Typical items are newly acquired buildings or fit out work undertaken on rented properties
- The purpose of the CGS is to recognise the long life over which the asset can be used and to make input tax adjustments accordingly
- Adjustments work by applying a base level of input tax recovery and making an adjustments for the next 10 years (5 years for computer equipment) where the new recovery rate for that year changes compared to that base level of input tax recovery.
- Submitted alongside the second VAT return of the VAT year (i.e. the June VAT return)

PESM Recap

1. New application process introduced in 2021
2. Online portal application process (or via VAT Written Enquiries)
3. Detailed information to support application (Appendix 2, VAT Notice 706)
4. Submission process - *relatively* straightforward
5. HMRC reference provided
6. HMRC resourcing still challenging
7. Approval process - delays still significant
8. HMRC approval - process driven - limited discretion for local teams

Areas of challenge

HMRC understanding of methodology

Detailed questions / rounds of correspondence

Relatively minor changes - can lead to resubmission of methods

HMRC suggestions to alter proposed methods

Navigating /negotiation with HMRC important

HMRC open to range of methods (within reason) but need to be supportable

Potential loss of tax years

Use of SMO to (re)capture otherwise ‘lost’ years

Making Tax Digital for VAT

Making Tax Digital for Business ("MTD") is HMRC's flagship policy which aims to move all business tax reporting online.

Making Tax Digital for VAT is the start of a wider programme to digitise reporting across all taxes.

Overview of MTD requirements:

- Keep **digital records** (certain transactions, VAT accounts and summary of outputs)
- **Submit VAT returns digitally** via HMRC's Application Programming Interface ("API")
- **'digital links'** - audit trail from the transaction records to the VAT return filing - This is a marked shift and required manual transpositions to be removed from the VAT process.

HMRC's long term view

- HMRC's 2016 papers - increasing the scope of digital record requirements
- Requiring greater disclosure of transactional level data
- Similar approach with other taxes

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Common Pitfalls

VAT Registrations

Common problem areas

VAT grouping
- Housekeeping - additions, liquidations etc
- Larger groups - regular ‘stocktakes’
- Reconciliation with HMRC records
- HMRC - delays, authorisations

Restructuring
- M&A activity
- Post-Brexit - VAT simplifications no longer available

Substance - UK & overseas
- Sufficiency of staff and resources?
- Place of effective management of company?
- VAT registration and VAT grouping

Receipt of services from foreign suppliers?
- Applies to corporate entities & funds
- Creates irrecoverable VAT and administration

VAT registration
- Can be beneficial (VAT recovery)

If VAT registration required
- VAT returns
- Making Tax Digital - compliance
- AP/AR controls

Document positions
- Tax audit support
- Mitigation of penalties

What should I consider when making/receiving international supplies?

Reverse charge mechanism

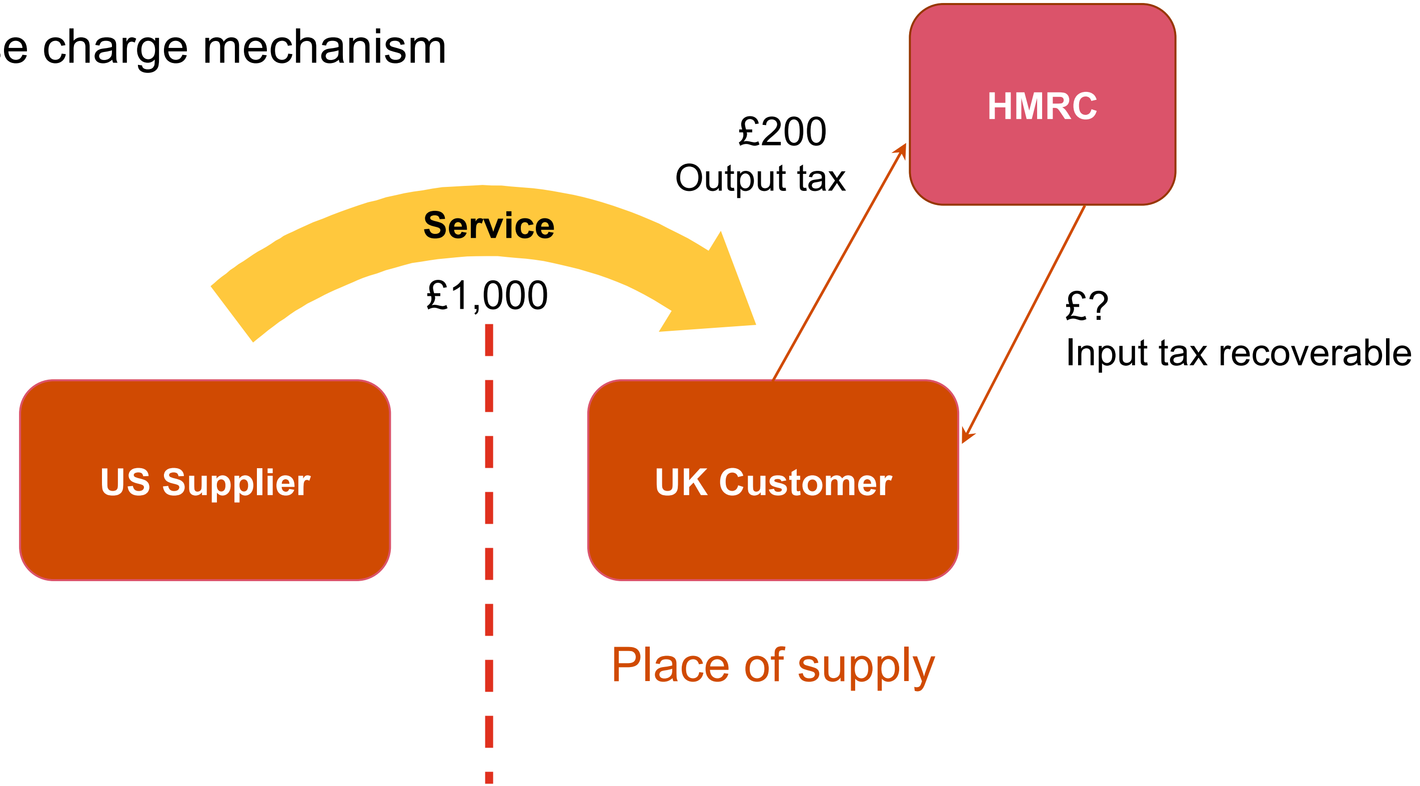
Reverse charge on supply of services

Where a transaction is subject to reverse charge i.e. taxable supply of services received in the UK from non-UK suppliers:

- The recipient self assesses output VAT calculated on the value of the supply
- This output VAT can also be recovered as input VAT (subject to any partial exemption restriction)
- If the supply falls into a VAT exemption in the territory where the supply takes place there will not be a reverse charge
- It is essential that businesses retain a sufficient level of information to show that they have confirmed the recipient of the supplies is located outside the UK. An inability to have this information will expose the business to the risk that its supplies will be subject to UK VAT.

What should I consider when making/receiving international supplies?

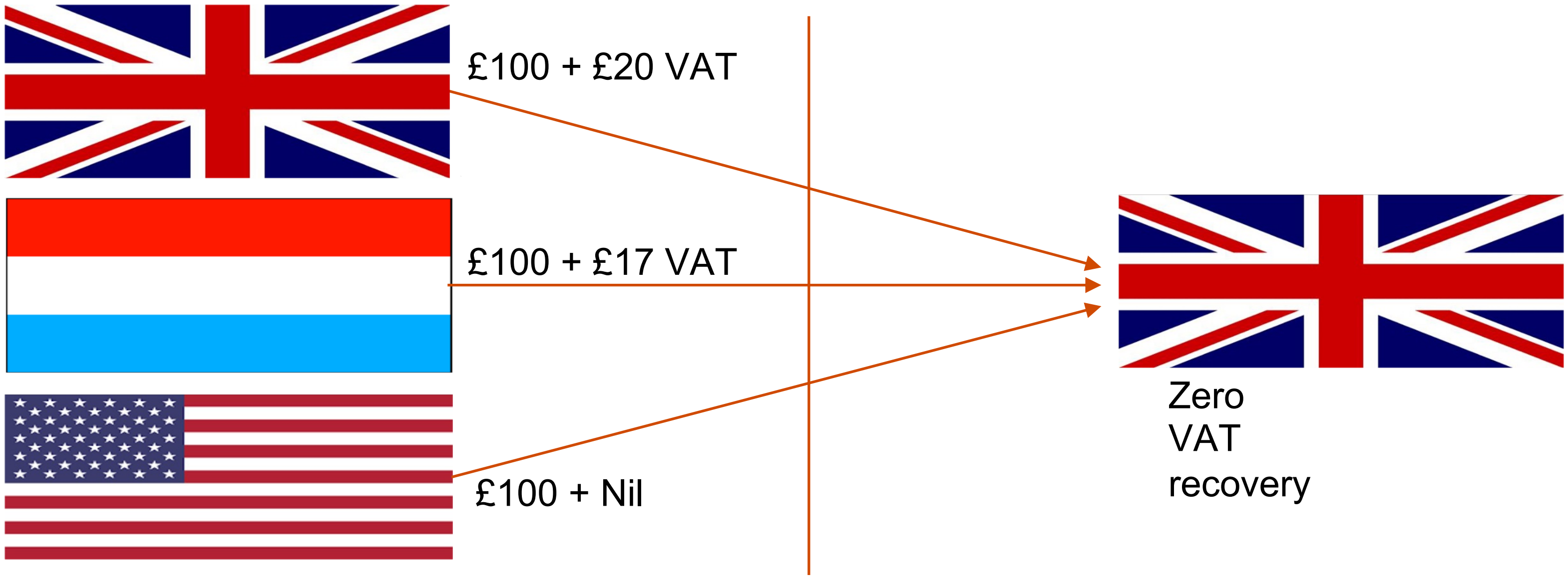
Reverse charge mechanism



What should I consider when making/receiving international supplies?

Reverse charge mechanism – Fairness and the EU

Supplies from UK, EU and Non-EU without reverse charge mechanism



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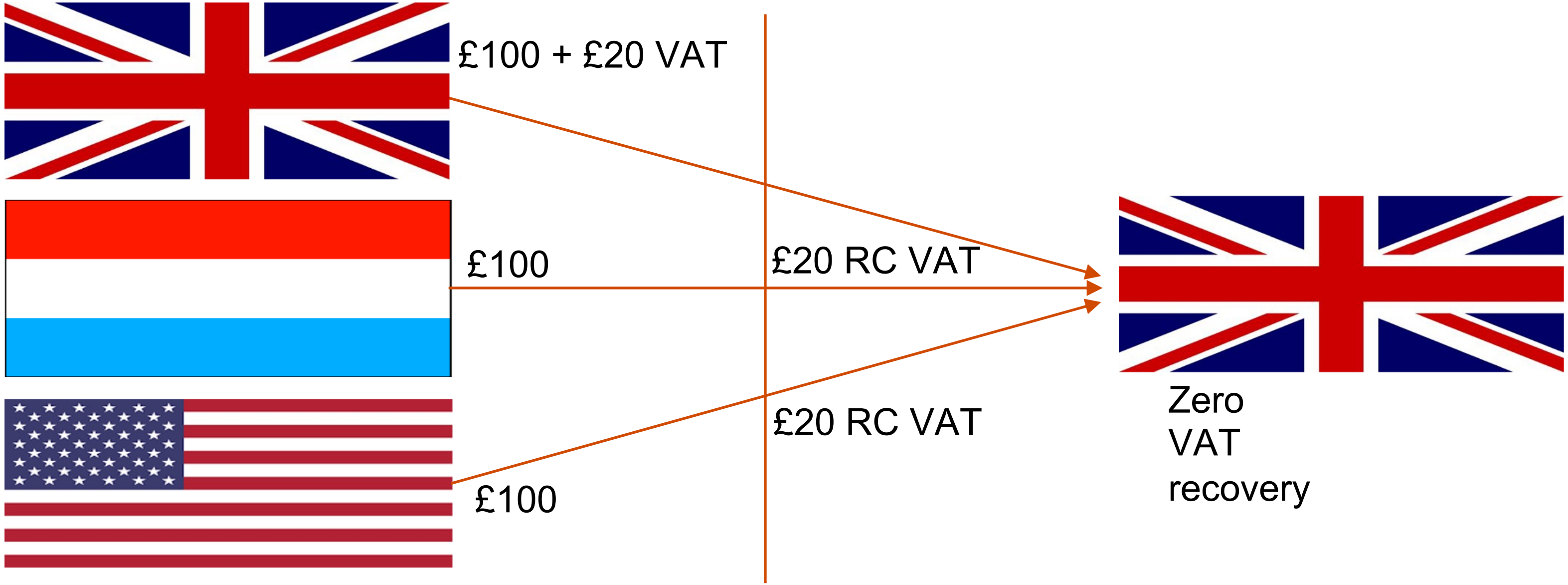

What should I consider when making/receiving international supplies?

Purpose of the reverse charge mechanism

Rules in relation to international trade can be somewhat complex (with different rules for supplies of services and goods)

The reverse charge mechanism aims to:

- Ensure fairness across the EU for suppliers i.e. VAT rates shouldn't be a deciding factor
- Reduce the compliance requirements in the EU through self-accounting of VAT
- Allows VAT to be accounted for in the country of recipient for B2B supplies

Dealing with errors in VAT returns

1. Assessing the position
2. Investigating the background and wider control environment
3. Engaging with HMRC
4. Making a disclosure
5. Consequences - dialogue with HMRC, penalty regime
6. Future position - system / process changes
7. Documenting the above

Components of an **"error correction notification"**

- Basis of disclosure
- Nature of error
- Quantum of error
- VAT periods impacted
- Control environment
- Actions to prevent recurrence

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Retained EU Law (Revocation and Reform) Act 2023

Retained EU Law (Revocation and Reform) Act 2023

UK Court Structure

Supreme Court

Court of Appeal

Upper Tribunal

First-tier Tribunal

EU Court

Court of Justice of the European Union

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Case law update and HMRC consultations

VAT liability decisions

Challenges with applying VAT exemptions for financial services:

- VAT exemptions interpreted strictly.
- Limited HMRC guidance - inconsistent VAT treatments applied in practice.
- VAT exemptions turn on the nature of the service itself, not on the service provider or customer.
- Subcontracting arrangements - services must be “specific and essential” to a financial services transaction.
- Recent case law - ***Target Group vs HMRC***.

Application of VAT exemption to intercompany transactions:

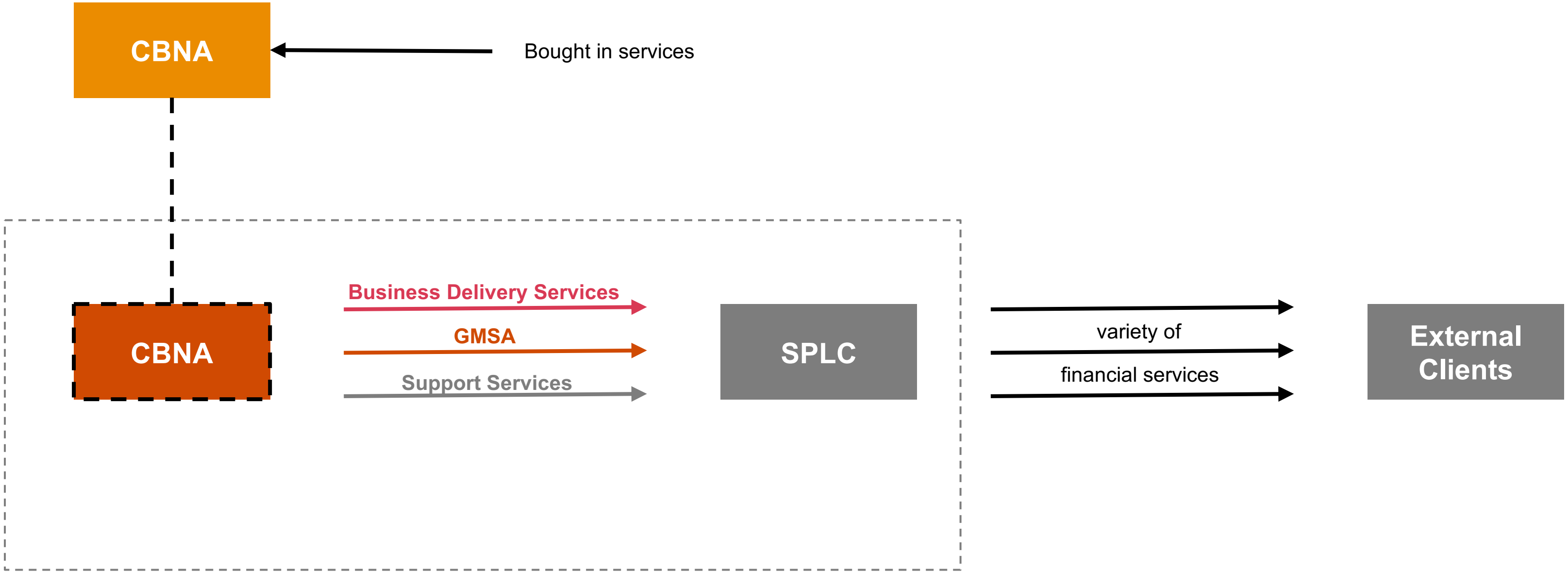
- VAT exemptions also applied strictly with intercompany transactions.
- Understanding the roles of respective entities is vital.
- Challenge with identifying discrete elements within a bundle of services.
- Importance of robust documentation - contractual and other commercial support for VAT exemption.
- Recent case law - ***JP Morgan Chase Bank v HMRC***.

Impact on the VAT recovery profile of partially exempt businesses

Commercial impact of VAT position in the supply chain

Contractual clauses and VAT

JPMC (1 of 2)



Key

- US
- UK

- Identification
- Supply
- Exemption

JPMC (2 of 2)

Key elements to decision:

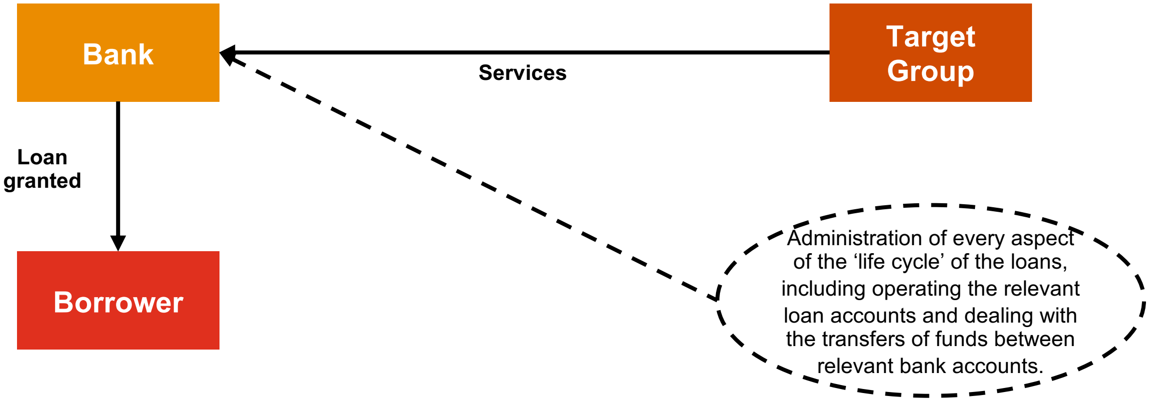
Detailed exposition of services and delivery model	Recognition of the substantial level of support from CBNA to SPLC	Changes to GMSA but no material change to supplies in practice	Interconnection of services
SPLC could not refuse to receive any elements of the supply from CBNA	Single supply based on thorough examination of case law	That supply was not all exempt - taxation therefore the answer	

Points for consideration:

- Challenge of identifying separation between Business Delivery Services and Support Services.
- Less commentary on intermediation than perhaps expected.
- Data challenges in efficiently accounting for transfer pricing and Section 43(2A).
- Business Delivery Services from a third party - could at least some of that qualify for exemption?

Target (1 of 2)

Target supplies loan administration services to a UK lending bank. Where the lending bank has granted loans e.g. a mortgage to its customers, Target is responsible for administering the loan, creating and operating individual loan accounts, instructing (via various methods) and processing payments to be made from borrowers. Loan accounts record transactions relating to the loan including charges, payments, interest, arrears, next payment due etc.



Target (2 of 2)

Key elements to decision:

- Target argued that the services were exempt as services concerning payments, transfers and debt
- HMRC argued that the exemption should be construed narrowly in line with EU law (DPAS)
- HMRC contended that the services were taxable credit management, or debt collection
- Composite supply analysis maintained
- SC concluded that a narrow interpretation of the exemption is correct
- Operating the loan accounts and issuing instructions via BACS not enough for exemption
- It is necessary to be involved in carrying out / executing the transfer or payment – "materialisation"

Points for consideration:

- Following DPAS it is the narrow interpretation of the VAT exemption for payments that is correct.
- Taxpayers who supply outsourced services to FS customers: a significant change to the VAT liability may now arise depending on the treatment currently applied.
- Where does the primary exemption go from here outside of banks / payment infrastructure (possibly)?
- Non-FS taxpayers receiving payments services may be impacted

Intelligent Money

Law (UK)	Insurance transactions and reinsurance transactions
CPP	Providing the insured in the event of materialisation of the risk covered with the service agreed when the contract was concluded
Prudential	Insured secures some benefit upon the happening of some event; event must involve some uncertainty; must be an insurable interest
Aspiro	Assumption of risk by an insurer
United Biscuits	The exemption is justified by the difficulty in determining the correct amount of VAT for insurance premiums relating to the coverage of risk
HMRC guidance	There is no statutory definition of insurance for VAT purposes although guidance can be gained from previous legal decisions in which the essential nature of insurance has been considered.
Winterthur	Provision of pension benefits could amount to the provision of pension benefits under an insurance contract

Implications:

1. This wasn't HMRC seeking to narrow the VAT exemption
2. Fiscal neutrality doesn't feature in the decision
3. Difference between UK definitions and VAT definitions of insurance.
4. Impact of EU law post-Brexit - impact of retained law removal?
5. Comments from court re: *Winterthur* and representations by appellant in para 19.

Recent experiences of consultations

The consultation	Closing date	The author(s)	Positives	Negatives	Consequences
VAT grouping	27 February 2017	HMRC	-	-	-
VAT Partial Exemption and the Capital Goods Scheme	26 September 2019	HMRC	Resulted in changes to the PESM application process	-	Further engagement expected
Insurance Premium Tax	5 February 2021	HMRC	Reached consensus to implement a Code of Conduct for brokers, but not yet implemented	Options proposed to tackle avoidance structures were not found to be proportionate solutions	Proposals to tackle avoidance structures may be revisited
VAT treatment of fund management	3 February 2023	HMT & HMRC	Appears that HMRC and HMT listened to feedback	Very limited ambition shown in consultation; appeared that direction set before consultation	To be seen - HMRC and HMT still considering responses
Uncertain Tax Treatments		HMRC	Removal of certain particularly complex matters		
Other consultations					
Early termination payments	[informal]	HMRC	HMRC resiled from original intention to change law with retroactive effect	Original HMRC policy would have benefitted from consultation prior to draft RCB; took significant industry pressure to move	Change in policy, still in a manner which increased VAT cost, but in a less problematic manner
VAT and pensions	[informal]	HMRC	Took into account different needs; resulted in material change to policy; aligned to European law	Required a phase 2 consultation (ongoing)	Updated HMRC guidance, further consultation

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IPT practical issues - overseas customers

Insurance Premium Tax ("IPT")

UK IPT

IPT Liability	Rate	Description
Standard Rate	12%	Most types of insurance
Higher Rate	20%	• Travel insurance • Mechanical or electrical appliances insurance • Some vehicle insurance
Exempt	N/A	• Most long-term insurance (e.g. Life) • Re-insurance • Insurance for commercial ships and aircraft • Insurance for commercial goods in international transit • Premiums for risks located outside the UK - may be liable to similar taxes imposed by other countries

Insurance Premium Tax ("IPT")

Key things to think about

- Typically due in the territory where the risk is located
- Each country has different IPT rules and rates
- Registration and reporting requirements
- Important to be able to accurately capture where the risk being insured is (and be aware of any changes).

Thank you

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