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VATflash

Trading internationally? You should be aware of the implications of the concept of 'establishment' for VAT purposes.

PLACE OF ESTABLISHMENT

If your business trades internationally you should be aware of the implications of the concept of 'establishment' for VAT purposes and how the agenda is being driven by the Courts.

The Principal VAT Directive states that services are supplied where the relevant person (supplier or customer as the case may be) has established his business. The Council Implementing Regulations further define that the place where a business is established is where the functions of its central administration are carried out.

The same Implementing Regulations go further and define an alternative 'fixed establishment' other than the business establishment referred to above, as any place 'characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to [provide or] receive and use the services supplied'.

WHAT DOES THIS MEAN FOR YOU AND YOUR BUSINESS?

As a supplier you will need to determine where your customer is established or resident for the purpose of receiving and using your services or, alternatively, whether you have a sufficient establishment in the first place to supply the services in question. The answer to the first question is that it means further calculations for you in determining the VAT treatment of your activities, how to structure your contracts, particularly internationally, and how much VAT might be payable or reclaimed. It is important though to bear in mind that the oft-quoted fall-back of 'if in doubt charge VAT', could actually make things worse. This is because VAT wrongly charged cannot be reclaimed as input tax by the customer who may be less than happy with an assessment from HMRC or his own tax authority some years later.

UK legislation is quite clear in that although the goods or services supplied overseas are outside the scope of VAT, if they would otherwise have been subject to VAT in the UK ('taxable supplies') the company is entitled to reclaim input VAT incurred on associated costs. The mechanism to do that in the UK is to register for VAT and file UK VAT returns, which has been the case for a long time for such companies. However, HMRC are more recently arguing that such a company does not have an establishment in the UK and is therefore not entitled to register for VAT. In raising such arguments, HMRC do often overlook the distinction between the main 'business establishment' and an alternate 'fixed establishment' despite the fact that a Companies House Registered Office is defined as a 'fixed establishment' of the company.

It may indeed be true that the main business establishment or head office is overseas, but the legislation and guidance from the European Commission is equally clear that in order to constitute an alternative 'fixed establishment' capable of making or receiving supplies for VAT purposes, the UK presence must have the sufficient degree of permanence and human and technical resources to make the supplies in the first place. Even discounting 'brass plate' or shell companies that would clearly fail this test, there are many UK companies registered for VAT that happen to trade largely overseas with only a limited physical presence in the UK. Their continued UK VAT registration is now in doubt and HMRC will be raising enquiries as time goes on.



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There is one particular problem emerging from the growing unease across the EU on questions of establishment, being that of in-house resources vs outsourcing. Outsourcing is a growing commercial facility that is of particular use for a business that trades largely elsewhere with remote directors. The argument that outsourced functions do not qualify for this test is verging on a restraint of trade if input VAT refunds are denied as a consequence. Indeed, the European Court stated in the Welmore case (see our latest tax blog for more on this) that there was no requirement to own the resources in question and that a fixed establishment could be created through the use of resources belonging to a third party.

TWO GENERAL PRINCIPLES FOR YOU AND YOUR BUSINESS

If you are a supplier of services seeking to register for VAT in a particular jurisdiction and claim input VAT refunds, ensure that you have sufficient human and technical resources in that country to enable you provide the services in question. It should not matter if you have your own staff and resources there or outsource them, but expect more detailed enquiries from the tax authorities if the latter.

If you have a customer with establishments or branches in more than one country, first determine where the head office or main business establishment is located. That will be the starting point for determining where your services are supplied. The European Court was quite clear that departing from this should be an exception. Secondly, however, consider whether your customer has any alternative fixed establishment elsewhere that is actually receiving and using your services. If your customer does have such an alternative establishment, your services are probably supplied there instead with the VAT consequences that flow from that.

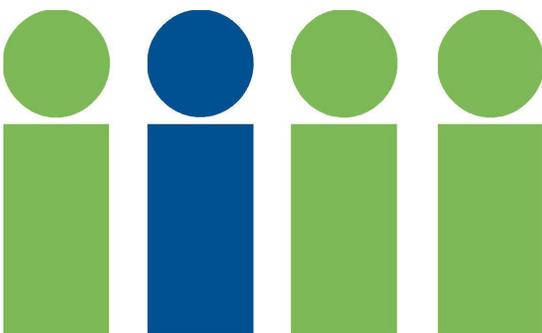
Our VAT specialists have considerable experience working with businesses that trade internationally and can help you to understand the concept of establishment and any implications you should be aware of.

THE NEXT STEP

If you would like any advice on the above, or if you wish to review your circumstances, please contact our specialist VAT advisers in our various offices.

Simon Newark, VAT partner
t: +44 (0)20 7216 4674
e: s.newark@uhy-uk.com

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