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Buying overseas services – the additional VAT cost for charities under the 2010 reverse charge rules

With effect from 1 January 2010, the purchase of services from outside the UK will have an impact on most UK charities. Services purchased in this way are subject to a reverse charge in the UK, and a recent ECJ case has further amplified the affect it could have on UK charities.

1. How does the reverse charge work?

The reverse charge puts the onus on a business customer to account for the VAT when the customer has purchased certain services from abroad. Charities may be viewed as being in business for this purpose.

If the service would have been subject to VAT at the standard rate, if received from someone in the UK, then the reverse charge applies as follows:

- the customer must convert the invoice in to Sterling
- the customer must apply the standard rate of VAT to the value of that supply. This VAT value should be recorded in Box 1 and 3 of your next VAT return
- the customer can recover VAT, subject to any partial exemption or non-business/business restriction that may apply, in Box 4 of the same VAT return.

The result of this in a majority of commercial cases is that the VAT position is neutral. That is, the VAT declared in Box 1 is subsequently recovered in Box 4.

2. Is that the same for Charities?

When receiving a supply from overseas the charity will need to look at what the supply being received is being used for. If it relates to a general overhead of the charity then the likelihood is that the recovery of this VAT on the self supply will be restricted by any partial exemption and/or business/non-business apportionment that the charity has to apply on its general overheads.

If the cost relates solely to an exempt or non-business activity then there will be no recovery at all on this reverse charge supply which the charity has to generate. See section 8 on non-business income, rather than non-business activity.

3. Has this always been applicable?

The simple answer is yes, the reverse charge has always been applicable and was introduced to protect the domestic marketplace for the obvious reason that it ensured there was some kind of fiscal neutrality.

Had it not been introduced, it would have been far too easy for entities who were not entitled to recover all of their VAT on their costs to purchase all their services from abroad in order to avoid domestic indirect taxation (i.e. UK VAT).

4. What has changed for 2010?

Within the UK, there has been domestic case law, which has provided charities with the comfort that HM Revenue & Customs (HMRC) has only sought to apply the reverse charge where the charity has purchased an overseas service for a business purpose. However this was not the view shared by some of the other European countries and their stance has been reinforced following the ECJ case 'Kollektivavetalsstelesen'.

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5. **What is Kollektivavetalsstelesen?**

This was an ECJ case relating to a Swedish entity. It confirmed that where an entity imports services, in this case from a Danish supplier, which it uses for its business and its non-business activities then the reverse charge is still applicable on the entire value of these supplies.

6. **Bad news for charities?**

The simple answer is yes and financially it may well be very costly for charities.

With effect from 1 January 2010, VAT will be applicable on all services, whether for a business or non-business purpose, which would be taxable if they had been supplied by a UK entity, where those services are supplied to a charity which is registered for VAT in the UK.

7. **What happens if the charity is not VAT registered?**

If a charity undertakes solely non-business activities and is therefore not VAT registered, there will be no reverse charge applicable to any overseas supplies received. In addition, the level of these reverse charges will not count towards the charity having to VAT register in the UK. However where a charity has some business activity the reverse charge will apply and contribute to the measurement of taxable supplies for the VAT registration threshold.

8. **If the charity is VAT registered what sort of services will be caught by it?**

As already stated, most services received from an overseas supplier which would attract VAT in the UK if made by a UK supplier, will be subject to the reverse charge.

Previously services such as administration and management services charged between international branches of charities, were not captured by this charge. From 1 January they will be caught and there is potential to create internal sticking tax within an international organisation.

Importantly costs incurred in relation to overseas non-business income are included. For example if a charity has an overseas Investment Management Fund and incurs overseas investment management fees, these will now be subject to the reverse charge. The recovery of the VAT on these types of fees in relation to generating non-business income under the reverse charge will be based upon how the charity uses the funds generated from these investments. This is the same principle that was established in the 'Children's Society' Case.

Therefore if the funds generated by the investment management are used by the charity solely for taxable activities, then the VAT can be recovered in full. If the funds are used for the charity generally, the recovery will be based on the normal restrictions that may apply.

Services not affected, are those which have a place of performance, e.g; cultural services, educational services, exhibition services etc.. However these will also fall into the trap in 2011 unless they are operated on an admissions basis. Other services not affected are land related services and certain digitised communication services.

9. **What about overseas branches and subsidiaries?**

International charities registered for VAT may have to review contracts and supplies where they are responsible for receiving the supply of services from overseas suppliers.

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A new interpretation may be required but charities may need to consider:

- who is receiving the supply?
- who is contracted for the supply?
- who is benefiting from the supply?
- would it be more beneficial for the supply to be redirected to the particular overseas branch and the UK based charity solely act as the paymaster?
- should the UK charity consider recharging these expenses to the branch/subsidiary or country of origin under a general management fee?

Conclusion

It seems that the issues brought about by the reverse charge have almost been unnoticed until recently, when the charity sector began to realise the financial impact.

Since then, the publicity given to it means that everybody should be now aware of its significance and its potential cost.

If you are receiving services from abroad, checks need to be made to ensure that you are either accounting for them correctly, or if they relate to non-business activities that you are ready to start the process from 1 January 2010.

Without wishing to pre-empt the matter, we are sure this will be an area HMRC's inspectors will be focusing some time on during future visits. Suppliers of EU services will need to complete an EC Sales list from 1 January 2010. HMRC will have access to these detailed records of what services have been supplied to whom. It should be remembered that this is against a background of a stringent penalty regime.

It is also an area where charities may need to look at opportunities either to move the cost overseas either directly from the supplier or indirectly via themselves thus creating a taxable supply and avoiding possible restrictive VAT.

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Seminar: This topic and others will be covered in more detail at our next VAT update

Date: Thursday 28 January 2010

Time: 4.00pm registration for a 4.30pm start. To conclude at 6.00pm followed by canapés

Venue: Horwath Clark Whitehill, St Bride's House, 10 Salisbury Square, London EC4Y 8EH

To register for this event or for more information, please contact Rhiannon Cutler at rhiannon.cutler@horwath.co.uk or 020 7842 7209.