



VAT GROUPING – ESTABLISHMENT, ELIGIBILITY AND REGISTRATION CALL FOR EVIDENCE

Issued 19 November 2020

ICAEW welcomes the opportunity to comment on the VAT Grouping – Establishment, Eligibility and Registration call for evidence published by HM Treasury on 28 August 2020, a copy of which is available from this [link](#).

Retain whole establishment VAT groups
Do not introduce compulsory VAT grouping

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KEY POINTS

1. If whole establishment VAT groups were to be replaced by establishment only VAT groups, the effects of the potential addition of UK VAT to overseas branch salaries would require reversing. As a minimum, the value of overseas salaries should be deducted from the amount that would be subject to the UK reverse charge.
2. If whole establishment VAT groups remain, consideration should be given to simplifying the burden of calculating S34(2A) reverse charge VAT. This should include the removal of the MTD for VAT digital linking requirements for transactions involving overseas branches.
3. Compulsory VAT grouping should not be introduced. If it is, the joint and several liability conditions of VAT grouping should be removed.

ANSWERS TO SPECIFIC QUESTIONS

Chapter 1: VAT grouping and establishment provisions

Question 1: What are the advantages of ‘whole establishment’ provisions; how do they facilitate business activity in the UK?

4. There are various advantages including the one identified at paragraph 24. That is the ability to make supplies of services from an overseas branch or head office of an entity which is a member of the VAT group to another member of the VAT group established in the UK which do not attract any liability to VAT to the extent that the charge for the service is comprised of the costs of salaries of staff employed in the overseas establishment. The advantage of the whole establishment provisions to a partly exempt business in the UK which is VAT grouped with a company which has its head office or a branch overseas is that it will not be required to account for reverse charge VAT on the salaries element of fees paid for services supplied by its overseas staff. Without these provisions, the value of the supplies of services from the overseas head office or branch would effectively include these salaries, making them liable to UK VAT. This would therefore create the situation where the salaries of overseas staff would be subject to UK VAT, whereas the salaries of UK staff would not. That would be an unwelcome distortion.

Question 2: Do the ‘whole establishment’ provisions make the UK a more attractive business destination than countries that utilise ‘establishment only’ provisions, both across all industries and within specific sectors?

5. The whole establishment provisions make the UK more attractive for businesses that would be unable to recover their input VAT in full in relation to the import of services that would be subject to the reverse charge under the establishment only provisions. This is likely to affect many companies in the finance, insurance, charity and not for profit sectors.

Question 3: Are the advantages of the whole establishment provisions equally accessible to all companies? Does the size or location of the VAT group head office impact this?

6. The establishment provisions are equally accessible to all companies that have the option as to how they structure their overseas operations. The advantages are greater for those businesses that are unable to deduct all their input VAT and import services into the UK with a significant internal salary cost component.

Question 4: What additional benefits do ‘whole establishment’ provisions bring to businesses and sectors, including those unrelated to tax?

7. Simplicity, as affected businesses do not have to consider VAT when making transfers between its UK and overseas operations. The whole establishment provision, in principle,

affords the greatest degree of administrative simplification although this simplification is partly removed by the need to comply with s43(2A) VAT Act 1994, which is a complex obligation to comply with in practice.

Question 5: What disadvantages arise as a result of the ‘whole establishment’ provisions?

8. Compliance with the overseas establishment reverse charge provisions of S43(2A) can be burdensome. A specific example of which we are aware is a non-profit body with overseas branches in China and Dubai. It is necessary to identify local purchases, invoiced in local language and currency, that are subject to the reverse charge in the UK. Capturing such purchases in such a way as to fully comply with the need to quantify the amount of VAT due, the tax point etc so as meet the conditions for MTD for VAT provisions is particularly costly and challenging.
9. Anomalies and added complexities are also likely to arise when an entity which is VAT grouped in the UK also has branches or establishments which are themselves VAT grouped with entities in countries which adopt establishment only VAT grouping rules.

Question 6: How would a change to ‘establishment only’ provisions affect UK businesses that utilise VAT grouping? Please outline both positive and negative changes.

10. Businesses that are unable to fully recover input VAT would be disadvantaged in relation to imports of services received from overseas establishments within the VAT group. This would be particularly severe for businesses that have significant numbers of overseas staff who support activities of members of the VAT group in the UK as the costs of their salaries would become subject to irrecoverable reverse charge VAT for the first time.
11. There would be a simplification in not having to identify local purchases by overseas establishments that could be subject to reverse charge VAT in the UK under S43(2A) if this provision were to be abolished.

Question 7: Which sectors would likely be affected if the UK were to adopt ‘establishment only’ provisions?

12. Any sector where input VAT is not wholly recoverable would be liable to an adverse impact. Finance, insurance, charities and not for profit organisations would be likely to be particularly affected if the establishment only provisions were to be adopted in the UK.

Question 8: Would adopting the ‘establishment only’ provisions result in a reduced administrative burden for businesses?

13. There would likely be an immediate cost to businesses which have structured their activities on the assumption that the UK affords the benefits of a whole establishment VAT grouping regime as they may decide to restructure. There could be limited savings in administration of complying with the overseas branch reverse charge provisions in S43(2A), but these are likely to be insignificant in comparison to the financial cost incurred by a partially exempt organisation.

Question 9: Would adopting the ‘establishment only’ provisions result in any increased administrative burden from applying the reverse charge to all supplies from overseas? Would this be offset by the reduction of administration in applying the current anti-avoidance legislation, S43(2A)?

14. This would depend on the particular circumstances of a business. In principle a business which is not currently required to comply with S43(2A) as its imported services are based on salary costs would be adversely affected as it would have to administer a reverse charge accounting process for these cost recharges.

15. Any offset by the reduction of administration would depend upon the individual businesses and volume of transactions. Compliance with MTD for VAT could become more difficult and costly, as transactions that would otherwise not be relevant would be caught for the first time.

Question 10: Would adopting the ‘establishment only’ provisions have a financial impact upon affected businesses?

16. Yes, and this could be significant in some cases. This would be particularly severe for businesses that have significant numbers of overseas staff whose salaries would become subject to irrecoverable reverse charge VAT for the first time.

Question 11: Would adopting the ‘establishment only’ provisions have an impact on the geographical allocation of jobs (both within and outside of the UK) in affected businesses?

17. This could have an impact and could depend on how other countries apply VAT grouping and similar regimes (eg article 132.1.f of the 2006/112/EC Directive). The change could have the effect of adding 20% to the cost of employing staff overseas if their salaries became subject to irrecoverable reverse charge VAT. In some cases, this may be sufficient for a business to reconsider the employment of some of its overseas staff, or even close its overseas operations.

Question 12: Would adopting ‘establishment only’ provisions impact on business competitiveness, both for those VAT groups that are headquartered in the UK and those based overseas?

18. If the non-deductible VAT on staff costs were to increase, as noted at question 11 above, this would inevitably impact on the competitiveness of affected businesses.
19. The adverse effects could be reduced if the value of the costs liable to the UK reverse charge were to be reduced by the value of the internal costs, such as the salaries of the overseas employees. This would bring the amount of the UK reverse charge closer to that which is currently due under S43(2A).

Question 13: What impacts have the revised arrangements introduced in response to the Skandia ruling had on your business?

20. Not applicable.

Question 14: Would any further changes to the current arrangements materially impact your business or sector?

21. Not applicable.

Question 15: Do you want to maintain the current arrangements that were implemented in response to Skandia, or reverse them?

22. We believe that unnecessary complications should be removed from the VAT system to make it as simple as possible. Following the departure of the UK from the EU, we believe that simplification could be achieved by eliminating any distinctions between supplies with EU countries and any other countries. The VAT grouping rules in any other country would then become irrelevant when considering the UK treatment, making it unnecessary to separately identify counterparties located in countries that adopt establishment only rules. This approach suggests that the current arrangements which were announced in Revenue & Customs Brief 18/2015 in response to Skandia should be reversed.

Chapter 2: Compulsory VAT grouping

Question 16: What benefits or disadvantages could a system of compulsory VAT grouping deliver for businesses? Would this vary between different sectors?

23. We are concerned that compulsory VAT grouping would impose joint and several liability on businesses that do not wish to accept such liabilities. For example, a charity may not wish to accept the liabilities of a trading subsidiary or a limited partnership may not want to be grouped with an associated limited company.
24. Export companies are generally excluded from the perimeter of a UK VAT group to maintain the cashflow benefits. Compulsory VAT grouping, which would require very precise rules to be applied, can lead to retroactive measures if the VAT group was not aware that the grouping rules had been met.

Question 17: How would compulsory VAT grouping impact the administrative processes for businesses?

25. This would vary significantly according to the type of businesses involved. In large groups, the consolidation of figures for a VAT return from numerous remote locations could be almost impossible to complete by the due date, particularly if the requirement to have digital linking of MTD for VAT is adopted.
26. We understand that the experience of advisors in Germany, where VAT grouping is compulsory if the administrative and economic ties tests are met, is that it is often difficult for taxpayers to know if they should be grouped, leading to significant litigation as to whether a group is formed or not. Although the UK operates slightly different tests of control, it can be difficult to work out whether one person controls another, as sometimes found when trying to apply AML control tests. This could lead to issues and litigation if the group registration is mandatory.

Question 18: How would compulsory VAT grouping interact with 'establishment only' VAT grouping provisions, if they were to be implemented?

27. It would need to be clear to businesses which were compelled to form a VAT group whether the whole entity would become a member or only its UK established part(s).

Question 19: How would compulsory VAT grouping impact businesses of different sizes, and would the minimised risk of errors be of benefit?

28. Compulsory VAT grouping would not necessarily reduce the risk of errors and could increase them in some circumstances. For example, where there are transactions between group companies, it may be difficult to suppress the usual VAT default coding, with the possible result of input VAT being claimed by the recipient and output tax being omitted on the sale within the VAT group.

Question 20: Are there any instances where businesses are not VAT grouped for specific commercial or regulatory reasons? Please provide examples.

29. There are instances where a business would choose not to form a VAT group due to cash flow benefits that could be obtained by remaining separate. Export companies, as mentioned at paragraph 24 above, are an example of this.
30. There are logistical reasons whereby it would be difficult for associated businesses to consolidate their financial information in time to complete a VAT return by the due date. This is likely to have increased with the imposition of MTD for VAT and the requirements to digitally link remote systems.

Chapter 3: Eligibility criteria: partnerships

Question 21: How do limited partnerships (LPs) and Scottish limited partnerships (SLPs) currently participate in VAT groups?

31. In line with the decision in *H Saunders and T G Sorrell* (1980) 1 BVC 1133, Limited Partnerships can be VAT grouped where the general partner is a body corporate and meets the eligibility criteria to VAT group. The effect of such an arrangement is to bring the activities of the LP into a VAT group, as it is only the general partner which is permitted to manage the business activities.

Question 22: How do LPs and SLPs tend to be used within the structure of corporate groups and what is the commercial rationale for inserting them into VAT groups?

32. No comment.

Question 23: What, if any, commercial reasons are there for having more than one general partner in a LP that may affect VAT grouping arrangements?

33. No comment.

Question 24: In cases where a LP has more than one general partner, what commercial reasons are there to add more than one general partner to the same VAT group?

34. No comment.

Question 25: If the test for VAT grouping LPs/SLPs changed to a control and beneficial ownership test, how would this affect current VAT groups and the LPs/SLPs in question, including those that would be able to VAT group, and those that would have to be removed from existing VAT groups?

35. No comment.

Question 26: When considering the normal eligibility tests for VAT grouping, what would the impact be on VAT groups if those tests were applied to LPs and Scottish partnerships as a whole rather than just general partners?

36. No comment.

Question 27: Would it be beneficial to allow Scottish partnerships to join a VAT group subject to the same rules as other entities (i.e. where they are controlled, rather than controlling all other members of the VAT group)? Should the same treatment also apply to general partnerships?

37. No comment.

Question 28: Were any changes discussed in chapters one and two to be implemented, how could they impact on the inclusion of partnerships within VAT groups?

38. If the joint and several liability conditions of compulsory VAT grouping were to be imposed upon limited partnerships, it could seriously impact the desirability of ownership by LPs of corporate businesses where they were forced to join a VAT group registration.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).