

## VAT: THE PLACE OF SUPPLY OF SERVICES

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In the first article on determining the place of supply for VAT purposes (OTPR Vol 1 Issue 3) we discussed how, in relation to the making of supplies of goods in the UK, an inconsistency existed between UK and EC legislation. It was shown that, in relation to goods despatched to the UK by an overseas supplier which were then installed in the UK by him or on his behalf, the two systems are capable of producing different answers to the question of where the goods have been supplied.

This article looks at the supply of services and the provisions governing their place of supply. What, however, do we mean by a supply of services? The VATA 1983 s.3 prefers definition by exclusion:

"Anything which is not a supply of goods but is done for a consideration ... is a supply of services."

Similarly, Art.6 of the Sixth Directive refers to a supply of services as:

"Any transaction which does not constitute a supply of goods within the meaning of Art.5."

Art.6 then goes on to list a number of transactions which will be supplies of services. Typically these include supplies of intangible property such as assignments of copyright and trade marks and legal, accountancy and other similar services.

So far as VATA 1983 is concerned, tax is charged on any supply of goods or services made in the UK where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him (s.2). The place of supply of services must therefore be within the UK in order for the tax to be levied.

When we look at the detailed rules in both VATA 1983 and the Sixth Directive it becomes clear that harmonisation is not with us - at least not in the way in which one approaches the question of place of supply. The draftsman of the Sixth Directive

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obviously realised that determining the place of a supply of services might cause problems between Member States.

Para.7 of the preamble to the Sixth Directive states:

"whereas the determination of the place where taxable transactions are effected has been the subject of conflicts concerning jurisdiction as between Member States, in particular as regards supplies of goods for assembly and the supply of services; whereas although the place where a supply of services is effected should in principle be defined as the place where the person supplying the services has his principal place of business, that place should be defined as being in the country of the person to whom the services are supplied, in particular in the case of certain services supplied between taxable persons where the cost of the services is included in the price of the goods"

Art.9 of the Sixth Directive, which sets out the general rule regarding place of supply of services, is unequivocal. The place where a service is supplied is to be deemed to be the place where the supplier has established his business or has a fixed establishment from which the service is supplied or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides.

Art.9 then goes on to define a number of exceptions to this general rule. In particular, in relation to certain supplies of services (those set out in VATA 1983 Sch 3, e.g., legal, accountancy and advertising services) the place where such services are supplied when performed for customers established outside the EC, or for taxable persons established in the EC but not in the same country as the supplier, is to be the place where the customer has established his business or has a fixed establishment to which the service is supplied or, in the absence of such a place, the place where he has his permanent address or usually resides.

Other exceptions to the general rule in Art.9 include services connected with immoveable property which are taxed where the property is situated. Transport services are taxed where the transport takes place having regard to the distance covered. Services in relation to cultural, artistic, sporting, scientific, educational, entertainment and similar activities are taxed in the place where they are carried out, as are ancillary transport activities and valuation and other work performed on moveable tangible property.

Accordingly, such supplies of services as fall outside the general rule will not be taxed in the country where the supplier has his business. So far as the supplier is concerned the supply will not be within that country's VAT net in the first place as it will not be a taxable supply.

VATA 1983 approaches the question in a somewhat different manner even though it is the primary legislation for implementing the provisions of the Sixth Directive in the UK.

VATA 1983 s.6(5) states that:

"A supply of services shall be treated as made -

- (a) in the United Kingdom if the supplier belongs in the United Kingdom; and

- (b) in another country (and not in the United Kingdom) if the supplier belongs in that other country."

Aside from special cases, such as tour operators and formal instruction courses, the whole question therefore depends on whether the supplier belongs in the UK and s.8 of VATA 1983 contains the detailed rules for determining this. These rules mirror Art.9(1) of the Sixth Directive.

Under s.8(2) the supplier of the services is to be treated as belonging in the country if:

- (a) he has there a business establishment or some other fixed establishment and no such establishment elsewhere; or
- (b) he has no such establishment (there or elsewhere) but his usual place of residence is there; or
- (c) he has such establishment both in that country and elsewhere and the establishment of his which is most directly concerned with the supply is there.

A "presence" will fall within sub-para (a) above as an "establishment" if it has a sufficient minimum strength in the form of the permanent presence of the human and technical resources necessary for supplying specific services *Berkholz v Finanzamt-Mitte-Altstadt* [1985] 3 CMLR 667.

But what about those supplies which the Sixth Directive deems to take place outside the country of the supplier's place of business (for the purposes of this article, the UK)? VATA 1983 does not deem them to take place outside the UK. Rather, by the application of s.16(2), Sch 5, Group 9 and Sch 3, the supplies of those services remain taxable supplies taking place within the UK but taxable at zero-rate.

So, for example, suppose a UK company hires out a portable fax machine to a French company. There will be a supply of services within the UK, but taxable at the zero-rate by reason of VATA 1983, Sch 5, Group 9, Item 5. Under the Sixth Directive, Art.9(2)(e) will deem the place of supply to be France. The immediate tax effect for the UK company will be the same whatever legislation is looked at. In the former case, the UK company will merely charge the hire price with VAT at 0%. In the latter case, the supply will not be a taxable supply in the first place so that no VAT is charged. So far as the French company is concerned, it will have to account for VAT on those services as though it had "imported" them - a concept equivalent to the UK's reverse charge provisions. The French VAT on such services will be recoverable according to the company's recovery ratio.

The underlying tax effect for the UK company is perhaps more significant. In the case of the taxable supply under VATA 1983, the value of the supply will be taken into account in determining:

- (a) whether the supplier has made sufficient taxable supplies in order for him to be registrable as a taxable person; and
- (b) to the extent that the supplier makes exempt supplies, the partial exemption calculation which determines his ability to recover input tax.

If one looked at the position solely from the perspective of the Sixth Directive, the

supply would be outside the scope of VAT and as such might reduce the amount of creditable input tax available to the supplier under the partial exemption regulations. It should however be arguable that Regulation 30A of the VAT (General) Regulations 1985 will come to the aid of the taxpayer. This regulation deems input tax to be attributable to taxable supplies where the input tax is incurred on supplies which are used for making supplies outside the UK that would be taxable supplies if made in the UK.

On the other hand, there is no similar provision to Regulation 30A in relation to registration limits. It may be the case in theory (although the writers have not come across such an instance in practice) that a UK business with a high proportion of sales of services within VATA 1983 Sch 3 to overseas customers may find that its other taxable supplies may not exceed the current registration threshold (£35,000) with the consequence that it may not be required to be registered for VAT. This is therefore an area where the taxpayer may be able to take advantage of discrepancies between the UK and EC systems.

The apparent differences between the Sixth Directive and VATA 1983 will be of no assistance, however, to Customs. They will not be able to rely on the provisions of the Sixth Directive as against a UK person if the Sixth Directive is more favourable to them: see *Marshall v Southampton and South West Hampshire Health Authority* [1986] 1 CMLR 688 ECJ.

### **A Change to the Origin Principle**

Finally, a brief mention should be made of the proposed change in the basis of VAT from the destination to the origin principle. In 1990, the Commission published a set of proposals in relation to the common system of VAT in the EC, the ultimate aim of which was to introduce a system of taxation to be in effect as of 1st January 1997 whereby all expenditure would be taxed in the country of purchase (i.e., where the goods were produced or the services supplied). To use EC jargon, this would be a change from the destination principle to the origin principle.

Any change to an origin basis will require considerable amendments to the provisions dealing with the supply of services. Under Art.9 of the Sixth Directive, as we have seen, the place of supply will often be such that taxation is levied in the country of actual use of the service - i.e., the destination principle. This may either be because the consumer of the services has received an "import" and a reverse charge applies (as in the UK) or because the supplier is taxed through a representative in accordance with Art.21. In this regard, mention should be made of Art.9(3) of the Sixth Directive which allows Member States to derogate from the provisions of Art.9(2)(e) and locate the place of supply of services either inside or outside the EC in order to avoid double or non-taxation. This has allowed the UK to introduce its reverse charge provisions.

The proposals for a change to the origin system will make it unnecessary to deem the supply of certain services to be within the consumer's country. Such international services will be charged to tax in the supplier's country and an amount of VAT will be deductible in the consumer's country (thus the need to harmonise tax rates across the EC). This will mean that, for example, the services as set out in VATA 1983 Sch.3 will not be capable of being zero-rated. In our example above, the UK company will charge VAT at 17½% on the hire of the fax machine which the French company may be able to utilise as creditable input tax against its own outputs.

The preamble to the Sixth Directive seeks non-discrimination and the avoidance of double taxation in Member States as regards VAT. Harmonising the rules relating to place of supply, particularly in relation to services, is of fundamental importance in both achieving a move to the origin system and avoiding double taxation. Double or non-taxation should therefore only occur by reason of a different classification of transactions in different Member States. In particular the hiring of moveable tangible property in one Member State may be the provision of a service relating to immoveable property in another. Requesting Member States to harmonise their classification of certain transactions is another matter, beyond both the scope of the VAT proposals and this article.