

# VAT Newsletter

## Welcome

Welcome to the latest edition of our VAT Newsletter, which provides up to date detail of significant VAT changes over the past few months.

Many VAT professionals breathed a sigh of relief following the previous UK Government's Budget of March 2010 when no increase in the standard rate of VAT was announced. Such relief though was short lived as the new Government announced an emergency Budget, which delivered the expected increase to the standard rate to 20% which will take effect from early 2011. This brings the UK (and therefore the Isle of Man) into line with many other European countries where the standard rate is often in excess of 20%. If UK/IoM VAT is a cost to your business you may wish to consider budgeting early for larger items of expenditure.

Otherwise, other changes in the past few weeks see further developments from various cases heard by the European Court of Justice and further details provided regarding up and coming changes to domestic legislation.

This edition of the newsletter also takes an in depth look at the UK penalty regime now into its second year of operation and how this is starting to bite. Further changes are proposed which will add greater emphasis to ensuring timely and correct administration of VAT related matters. However, penalties can be avoided or mitigated by making a prompt disclosure, but better to ensure timely, complete and accurate returns from the outset.

Please do not hesitate to contact any member of the VAT team (details are shown on the last page) if you require any assistance relating to a VAT matter.



I hope you enjoy our newsletter.

Peter Duchars  
Director of VAT Services

July 2010

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# UK News

## UK Budget

Few new changes were announced in the emergency Budget of 22 June, but the most significant change was the much anticipated change to the standard rate of UK VAT which brings the UK rate more into line with the rest of Europe. The 2.5% increase in the standard rate of VAT takes the rate to 20%, which is still below many other EC countries although is slightly above the rates levied by the UK's main competitors, France (19.6%) and Germany (19%). The increased rate will take effect from 4 January 2011 and it is pleasing to note that the current Government have taken on board comments made following the recent increase to 17.5% (following the temporary reduction to 15%) that a change on 1 January was particularly inconvenient.

No changes are proposed, at this time, to the zero rate or exempt categories and the only other impact of the change in standard rate will be that the percentages used in the Flat Rate Schemes will also increase. The anti-forestalling provisions used for the recent reversion to 17.5% have already been announced, which will ensure businesses do not artificially advance tax points such that VAT at 17.5% is charged rather than the increased rate.

Otherwise there have been few changes to the VAT provisions. The introduction of changes to the zero rating of aircraft has been delayed until 1 January 2011 (from 1 September 2010) in response to industry pressure and the changes previously announced to the exemption provided by the Post Office are now delayed until 31 January 2011.

Few other changes have been announced to the other indirect taxes, although one of the main changes has been an increase in the standard rate of insurance premium tax to 6% (from 5%) and an increase in the higher rate in line with VAT to 20%. These changes will also be applied to premiums received or written on or after 4 January 2011.

## Zero rating of aircraft

The recent emergency budget also announced a change to the date on which the conditions for zero rating of aircraft would change to 1 January 2011. Prior to the budget HMRC released, for discussion, a draft practice note that provides more details of the revised zero rating provisions.

The definition of a qualifying aircraft (ie one eligible for zero rating) includes an aircraft which "is used by an airline operating for reward chiefly on international routes". This differs significantly from the current definition where zero rating is based on a maximum take off weight in excess of 8,000kgs. In considering the above:

- an airline is defined as being "an undertaking which provides services for the carriage by air of passengers or cargo";
- "operating for reward" means that the business should provide either passenger or freight transportation on scheduled or unscheduled flights for a consideration;
- "international routes" will be satisfied where the journey crosses an international boundary, although not in circumstances where the journey then crosses back into the same country; and
- "chiefly" means that international routes must exceed domestic operations, perhaps by reference to the respective turnovers.

The above would exclude a charter or dry lease from the zero rating of aircraft. Provision is contained such that a customer under a dry lease or charter arrangement can issue a declaration that they will use the aircraft in accordance with the zero rating provisions outlined above, in which case the lessor or charterer can similarly zero rate their supply.





## Treatment of the carbon market

In an attempt to resolve the uncertainty that exists within certain sectors of the carbon market HMRC recently issued Business Brief 28/10 that considers the liability of non-compliance credits and carbon offsetting schemes. These areas are particularly complex, but the brief deals with those businesses that voluntarily choose to offset their emissions using credits from carbon-reducing projects overseas (eg Verified Emissions Reduction) or use offsetting services providers.

In both cases the supplies of these services will be outside the scope of VAT, but the actual provisions leading to payment are important in the case of offsetting services and as such these payments may well fall within the scope of VAT.

## MTIC Fraud

A number of cases have been heard recently in the UK relating to missing trader intra-Community fraud. The scale of this type of fraud is huge and it is estimated that there are some 800 live appeals on this issue currently totalling some £2 billion. Such fraud now affects both supplies of goods and services and often the reaction of the Revenue authority is to seek to recover any tax lost from anyone within the supply chain, even those with no knowledge of the fraud.

All businesses should seek to ensure that adequate checks are in place, and can be evidenced, to verify the legitimacy of business operations carried on within the supply chain. This is likely to be the only defence against claims that the businesses “should have known” of the fraud.

# VAT news from the Isle of Man

## Yacht chartering and leasing

The transitional period to review and amend “abusive” yacht lease and charter structures expired on 31 May 2010 and it is known that several existing structures have been reorganised. Isle of Man Customs & Excise will undoubtedly review all yacht structures in due course, although there are currently no plans for a specific exercise in this regard to be undertaken. As such, it is advisable that any VAT registered yacht structures are reviewed to ensure they are acceptable and meet the revised definition of undertaking a commercial undertaking.

## On line VAT EC Sales List submissions

The proposed date for on line filing of EC Sales Lists has now passed, with no immediate detail of when such submissions may be possible. It is understood that testing is now ongoing so it is envisaged that on line submissions will be possible shortly, but in the meantime the submission of paper returns will be due within 21 days of the end of the relevant period.

## VAT rate increase

The changes announced in the recent emergency UK budget will also be implemented in the Isle of Man. The increased VAT rate is anticipated to result in an estimated £25m per year additional revenue by 2014.

# Review of UK/Isle of Man penalty regime

Recently HMRC has undertaken a review of various penalty regimes in an attempt to streamline and standardise penalties across a wide range of taxes. By virtue of the UK/IoM VAT agreement, Isle of Man Customs & Excise have and will adopt these new penalties.

The penalties are based upon the reason for the failure and the nature of disclosure or discovery. The aim of the new regime is to encourage businesses to make prompt disclosures, to submit accurate and timely returns and maintain accurate records. HMRC does accept that mistakes happen and provided reasonable care can be demonstrated they may not issue a penalty or may suspend the penalty. Reasonable care varies according to the person, their circumstances and their abilities.

A number of penalties were introduced from 1 April 2010, including:

## Belated notification of an obligation to register for VAT

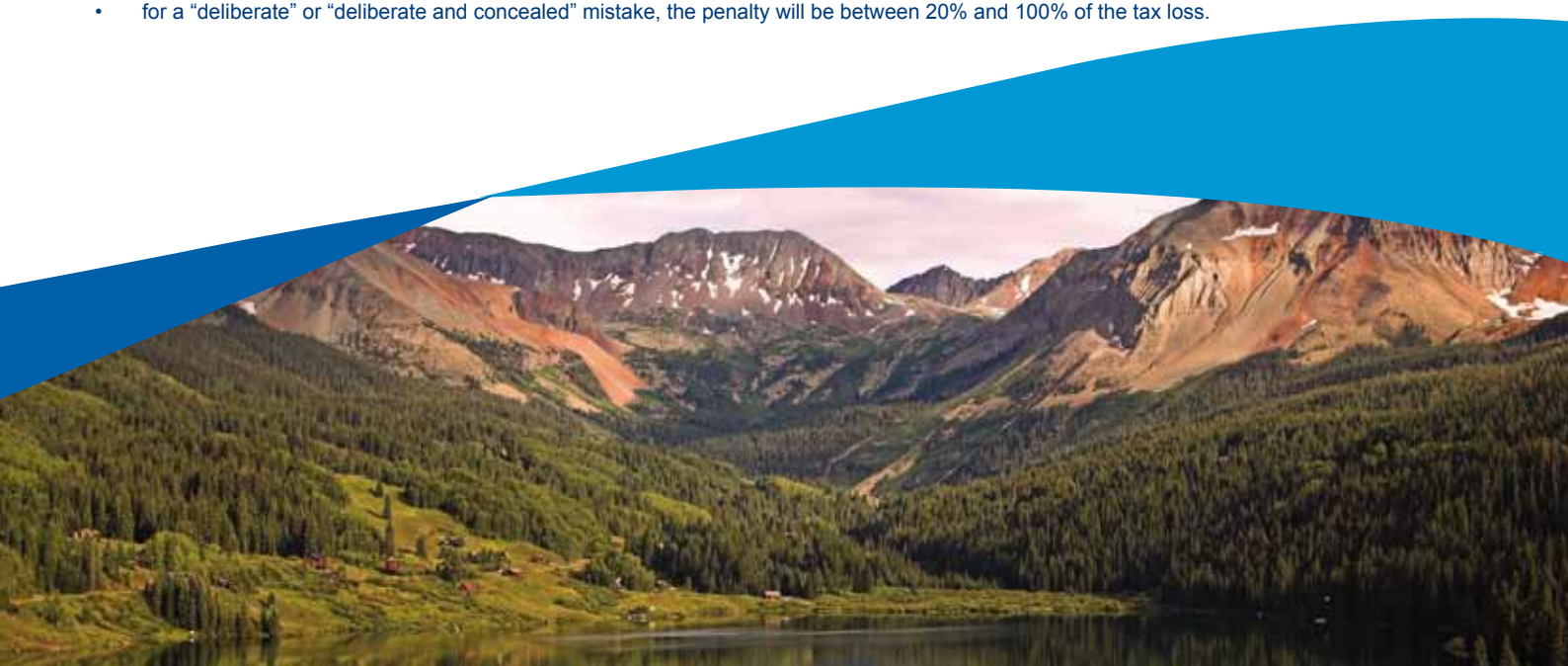
The penalty for failing to notify an obligation to register for VAT on time has changed. Penalties applied will vary according to the reason and where it can be shown there is:

- “reasonable excuse” or “not deliberate”, the penalty will be between 0% and 30%; but
- if the failure is considered “deliberate” or “deliberate and concealed”, the penalty can be between 20% and 100% of the tax due in the period.

## Inaccuracy penalty

A penalty will be applied if a VAT return is inaccurate and as a result insufficient VAT is paid. The penalty rate depends upon the type of inaccuracy and type of disclosure. HMRC may not charge a penalty if it can be shown the business took “reasonable care” to get things right but still made a mistake. Penalty rates will be:

- for a “careless” mistake the penalty will be between 0% to 30%; and
- for a “deliberate” or “deliberate and concealed” mistake, the penalty will be between 20% and 100% of the tax loss.





If an agent completes the VAT return, it is still the responsibility of the business to make sure the return produced is correct. In addition, HMRC can also charge a penalty to a third party if they deliberately withhold information or deliberately supply false information to another person who has to complete a return or provide documents.

If an error is discovered in a document after it has been submitted HMRC must be advised promptly, otherwise, despite taking reasonable care, HMRC may treat the error as a careless mistake and charge a penalty. This even applies to voluntary disclosures under the relevant thresholds (currently generally £10,000) which may be corrected on a current VAT return.

## Wrongdoing penalty

This is a new penalty introduced to prevent abuse in the VAT regime and will be applied where a person issues an invoice that includes VAT which they are not entitled to charge.

Again, the penalty will be based upon the type of wrongdoing and the type of disclosure.

- For “reasonable excuse” or “not deliberate” the penalty will be between 0% and 30%; and
- If the reason was “deliberate” or “deliberate and concealed”, the penalty will be between 20% and 100%.

## Late filing of returns and payment of tax

HMRC have also announced in the two recent budgets that they intend replacing the current late filing and payment penalty regime and bringing in separate penalties for the late filing of returns and the payment of VAT. It is anticipated these changes will be implemented in late 2010/early 2011.

The penalties are designed to encourage filing and payment by the correct dates by introducing an escalating series of penalties (regardless of whether there is a VAT liability) depending upon the number of failures within a set period and also if there is a prolonged delay in filing returns or paying VAT.

The penalty for late filing starts at £100 and can increase to a maximum of £400, although a tax related penalty can also apply after six and 12 months. In addition, penalties for late payment can also apply which can range from 2% to 5% of the tax due.

## EC Sales Lists (“ESLs”)

Following the recent changes to the EC VAT system where UK and Isle of Man businesses have to prepare monthly and/or quarterly ESLs for supplies of goods and/or services, penalties have now been introduced.

If the ESL is submitted late, a business may be liable to a daily penalty of £5, £10 or £15, with the actual rate depending on the number of times the business has been late. The business will remain liable to penalties until 12 months has elapsed without further default. In addition, if an ESL contains a material inaccuracy (eg data missing, invalid VAT numbers are used and information on the ESL is factually incorrect) and HMRC is not notified a penalty of £100 can be charged, unless it can be demonstrated that reasonable care was taken. Initially such penalties may not be levied whilst the new ESL system is implemented.

# News from the EU

## Weald Leasing case

This case is of importance to many businesses that are involved in asset leasing. The UK believes arrangements where a business that cannot obtain credit for all VAT incurred defers the payment of VAT by entering into a lease agreement with a related leasing company is “abusive”.

The European Commission has indicated that their view is that leasing per se is not abusive, although other aspects of the case may well be. The opinion of the Advocate General is expected later in the year, but the omens look good, especially for yacht leasing arrangements that have recently been blocked in the Isle of Man.

## Facet Trading BV case

This case could have a significant impact on those businesses that are involved in cross border trading within the EC. Where a customer provides a VAT number to a supplier VAT is accounted for by the customer using their VAT number, under the “fallback provisions”. Previously the imputed VAT was available for recovery, but in the case of Facet goods were sold by customers in several EU countries to a Dutch company. The goods were delivered to Spain and the customer’s Dutch VAT number was quoted. The question posed was whether the Dutch company had the right to deduct the VAT accounted for in Holland. The ECJ ruled that there was no such right of recovery anywhere other than the place of final destination of the goods.

UK legislation does currently provide for recovery in such circumstances and it is understood that HMRC are currently reviewing their legislation in this regard. Whilst this will not affect supplies of goods undertaken under the so called “triangulation” provisions this will impact on other transactions, particularly those involving yacht purchases.

## VAT grouping

The European Commission have recently referred the UK to the ECJ with regard to their treatment of VAT groups. As previously advised, in 2009 the Commission requested the UK (and six other states) review their domestic legislation relating to VAT grouping.

The UK permits non-taxable companies (eg holding or dormant companies) within VAT groups, which is not in accordance with EU legislation. Further action will now be considered by the ECJ, but if upheld it is likely that the suggested changes will have a significant impact on many structures, particularly those operating in the financial sector.





## VAT rate increases

VAT rates continue to increase throughout Europe and included is a 1% rate increase on all rates in Portugal (which will see the standard rate increase to 21%) and further increases in the rates of VAT will be introduced in Greece from 1 July 2010 taking the standard rate to 23%, notwithstanding the rate was only increased on 15 March 2010. The largest increase however is to be introduced in Romania where the standard rate will increase by 5%.

The impact of the changes notified can be seen on the following table, which details the rates currently applying, or due to be enforced, on 1 July 2010.

Austria	20	Germany	19	Netherlands	19
Belgium	21	Greece	23	Poland	22
Bulgaria	20	Hungary	25	Portugal	21
Cyprus	15	Ireland	21	Romania	24
Czech Republic	20	Italy	20	Slovakia	19
Denmark	25	Latvia	21	Slovenia	20
Estonia	20	Lithuania	21	Spain	18
Finland	23	Luxembourg	15	Sweden	25
France	19.6	Malta	18	UK	17.5

In France, however, TVA on restaurant services has been reduced to 5.5%, which has been welcomed by operators, but a recent proposal to reverse the rate change has been over turned. Calls to reduce the rate on such services have recently been made in the UK, which will no doubt be strengthened following the notification of the rate increase.

## VAT news from elsewhere

New Zealand has announced an increase in its standard rate of VAT from 12.5% to 15% to be effective from 1 October 2010

In Canada the implementation of the Harmonized Sales Tax (HST), which seeks to combine the Goods and Services Tax (GST) and Provincial Sales Tax (PST) into a single sales tax, is gathering pace and to date Ontario, British Columbia and Nova Scotia have either announced an implementation or increase in rate of the tax.

Jersey implemented a Goods & Services Tax, identical in many respects to VAT, in May 2008. At that time the standard rate, which applied to most goods and services was 3%, which was set for a minimum period of three years. Recently, however, the States of Jersey issued a tax consultation document that proposes an increase in the rate to 5%, although to meet the anticipated budget deficit it is envisaged that a much more significant rise would be required.

Guernsey meanwhile has announced a review of its taxation system, which cannot rule out the introduction of a GST or VAT system at some stage in the near future.

## Contacts

SMP Accounting & Tax now have a dedicated team of four staff working full time on VAT. The VAT team are able to provide VAT compliance services for businesses based in the Isle of Man, UK and Ireland. In addition, VAT consultancy can be provided in respect of any situation from structuring a business, to advice on particular transactions or dealing with the relevant Revenue authorities.

For further detail on any VAT related matter please contact:

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