Implementing Directive which, as far as he could see, required there not to be a gap between Articles 44 and 45 of the PVD. Consequently, he found that the Trust was not required to account for the VAT on the investment management services it received from outside the EU.

UK legislation

Finally, the judge considered the impact on UK legislation, which he noted was clearly not compliant with his interpretation of Articles 43 and 44 of the PVD. Applying the principle of interpreting national legislation in accordance with EU law, he held that VATA 1994, s 7A could be read in conformity with the PVD if "or non-economic" was inserted in subsection 4(d), such that it read "received by the person otherwise than for private [or non-economic] purposes".

Discussion

There are a number of important features about this case. First and foremost, it clarifies the position of non-economic business activities, such as investment management fees paid by trustees of a charity, for the purposes of place of supply provisions. These, as this case demonstrates, fall into a gap between Article 44 and 45 of the PVD. Consequently, although they cannot be treated as supplies for private purposes, and therefore do not fall under Article 45, neither should they be treated in the same way as economic business activity under Article 44.

Secondly, this judgment demonstrates the willingness of the tribunal to allow a gap in the legislation where this did not lead to uncertainty. Despite the fact that the Trust's interpretation effectively left non-economic business activities outside the scope of Articles 44 and 45, the judge did not find this problematic as it did not undermine the efficacy of the system under the PVD as a whole.

Thirdly, it reiterates both the importance of and correct approach to the *Travaux Preparatoires*. The judge here made clear that while the *Travaux Preparatoires* are a key guide to interpretation where there are ambiguities in a convention, they must be sufficiently precise to be determinative. It is not enough that they hint at a certain interpretation, or point in that direction – they must, in the words of Lord Steyn, score a "bull's eye". However, even in cases, such as the present, where they are not sufficiently certain, they can be a helpful way of narrowing down the options legitimately available. While here the *Travaux Preparatoires* did not definitively provide an answer, they did make clear that any interpretation that required "acting as such" to be meaningless was inappropriate.

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VAT IN THE CONSTRUCTION INDUSTRY

Building a new reverse charge

The way VAT is accounted for in the construction industry will change from 1 October 2019. Draft legislation has been published, along with a variety of guidance notes, explanatory documents and policy papers.

In this article we will work through the new announcements and draw out some of the issues that businesses and their advisers will need to address.

Foundations

On 20 March 2017, a consultation paper was published following the Spring Budget 2017. The subject was the Government's concern that some contractors were registering for VAT, charging VAT to, and collecting VAT from, their clients, but then going missing without paying it to HMRC.

After considering several alternatives and after further mentions in the Autumn

Budget 2017 and the Budget 2018, a new domestic reverse charge was announced. Draft legislation and supporting documents were eventually published on 7 November 2018, the new rules becoming effective from 1 October 2019.

The plan

The Government's idea is that the potential loss of VAT can be prevented at one stroke by having the customers not pay the VAT to the suppliers at all. The mechanism chosen is the reverse charge.

It operates slightly differently from the reverse charge for international services, so it is known as the domestic reverse charge. But it is effectively the same: the supplier makes the supply and issues an invoice, but does not charge or collect VAT; the customer receives the supply and the invoice, but effectively charges the VAT on that supply to itself, recovering this as input tax in accordance with the usual rules for input tax recovery.

Simple.

The framework

The legislation will be known as Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019. The supply of specified construction services will fall under the new domestic reverse charge.

Specified construction services are:

(a) construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations;
(b) construction, alteration, repair, extension or demolition of any works forming, or to form, part of the land, including (in particular) walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipe-lines, reservoirs, water-mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence;
(c) installation in any building or structure of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection;
(d) internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration;
(e) painting or decorating the internal or external surfaces of any building or structure;
(f) services which form an integral part of, or are preparatory to, or are for rendering complete, the services described in paragraphs (a) to (e), including site clearance, earth-moving, excavation, tunnelling and boring, laying of foundations, erection of scaffolding, site restoration, landscaping and the provision of roadways and other access works.

Expressly excluded from these specified construction services are:

(a) drilling for, or extraction of, oil or natural gas;
(b) extraction (whether by underground or surface working) of minerals and tunnelling or boring, or construction of underground works, for this purpose;
(c) manufacture of building or engineering components or equipment, materials, plant or machinery, or delivery of any of these things to site;
(d) manufacture of components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or delivery of any of these things to site;
(e) the professional work of architects or surveyors, or of consultants in building, engineering, interior or exterior decoration or in the laying-out of landscape;

(f) the making, installation and repair of artistic works, being sculptures, murals and other works which are wholly artistic in nature;
(g) signwriting and erecting, installing and repairing signboards and advertisements;
(h) the installation of seating, blinds and shutters;
(i) the installation of security systems, including burglar alarms, closed circuit television and public address systems.

Looks simple enough. Provided you are supplying or purchasing one of the services in either list.

But there is more. The legislation states that any service expressly excluded from specified construction services is nevertheless covered by the new domestic reverse charge if it forms part of a single supply that includes a specified construction service. This will not always be straightforward to determine and there have already been numerous disputes across many industries as to whether some supplies are part of a wider, single supply or are discrete supplies in themselves.

The new law isn't finished yet: next come the excepted supplies. "Excepted" does not mean excepted from the excluded supplies, but excepted from the new domestic reverse charge. In other words, VAT is charged by the supplier as usual on:

- Supplies to an "end user". An end user is a taxable person who does not use the bought-in specified services in making their own supplies of specified services.
- Supplies to an intermediary supplier where there is a connection between the intermediary supplier and the end user or where they both have a relevant interest in the land, buildings or civil engineering works specified services.
- Supplies where payments in respect of a return under Regulation 4 of the Income Tax (Construction Industry Scheme) Regulations 2005 are not required, i.e.:
  - Small payments under £1,000 (for all supplies across a construction project), where HMRC has approved the customer for CIS purposes, and that customer:
    - is one of an approved list of public bodies, or
    - owns the property or is an agricultural tenant in the property on which they are working.
  - Reverse premiums.
  - Payments by a local education authority, such as payments by a maintained school.
  - Supplies in respect of property used for the customer's business (although letting or selling investment property is excluded from "business").
  - Private finance transactions where the customer is one of an approved list of a public bodies.
  - Where the customer is established for charitable purposes only.

Finally, there is the exception to these excepted supplies.

These excepted services can be agreed between sub-contractor and contractor to be included within the new domestic reverse charge if the supplier is also making, or has previously made, other supplies (not one of the "excepted supplies") to the same customer in relation to the same construction site.

Overview

All quite intricate. The VAT legislation on food is similarly structured and has led to a continuous stream of disputes with HMRC and cases in the tribunals. Let's hope this legislation develops less contentiously in practice.

In its simplest form, the new domestic reverse charge will apply to the listed construction services. If there is a reverse

charge element in a supply, then the whole supply will be subject to the domestic reverse charge.

If there has already been a domestic reverse charge supply on a construction site and if both parties agree (e.g. to avoid having to apportion services), the new domestic reverse charge will apply to all subsequent supplies on that site between the two parties.

In practice, therefore, contractors might find it simpler to insist, where possible, that their sub-contractors reverse charge all their services and the contractors will simply recover all the VAT incurred under the reverse charge, as their onward supplies will be taxable under the zero, reduced or standard rate. There will be some suppliers who cannot agree to apply the reverse charge, such as suppliers of goods only (materials, parts) without installation services, but this would minimise piecemeal charges of VAT and reverse charged services.

The drawback for the contractors is that they will be required to determine the appropriate rate of VAT for each supply by the sub-contractor.

Snags?

The concern with mixed supplies has been mentioned already, but if both supplier and customer agree this can be overcome by reverse charging the entire supply.

Another concern is the Guidance Note which was published at the same time as the draft legislation. This states HMRC's policy that it will be the end user's responsibility to make the supplier aware that they are an end user and that VAT should be charged in the normal way instead of being reverse charged. HMRC confirm that suppliers will need this stated in a written form and if the end user does not provide its supplier with confirmation of its end user status, it will still be responsible for accounting for the reverse charge. How many customers who are having some construction work done perhaps for the first time will be aware of this requirement? How many VAT-registered customers, on being handed an invoice by a contractor charging no VAT and referring to a reverse charge which the customer does not understand, will know to declare a reverse charge?

There is also the oddity that, under the domestic reverse charge, the customer does not enter the purchase in its sales in Box 6 of its VAT return. This is different from the domestic reverse charge that accountants are accustomed to and this too might cause inaccuracies.

Other points of interest?

Invoice formats

Invoices issued under the domestic reverse charge are required by law to include a reference to "reverse charge". There is no prescribed wording, but HMRC suggests that the following examples will be acceptable.

- Reverse charge: VAT Act 1994 Section 55A applies
- Reverse charge: S55A VATA 94 applies
- Reverse charge: Customer to pay the VAT to HMRC

Tax points

The provision of building and construction services are continuous supplies of services. The tax points are therefore the issue of a VAT invoice or the receipt of payment, whichever is earlier (VAT Regulations 1995 (SI 1995/2518), reg 90). Where there is a delay beyond one year in issuing a VAT invoice or receiving payment, an annual tax point will apply (SI 1995/2518, reg 94B(5)).

Finishing off

The new domestic reverse charge is an important development in the fight against suppliers who fail to pay to HMRC the VAT which has been collected from honest taxpayers. While it is not expected to create VAT losses to

contractors, the reverse charge is a counterintuitive mechanism and some issues will arise in an industry as large and varied as the construction industry.

Hopefully HMRC will proceed with a light touch while the new rules are bedding in!

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OUTPUT TAX APPORTIONMENT

Practical examples for businesses

Independent VAT consultant and author Neil Warren gives practical examples of when and how a business will need to apportion its output tax.

Exempt use

If a business did not claim any input tax when it bought an asset (or goods) because it wholly related to exempt activities, then the good news is that no output tax is payable when the item is sold in the future. The sale is exempt from VAT by virtue of VATA 1994, Sch 9, Group 14 – Supplies of goods where input tax cannot be recovered. But a twist to the tale is that if the asset was used for both exempt and taxable purposes, i.e. a proportion of input tax was claimed as residual input tax, then output tax is still chargeable on the full selling price. This is not such a good deal – 100% output tax being paid on the selling price but less than 100% claimed for input tax purposes.

Example 1

Janet trades as a financial services adviser, so is partly exempt for VAT purposes. She purchased a computer three years ago and only claimed 50% input tax under the partial exemption standard method (residual input tax) because the item was used for both taxable and exempt activities. She bought another computer at the same time and claimed no input tax because it wholly related to exempt use. Each computer is now being sold for £1,000 – how much output tax is payable?

Answer – the partial input tax claim mean that output tax is due on the full selling price of the first computer i.e. £1,000 x 1/6 = £166.67. But no output tax is due on the sale of the second computer because input tax was wholly blocked when it was purchased.

Private or non-business use

When input tax is blocked on the purchase of goods because there is partial or total use for private or non-business purposes, this part of the asset is being taken out of the business. So when it is subsequently sold, there is no output tax to declare on the same percentage. This outcome is particularly important for many charities, which often have non-business and business activities, but also many commercial organisations as well.

Example 2

Sean the builder bought a van for £5,000 plus VAT last year and only claimed input tax on 80% of the expense and he blocked the other 20% as being relevant to private use. He is now selling the van for £3,000 plus VAT.

Sean will want to ensure he does not overcharge VAT on the sale because it is possible the buyer might not be able to claim input tax. Output tax is charged on 80% of the selling price i.e. £3,000 x 80% x 20% = £480.

Flat rate scheme (FRS)

An important exception to the rules considered so far relates to the FRS. The sale of assets is always included as flat rate turnover if no input tax was claimed on the purchase of the item. So as an example, if a VAT-registered accountant who uses the FRS sold his business motor car for £3,000, he would not charge VAT on the sale to the buyer but must still account