

**Legislating an extra-statutory Concession – Group supplies  
using an overseas member – ESC 3.2.2**

**HM Revenue & Customs**

**Technical note**

**Publication date: 10 May 2011**

**Closing date for comments: 3 August 2011**

## Summary of Basic Information

<b>Subject of this consultation:</b>	This technical note concerns legislating for Extra-statutory Concession 3.2.2 which allows VAT groups to value a statutory intra-group charge in a fair way.
<b>Scope of this consultation:</b>	This note seeks views on the best legislative approach to giving effect to the concession. It also seeks comments on any potential further issues and the need for transitional arrangements.
<b>Who should read this:</b>	Partly exempt VAT groups that buy in services via group members with overseas premises. Businesses in sectors to which the concession currently applies (e.g. banks and insurance companies), organisations representing them and tax, accountancy or legal bodies are most likely to wish to comment.
<b>Duration:</b>	10 <sup>th</sup> May to 3 <sup>rd</sup> August 2011
<b>Enquiries:</b>	Enquiries about the content or scope of the consultation or requests for meetings should be addressed to Phil Mattacks, Deductions and Financial Services Team, Room 3C/12, 100 Parliament Street, London SW1A 2BQ; Tel 0207-147-0538; Email phil.mattacks@hmrc.gsi.gov.uk
<b>How to respond:</b>	Responses can be sent by Email or hard copy to Phil Mattacks at the above address
<b>Additional ways to be involved:</b>	As this is a technical consultation written responses would be most helpful. However, if a discussion would be helpful then please contact Phil Mattacks at the above address to discuss arrangements.
<b>After the consultation:</b>	A response document, draft clauses and, if appropriate, regulations will be exposed for further consultation in the Autumn for inclusion in Finance Bill 2012.
<b>Getting to this stage:</b>	Requests for guidance on this area led to the release of Revenue and Customs Brief 16/11, copied in the Annex below. This sets out how the ESC should be interpreted pending its legislation.
<b>Previous engagement:</b>	None

## Introduction

At Budget 2011 the Government announced its intention to bring forward legislation to give statutory effect to a concession HMRC operates relating to VAT grouping. Before exposing the draft legislation for comment, views are welcome on the approach to be taken.

### 1 The concession

#### Some basics on reverse charges and VAT groups

##### Reverse charges

A special rule is needed when services supplied by an overseas supplier are received in the UK, and VAT rules provide that the supply takes place in the UK. Those services need to be taxed in the UK but the supplier will not be based or registered here. VAT rules provide that the person receiving the supply has to tax it and this is done by a 'reverse charge'. The person receiving the supply calculates VAT on it and declares that to HMRC alongside other VAT on the supplies they make. They can recover the VAT along with other VAT on their purchases, but only insofar as the supplies received will be used to make onward taxable supplies.

##### VAT grouping

VAT grouping is a facility to treat several corporate bodies, which are closely linked and under common control, as if they were a single entity for VAT purposes. The group is treated as a 'black box' with all supplies between grouped companies ignored and only supplies from or to persons outside the group taken into account. All group members must have a UK establishment but they may also have overseas establishments.

#### The issue – why the ESC was needed

In 1997 legislation was introduced to combat a VAT avoidance scheme. The scheme was a way of partly exempt VAT groups avoiding being charged VAT on some services received. The services were those listed in Schedule 5 of the VAT Act; services supplied where received. Services (whether sourced in the UK or abroad) were routed through a VAT group member belonging abroad. No VAT was charged to the overseas group member because the supply was made outside the UK and was thus not within the scope of UK VAT. The services were then introduced into the UK via an intra-VAT group charge. As intra-VAT group charges are disregarded for VAT purposes, then again no VAT was chargeable. The net result was VAT-free services.

The legislative solution to this avoidance was to make the VAT group declare a reverse charge on the intra-group supply. The charge applies when an intra-group supply either is a recharge of, or makes use of, supplies of services which the overseas member received overseas. Where this rule applies the normal rules for valuing reverse charges also apply.

This new rule often went further than simply removing any tax advantage that would otherwise be gained. It included services generated within the group in the value of the charge, thus eroding the purpose of VAT grouping. The ESC was needed to restrict the impact of the new legislation to removing unjustified advantages.

## **The introduction of the ESC**

What is now ESC 3.2.2 in Notice 48 was first announced in 1997 in Business Brief 11/97 (both the current version and the version from the original Brief are in the Annex). It allows reverse charges required under the amended VAT grouping rules to be valued only by reference to the overseas services included in the intra-group supply, so long as the values can be evidenced and are not artificially low. It was intended initially that the ESC would quickly be replaced with VAT regulations, but this did not happen and the ESC is still in operation.

## **Changes to place of supply of services rules**

The rules for determining where supplies of services are made changed on 1<sup>st</sup> Jan 2010. Far more services are now treated as supplied where received because the new general rule is that all services supplied from one business to another are supplied where the recipient belongs. Schedule 5 of the VAT Act (which was a list of the services treated as supplied where received) became redundant and was repealed. The VAT grouping rules were updated so that all references to Schedule 5 were replaced by references to where the new rule is set out in the law (section 7A of the Act – not reproduced in the Appendix).

## **The effect of the above changes on the ESC**

The purpose of the ESC remains unchanged but its precise wording has become outdated (as it still refers to Schedule 5). Despite its purpose being unchanged the 2010 place of supply changes have resulted in the necessity to apply the ESC on a wider basis. This is because more services are now treated as supplied where received. HMRC have released a Revenue and Customs Brief (16/11 included in the Annex) setting out how the ESC should be read in the light of the recent changes.

The ESC needs to be legislated or withdrawn as it does not accord with the guidance of the Courts in the case of *Wilkinson (R v HM Commissioners of Inland Revenue ex p Wilkinson)* [2005] UKHL 30). The widened scope of the services that the ESC was originally intended to provide for means that we need to make this change quickly. It also means that the way that many of HMRC's ESCs have been legislated, based on a special provision in Finance Act 2008, cannot be used.

## **The way forward and this consultation**

The Government has announced that legislation to give effect to the ESC will be included in Finance Bill 2012 and that the ESC will be applied in a way that will maintain its intended effect in the interim. The decision to legislate has been taken and is not the subject of this consultation.

## **2 Options for legislation**

### **Preferred option – amending Schedule 6 of VAT Act 1994**

VAT group rules in section 43(2C)(c) of VATA state that the charge created is valued as if it were a normal reverse charge under section 8 of VATA.

Schedule 6 to VATA is the schedule of ‘valuation: special cases’. Paragraph 8 of Schedule 6 sets out how reverse charge services are to be valued. So paragraph 8 of Schedule 6 is the law that the ESC provides a relief from when valuing charges arising from intra-group supplies.

Given the above, an additional valuation rule in Schedule 6 is the obvious way of bringing the ESC into the law. It is envisaged that the new provision would set out the following rule to be applied to the charges created by section 43(2A) of VATA.

- Where the taxpayer concerned can demonstrate the value of bought in services included within the intra-group charge to the satisfaction of the Commissioners, and the services were bought in for at least an open market value, the charge will be valued at the aggregate value of the bought in services
- Where the taxpayer can demonstrate the value of the bought in services, but that value is less than open market value for some of the bought in services, the open market value of bought in services will be substituted where necessary in valuing the charge
- Where the taxpayer cannot demonstrate the value of the bought in services the charge will be valued at the whole of the intra-group supply

To leave flexibility in case of further changes to VAT grouping rules the new provision would create a power to amend the new paragraph of Schedule 6 by Treasury Order.

### **Alternative option – valuation regulations in the VAT Regulations**

When the ESC was first announced (in Business Brief 11/97, a copy of which is included in the Annex) it was also announced that regulations would be made quickly to give legislative effect to the ESC. HMRC thought at that time that section 43(2C) of VATA gave a power to the Commissioners to set the valuation by regulation.

HMRC now consider that section 43(2C) does not give such a power to the Commissioners. However taking and then using a regulation-making power remains an option now. The new regulations would set out the same valuation rule as is set out above.

The Schedule 6 option is preferred as it is more direct, made in the normal place for valuation special cases and no less flexible in case of future

changes to VAT grouping rules. However an alternative option could be considered if there are good reasons to do so.

**Question 1**

- (a) Is amending Schedule 6 to the VAT Act 1994 the most sensible way of legislating for this ESC?**
- (b) Does it achieve the intended result? If not, why not?**
- (c) Would the alternative of legislating a power to make regulations and then making those regulations be a better way of legislating? If so, why? What would be the impact?**
- (d) Are there any further, better options that have been overlooked?**

### **3 Other issues and transitional matters**

HMRC wants to ensure that nothing is overlooked in legislating the concession.

#### **De-minimis levels of bought in services**

When the ESC was first announced (in Business Brief 11/97, a copy of which is included in the Annex) a 'de-minimis' element of intra-group supplies (i.e. when the element of an intra-group supply that is a re-charge of bought in services is so low that it can be ignored) was also addressed. The rule of thumb was that if the bought in supplies were 5% or less of the total value, this would be ignored, subject to certain provisos.

We consider that this element of the original announcement does not need to be legislated as it was not concessionary. The law is not concerned with trifles so, in the present circumstances, where the element of an intra-group supply that represents recharged bought in services is trifling, a charge will not be required to be calculated.

As a result HMRC does not intend to include any reference to de-minimis levels of bought in services in whatever legislation is made. HMRC will set out its policy on the circumstances in which the element of an intra-group charge will be considered to be so trifling that it can be ignored.

#### **Question 2**

- (a) Do you agree that it is not necessary to legislate for a de-minimis level of bought in services included in intra-group supplies below which they can be ignored?**
- (b) Is the 1997 guidance material on de-minimis essentially right?**

#### **Transitional issues**

Given that the legislation is intended to preserve the effect of ESC 3.2.2 no transitional rules or special arrangements are anticipated. However, we want to ensure that nothing is overlooked and that any necessary arrangements are built in to ensure that the legislation causes no disruption.

#### **Question 3**

**Will any transitional arrangements be necessary on the introduction of the new law, whether under the preferred or alternative options or under another way of legislating?**

## **4 Summary of questions**

### **From section 2 – options for legislation**

#### **Question 1**

- (a) Is amending Schedule 6 to the VAT Act 1994 the most sensible way of legislating for this ESC?**
- (b) Does it achieve the intended result? If not, why not?**
- (c) Would the alternative of legislating a power to make regulations and then making those regulations be a better way of legislating? If so, why? What would be the impact?**
- (d) Are there any further, better options that have been overlooked?**

### **From section 3 – other issues and transitional matters**

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- (a) Is the 1997 guidance material on de-minimis essentially right?**

#### **Question 3**

**Will any transitional arrangements be necessary on the introduction of the new law, whether under the preferred or alternative options or under another way of legislating?**

## **5 Other matters**

### **Who is being consulted?**

This document is being circulated to Joint VAT Consultative Committee (JVCC) members plus banking organisations not represented on the JVCC. Those circulated are welcome to pass the document on to any further stakeholder persons or bodies overlooked. The document will also be on the HMRC web site consultations page and accessible via link from the HM Treasury web site Tax Consultation Tracker.

### **How to respond**

Responses should be with HMRC by 3<sup>rd</sup> August 2011. They may be sent by Email or hard copy to; -

Phil Mattacks,  
Deductions and Financial Services Team, VAT Directorate  
Room 3C/12,  
100 Parliament Street,  
London SW1A 2BQ

Tel 0207-147-0538 – Email [phil.mattacks@hmrc.gsi.gov.uk](mailto:phil.mattacks@hmrc.gsi.gov.uk)

HMRC will publish the responses to this consultation when it is complete. The form of the publication will depend on what responses are received.

### **Confidentiality**

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

## Annex - Relevant (current) Government Legislation and Extra Statutory Material

**The following is an extract from Finance Act 1997, setting out the additions made to VAT grouping rules at that time to counter VAT avoidance.**

### 41 Group supplies using an overseas member

(1) In section 43 of the Value Added Tax Act 1994 (groups of companies), after subsection (2) there shall be inserted the following subsections—

"(2A) A supply made by a member of a group ("the supplier") to another member of the group ("the UK member") shall not be disregarded under subsection (1)(a) above if—

(a) it would (if there were no group) be a supply of services falling within Schedule 5 to a person belonging in the United Kingdom;

(b) those services are not within any of the descriptions specified in Schedule 9;

(c) the supplier has been supplied (whether or not by a person belonging in the United Kingdom) with services falling within any of paragraphs 1 to 8 of Schedule 5;

(d) the supplier belonged outside the United Kingdom when it was supplied with the services mentioned in paragraph (c) above; and

(e) the services so mentioned have been used by the supplier for making the supply to the UK member.

(2B) Subject to subsection (2C) below, where a supply is excluded by virtue of subsection (2A) above from the supplies that are disregarded in pursuance of subsection (1)(a) above, all the same consequences shall follow under this Act as if that supply—

(a) were a taxable supply in the United Kingdom by the representative member to itself, and

(b) without prejudice to that, were made by the representative member in the course or furtherance of its business.

(2C) A supply which is deemed by virtue of subsection (2B) above to be a supply by the representative member to itself—

(a) shall not be taken into account as a supply made by the representative member when determining any allowance of input tax under section 26(1) in the case of the representative member;

(b) shall be deemed for the purposes of paragraph 1 of Schedule 6 to be a supply in the case of which the person making the supply and the person supplied are connected within the meaning of section 839 of the Taxes Act (connected persons); and

(c) subject to paragraph (b) above, shall be taken to be a supply the value and time of which are determined as if it were a supply of services which is treated by virtue of section 8 as made by the person by whom the services are received.

(2D) For the purposes of subsection (2A) above where—

(a) there has been a supply of the assets of a business of a person ("the transferor") to a person to whom the whole or any part of that business was transferred as a going concern ("the transferee"),

(b) that supply is either—

(i) a supply falling to be treated, in accordance with an order under section 5(3), as being neither a supply of goods nor a supply of services, or

(ii) a supply that would have fallen to be so treated if it had taken place in the United Kingdom,

and

(c) the transferor was supplied with services falling within paragraphs 1 to 8 of Schedule 5 at a time before the transfer when the transferor belonged outside the United Kingdom,

those services, so far as they are used by the transferee for making any supply falling within that Schedule, shall be deemed to have been supplied to the transferee at a time when the transferee belonged outside the United Kingdom.

(2E) Where, in the case of a supply of assets falling within paragraphs (a) and (b) of subsection (2D) above—

(a) the transferor himself acquired any of the assets in question by way of a previous supply of assets falling within those paragraphs, and

(b) there are services falling within paragraphs 1 to 8 of Schedule 5 which, if used by the transferor for making supplies falling within that Schedule, would be deemed by virtue of that subsection to have been supplied to the transferor at a time when he belonged outside the United Kingdom,

that subsection shall have effect, notwithstanding that the services have not been so used by the transferor, as if the transferor were a person to whom those services were supplied and as if he were a person belonging outside the United Kingdom at the time of their deemed supply to him; and this subsection shall apply accordingly through any number of successive supplies of assets falling within paragraphs (a) and (b) of that subsection."

### **The following is an extract from Public Notice 48 setting out the currently published form of the concession**

#### **3.2.2 Second part of concession**

Second, the amount of the tax charge under section 41 is calculated with reference to the value of the supply by the overseas member to the UK member. By concession, the value for calculating the tax charge may be reduced to the value of the Schedule 5 services purchased by the overseas group member, provided that the group is in a position to provide evidence in the UK of the value of those services, and that those services have not been undervalued. This concession will be given legal effect when Regulations are made under section 41.

**The following copy Business Brief has had elements not relevant to this consultation removed. Removed sections are replaced by a ...**

**Business Brief 11/97 09 May 1997**

**GROUP SUPPLIES USING AN OVERSEAS MEMBER - Section 41 of Finance Act 1997**

Since 26 November 1996 there has been a tax charge for the representative member of a VAT group, where certain supplies are purchased by an overseas member of a VAT group and used for making supplies to a UK member of the VAT group. Supplies affected are those set out in Schedule 5 to the VAT Act and include the assignment of copyright, advertising services, data processing and legal services, amongst others.

This business brief sets out two extra statutory class concessions (ESCCs), and a general statement of Customs' approach to the new measure.

The first ESCC anticipates government amendments passed during Committee Stage of the Finance Bill ...

### **Legal Background to both ESCCs**

With effect from 26 November 1996, a resolution under the Provisional Collection of Taxes Act has created a new tax charge for the representative member of a VAT group, where supplies of a type set out in Schedule 5 to the VAT Act are purchased by an overseas group member and used for making Schedule 5 supplies to a UK group member. This new tax charge was made permanent when the Finance Act 1997 was passed on 19 March 1997. The new tax charge is given effect by Section 41 of the Finance Act, which inserts the new rules into section 43 of the VAT Act at paragraphs (2A) to (2E).

### **First ESCC - Anticipation of Legislative Changes**

...

First ...

Second, the amount of the tax charge under Section 41 is calculated with reference to the value of the supply by the overseas member to the UK member. By concession, the value for calculating the tax charge may be reduced to the value of the Schedule 5 services purchased by the overseas group member, provided that the group is in a position to provide evidence in the UK of the value of those services, and that those

services have not been undervalued. This concession will be given legal effect when Regulations are made under Section 41. Draft regulations will be available for consultation by the end of the Summer.

This concession may not be used for the purposes of tax avoidance.

## **Second ESCC - Transitional Relief**

...

## **General Statement of Customs' Approach to Clause 41**

Since its introduction, Customs have received some recurring questions on how they will implement Section 41 in practice. Set out below are guidelines covering a variety of specific situations.

### **Evidence for reduced value**

Under the first ESCC, the value for calculating the Section 41 charge may be reduced to the value of the Schedule 5 services purchased by the overseas group member, if the group can provide evidence in the UK of the value of those services. Copies of invoices from the external supplier to the overseas group member will be acceptable evidence of the value of a bought-in service.

Alternatively, businesses may be able to agree with their local VAT assurance officer that different evidence is adequate. For example, where the overseas group member buys in services and applies a fixed mark-up, documentary evidence of this would normally satisfy a local officer that the value of the bought-in service was equal to the value of the onward supply less the mark-up.

Copy invoices or mark-up agreements are likely to be meaningful only where a service is bought-in by an overseas group member for the exclusive use of a UK group member. In many cases, an invoice to an overseas group member may not relate exclusively to an onward supply to a UK group member. Or, an overseas group

member may not code its costs according to the recipient of any intended onward supply at the time when those costs are incurred. It may calculate the value of its onward supply to each of its associated companies by uplifting its total costs, and then allocating shares to associated companies in accordance with a predetermined formula.

In these cases it will be necessary for the VAT group to calculate a fair and reasonable value for the Section 41 charge. The evidence required to support the reduced value would depend on the method of calculating it. However, in most cases the following evidence will be satisfactory - a summary statement of the overseas member's costs; and an outline of the basis on which the overseas member calculates its charge; and a record of the method for reducing the Section 41 charge to an amount based on the bought-in supplies.

Customs do not expect a group to estimate the costs that should be allocated to a supply where services have been bought in by the overseas member and supplied to the UK member in substantially the same state. In this case we expect the value to be accurate, and to be supported by documentary evidence.

### **Evidence not available**

Taxpayers who are not in a position to demonstrate a reduced value must account for VAT with reference to the full value of the intra-group supply. This does not require groups to provide Customs with evidence of reduced values prior to filling in their VAT Returns. Rather, they must be in a position to substantiate the value later, if asked.

### **De minimis levels**

Section 41 is triggered when an overseas member of a VAT group receives a Schedule 5 service, and uses this service for making a supply to another group member. If the bought-in supply forms a cost component of the onward supply, then the measure is triggered. However, a legal provision will not be applied to circumstances which the Courts consider to be de minimis.

An example of this for Section 41 might be where a company second staff to a fellow group member, and takes external legal advice on contractual arrangements. By far the greater part of the onward charge would relate to staff salaries. In such circumstances, Customs will take the view that the extent to which a supply is bought in and used for making an onward supply is de minimis, with the result that no tax charge arises.

As a rule of thumb, bought-in supplies are de minimis if their value is less than 5% of the value of the supplies from the overseas group member to the UK group member. However, Customs will not apply this rule mechanically, either if they suspect that supplies or values have been manipulated in order to meet the 5% test, or if they feel that, despite the fact that the 5% test is not met, the Section 41 charge would be insignificant. The extent to which VAT on the Section 41 charge could be recovered under the group's partial exemption method, along with the amount of the charge in the context of the group's size, will be considered when deciding whether or not a potential Section 41 charge is de minimis.

Evidence to show that the value of the bought-in Schedule 5 service is very small in the context of the overall supply will vary from case to case. In the example of supply of staff, the group would generally only be required to provide a copy of the agreement under which the staff were seconded. This should show that the supply was a supply of staff from a fellow group company. It should also be possible to see that the value of the supply was consistent with the number of staff seconded, so that any recharge of bought-in Schedule 5 services must be very small in the context of the overall supply.

### **Taxable, or nearly fully taxable groups**

Section 41 is principally an anti-avoidance measure aimed at the exempt sector, but it does not exclude fully taxable groups. Most groups affected by the measure will have some element of exemption, and it was not feasible to draft a specific threshold for Section 41 which would be proof against manipulation. Fully taxable groups should account for any Section 41 charge.

However, a fully taxable group is not expected to go to great lengths to demonstrate that its Section 41 supplies are de minimis or to justify any apportionment of supplies from overseas members between services falling within Schedule 5 and other supplies. In the unlikely event that Customs disagreed with the view taken by the group on these points, an assessment may be raised, but no interest or penalties would apply.

Groups which are almost fully taxable will have to account for the Section 41 charge in the same way as any other partly exempt group. They will be able to negotiate what evidence is required to reduce the value of their charge. Also, such groups can expect their local assurance officer to take into account the extent to which VAT on the charge could be recovered under the group's partial exemption method, along with the amount of the charge in the context of the group's size.

Some groups may even wish to propose a change to their partial exemption method, so that the Section 41 charge can be treated in a straightforward way for partial exemption purposes. In most cases it is expected that the Section 41 charges will be dealt with unproblematically within the terms of existing partial exemption methods.

### **Interim Payments**

... [overtaken by subsequent law changes]

## **Revenue & Customs Brief 16/11**

### **VAT: reverse charges within VAT groups – legislating a VAT grouping Extra Statutory Concession (ESC 3.2.2)**

#### **1. Introduction**

HM Revenue & Customs (HMRC) have a published Extra Statutory Concession (ESC) covering how a tax charge applicable to VAT groups should be calculated (ESC 3.2.2). HMRC is reviewing all its ESCs following the Wilkinson decision (R v HM Commissioners of Inland Revenue ex p Wilkinson [2005] UKHL 30). ESC3.2.2 is not 'Wilkinson' compliant. The Government intends to legislate to give statutory effect to ESC 3.2.2. This Brief sets out how the ESC should be applied in the interim.

#### **2. Who needs to read this?**

This ESC affects UK VAT groups with an overseas member that buys services from persons outside the VAT group and uses them to make supplies to the UK members.

### **3. Background**

A VAT group comprises two or more corporate bodies under common control within a single VAT registration. A VAT group can contain members that are established overseas provided that they are also established in the UK. Transactions between members of a VAT group are normally disregarded for VAT purposes.

In the mid-1990s a VAT avoidance scheme allowed partly exempt VAT groups to avoid paying VAT on certain services they bought in. The services involved were those where the VAT is accounted for by the customer. Services used in the UK would be bought by a VAT group member abroad so that UK VAT would not be charged (the supply being made outside the UK and thus outside the scope of UK VAT). The services would then be routed to the UK user via an intra-VAT group charge. As intra-VAT group charges were ignored for VAT purposes no VAT was chargeable at that point either. The net result was VAT-free services.

Anti-avoidance legislation was enacted in 1997 requiring a tax charge to be declared on certain supplies by the overseas members to the UK members of the group. The tax charge arose where:

- the supply incorporated services bought by the overseas member that would be treated as supplied here if bought by the UK members ('reverse charge services')
- and the supply was taxable and itself would have been treated as supplied in the UK

The legislation applied the tax charge to the whole intra-group transaction whereas the avoidance scheme only related to services bought in from third parties.

### **4. The purpose of the ESC**

ESC 3.2.2 was brought in to ensure that the anti-avoidance provision was limited to removing the tax advantage from such structures. The following is an extract from ESC 3.2.2:

'...the amount of the tax charge...is calculated with reference to the value of the supply by the overseas member to the UK member. By concession, the value for calculating the tax charge may be reduced to the value of the Schedule 5 services purchased by the overseas group member, provided that the group is in a position to provide evidence in the UK of the value of those services, and that those services have not been undervalued.'

The ESC works by restricting the tax charge to the value of reverse charge services bought in by the overseas member. These services were listed in Schedule 5 VAT Act 1994.

### **5. Changes to place of supply of services (POSS) rules**

On 1 January 2010 the POSS rules changed. The general rule determining where a supply was made for business to business transactions changed from the place where the supplier belongs to where the customer belongs. As a result of this change, Schedule 5 became redundant and was repealed.

### **6. How ESC 3.2.2 should be applied until it is legislated**

Where a group makes use of this ESC, it should be applied in a way that maintains its intended effect. To achieve this, the reference to Schedule 5 should be read as a reference to the new general rule for supplies to businesses, in VATA 1994 s7A(2)(a). The ESC will continue to allow VAT groups to value the tax charge by reference to the services the overseas member has bought in that would now be treated as subject to UK VAT if the UK group member bought them direct. Evidence of the value of the services bought in, and that they have not been undervalued, will still be needed.

### **7. Legislating ESC 3.2.2**

The Government will commence a technical consultation with stakeholders in May 2011.

Issued: 25 March 2011