

How to Save Tax with E-Commerce

VAT - UK ASPECTS

Is there a business for VAT purposes?

Many people buy and sell items using the internet on auction sites like "ebay" and "Amazon Marketplace" but they are not necessarily in business for UK VAT or tax purposes. They may be just selling on second hand items. So, the Taxman looks for indicators to determine whether an activity is a business that should be registered for VAT. Essentially these boil down to whether the activity is being run commercially and over a period. Liability to VAT is unlike income tax. It is not necessary to register for income tax but your activity should be for making a profit. On the other hand VAT only requires that there is a profit. That is, someone supplies goods or services and a return for some value. So, even if you make a profit they can still be subject to VAT if the activity is being run commercially. The "robot" to identify internet tra

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GENERAL TAX CONSIDERATIONS

What are the general tax considerations for e-commerce?

Income from selling over the Internet is treated the same way for tax purposes as that generated by any other method. But there can be differences in the VAT treatment of electronically supplied goods and services compared to providing them conventionally. Apart from VAT, there are no specific tax issues affecting income generated through Internet sales, but there are a good many tax issues to watch out for in respect of the costs incurred in creating and running a website. You'll need to be alert to make sure you get all the tax relief you're entitled to.

Is there a business for tax purposes?

Individuals and partnerships. Sometimes it is difficult to judge when your hobby of, say, selling items on Internet auction sites has turned into a business. If you are buying things to sell online as an individual, the Taxman may well classify your activities as a business. In this case you must register your business with the Taxman as a self-employed person and start to pay Class 2 NI contributions. You must do this within three months of starting your online business.

TIP

You can register for tax and National Insurance online at <http://www.hmrc.gov.uk/selfemployed/register-selfemp.htm>

Companies. When your company is formed and registered at Companies House, the Taxman is automatically notified and will send you a form CT41G to register for Corporation Tax. If you don't receive this form within a few months you should contact the Tax Office nearest to your company's registered office address and ask for one.

INCOME AND CORPORATION TAX - UK ASPECTS

Expenses - what's the difference between revenue and capital?

Before your website is up and working you'll incur costs in setting it up. After that there will be maintenance expenses. These costs are divided into three types for tax purposes:

Revenue expenses. Relate to day-to-day running expenses and overheads, e.g. rent, wages, telephone charges etc. These can be deducted in full from your profits in the accounting period they are incurred.

Capital costs (1). Relate to equipment, e.g. machinery, computers and software etc. that is expected to last for more than one or two years. Tax relief for these is spread over a number of years, although in some circumstances it can be claimed all at once (see below regarding the "Annual Investment Allowance"). In some circumstances, intangible assets such as goodwill or trademarks that are used in the business can also be claimed under this heading.

Capital costs (2). Relate to establishment assets such as buildings. These expenses only get deducted in working out Capital Gains Tax when the asset is sold.

The distinction between revenue and capital costs (1) are more easily understood by considering the following example: When you buy a car, you make a capital purchase as the car is expected to last some years. When you put fuel in the car you incur a revenue cost, as the benefit to the business of that expenditure will only last until the fuel tank runs dry.

A capital cost can only be deducted from your profits for tax purposes if it qualifies for a special tax allowance called a "Capital Allowance" (CA). These allowances are the Taxman's version of depreciation. He gives tax relief on the cost of an item that is expected to have a use in the business for more than a year or two. So anything from desks to printing presses would be covered.

CAs are also allowed to companies that purchase or create intangible capital assets, such as trademarks or goodwill. But the rules don't apply to unincorporated businesses, such as sole traders or partnerships.

What's the Taxman's approach to website expenses?

The Taxman's view of commercial websites is rather stuck in the past. In his business income manual (**Para. BIM35870**) he says:

"The cost of a website is analogous to that of a shop window. The cost of constructing the window is capital; the cost of changing the display from time to time is revenue."

Based on this statement he may try to disallow the development costs of your website. His outdated view suggests that the website costs are similar to constructing a shop window, and so akin to the second type of capital costs mentioned above. But he'll allow you to deduct the website maintenance costs, similar in his mind to changing the window display, and the website hosting costs, equivalent to renting the window space.

However, most commercial websites do a lot more than merely display the goods and services for customers to view. Many websites function as shops and so should be treated for tax purposes more like tills or credit card readers. That is, equipment used in a business and so falling into the first category of capital costs referred to above. This approach is reflected in the Taxman's capital allowances manual (see

CA23410) but not as yet in his business income manual.

TIP

If the Taxman challenges your claim to a deduction for website production costs, quoting his own business income manual as the authority, point out that his more recently updated capital allowance manual contradicts this. It confirms that tax relief can be claimed on such costs.

What's the right tax deduction to claim?

In general, the Taxman now takes the view that the tax treatment for a transaction should follow the accountancy treatment unless there is specific tax law that says otherwise. In that light, website costs can be put into four categories:

1. Planning costs

This includes expenditure on undertaking feasibility studies, determining the objectives and functionalities of the website, exploring ways of achieving the desired functionalities, identifying appropriate hardware and web applications and selecting suppliers and consultants. These costs should be immediately written off against your profits.

2. Application and infrastructure development costs

This covers the costs of obtaining and registering a domain name, of buying or developing hardware and operating software that relate to the functionality of the site. Unless you are building your website in-house, most of these costs will be incurred by the supplier you engage to develop the website. See below for how this type of expenditure should be claimed for tax.

3. Design costs

This includes expenditure to develop the design and appearance of the individual website pages, including the creation of graphics. If you have hired a company to develop the website for you, these costs will be part of their fees. See below for how this type of expenditure should be claimed for tax.

4. Content costs

This includes preparing, accumulating and posting the website content. These may be recurring as well as one-off tasks. Recurring tasks will be generally incurred as maintenance costs, which are deductible as they are incurred. See below for how this type of expenditure should be claimed for tax.

You may need the help of your accountant to decide whether the website will be an enduring asset for your business, or just a short-term advertising medium such as a brochure that needs to be refreshed every few months.

Where your website is expected to generate sales or other revenues directly, for example by allowing orders or bookings to be placed, it is an enduring capital asset. In this case the costs in categories B and C above should be treated as capital expenditure, but qualifying for deductions for CAs.

Where the website is to act only as an online brochure, the costs should not be capitalised. All of the costs in categories A to D above should be set against the business profits in the year in which they are incurred.

So what happens if the expenses qualify for CAs?

Where the costs of the website development are treated as capital, most of these will relate to writing and arranging the computer code that makes the website function smoothly, and to protect it from electronic attacks. The Taxman agrees that the value of this computer software should be treated as if it were a physical piece of machinery (see **CA 23410**).

Generally, all plant and machinery, which is not fixed to a building and has become part of that building, qualifies for CAs. Thus the cost of developing the software for your website also qualifies. The law specifically allows for this in s.71 of the **Capital Allowances Act 2001**.

From April 1 2008 (or April 6 2008 for unincorporated businesses), all businesses can claim the cost of most plant and machinery against their Annual Investment Allowance (AIA). This is a capital allowance that can cover expenditure of up to £50,000 per year. The expenditure on plant and machinery within that AIA limit receives 100% tax relief in the year of purchase. Any expenditure on plant and machinery that exceeds the AIA cap for the year is given tax relief at the rate of 20% per year.

One AIA of £50,000 is permitted for each single business, or group of related businesses - where the AIA can be spread amongst the businesses as you see fit. The AIA only applies to expenditure incurred after March 31 2008 (for companies), and the total annual cap is reduced for the accounting period that straddles April 1 2008 (or April 6 2008 for unincorporated businesses).

Example

IQware Ltd spent £10,000 on developing its new website in the year ended March 31 2009. In the same year it also spent £5,000 on computers and printers, £1,500 on office furniture and £20,000 on a car. IQware is not run as part of a group of companies under common control, so the full AIA of £50,000 is available. The tax rules specifically exclude expenditure on the car from being part of the AIA. However, the remaining capital expenditure totalling £16,500 does qualify. IQware Ltd can claim a CA of £16,500 against its profits for the year ended March 31 2009.

What about the cost of the domain name?

The Taxman will not treat the cost of the domain name as if it were a physical asset like a piece of machinery, although he does take this view for the cost of software. This means the cost of buying a domain name won't qualify for CAs.

TIP

In practice it's common to lease your domain name, i.e. pay for using it, for relatively short periods, say two to five years. The annual cost is quite small, perhaps as little as £10. This will be treated as revenue expenditure and so can be set against profits in the year it is incurred.

You may find you have to pay more for the particular domain name you want if someone else has already registered the name with a view to selling it on for a profit. This is known as cyber-squatting. In this case your business will only get immediate tax relief for the cost of acquiring the domain name if you trade as a company. This is because the Taxman treats the domain name as an intangible asset, a bit like a trademark.

A company can claim the cost of depreciating the value of the acquired domain name against its annual profits, but an unincorporated business, such as a partnership or sole-trader, cannot.

Trap. If you expect to pay large sums to acquire intangible assets, such as trademarks, or domain names, ensure these purchases are made through the company that will use those intangible assets. If you buy intangible assets personally, the cost is a capital expense and you won't receive tax relief for it until you sell those assets on. Any profit or loss you make from doing this will be subject to the CGT rules.

What if I sell the domain name as part of my business?

At some point you may wish to sell your business, including all the brand names, trademarks and domain names you have acquired while building it up. The tax you pay on any profit you make on selling these business assets will depend on who actually sells the asset, you personally or your company.

Where a company sells a domain name, which has been used in its trade, the profits will be subject to Corporation Tax (CT) at the same rate that applies to other trading profits. Where the profits made by the company for the year are less than £300,000, and there are no associated companies, CT is charged at 21% (until at least March 31 2010). Profits of between £300,000 and £1.5 million per year are taxed at a marginal rate of 29.75%. There could also be further tax charges on shareholders and directors when the profit (gain) made from the sale is taken out of the company.

Where a domain name is owned and then sold by an individual, the profit will normally be taxed as a capital gain. Any profit (gain) will be subject to Capital Gains Tax at 18%. However, most individuals are only taxed on gains that exceed their annual capital gains exemption, which for the tax year 2009/10 is £10,100.

TIP

You can save tax if you own your business's domain name personally. Profit from selling it will be charged to CGT at a maximum of 18% compared with CT rates.

Trap. Individuals who are not domiciled in the UK, and who claim the special remittance basis tax treatment for their non-UK income and gains, are not entitled to the annual capital gains exemption, so are taxed on every penny of their UK gains.

TIP

If you're disposing (selling) the domain name along with the rest of your business, or a part that can be operated as a business by itself, any gain may qualify for entrepreneurs' relief. This relief can reduce the effective rate of tax on your gain down to 10%. Entrepreneurs' relief is limited to the first £1 million of gains made from disposing of business assets.

What if I sell the domain name by itself?

If you own the rights to a domain name, you may also hold three related assets that you could sell:

- (1) the contract with the registration authority which gives you the right to use that domain name.
- (2) goodwill which the name may generate.
- (3) a registered trademark in respect of the name.

Asset (1) is a contractual right between you and the domain registrar and does not strictly contain any intellectual property rights. The holding of the domain name in isolation does not give it any value, but it may be worth something when considered in conjunction with (2) and (3).

Assets (2) and (3) will only exist if there is a trade or business in existence which is represented by the words or phrase used in the domain name. The person who holds the domain name may not have the right to use the words contained in that domain name as a trading name or trademark. Those words may already be registered as a trademark in the UK or in other countries, or used as a trading or brand name by someone else. Trademarks must generally be registered with the national registry of each country in which they are used.

As described above, the sale or assignment of the rights to use any of these by an individual or unincorporated business will be a disposal for CGT purposes. Where a company disposes of one of the above assets, which has been created or acquired since April 1 2002, the profit is taxed as part of the company's trading profits.

What about trading in domain names?

A business may trade in domain names by registering them for small sums, and then selling the rights to use each name. In this case the profit made will always be treated as income and so chargeable to CT for companies and income tax for unincorporated businesses.

Trap. You should be aware that trading in domain names could amount to "cyber-squatting", which may give rise to accusations of trademark infringement. Another business or individual may object to you holding on to the rights to use a particular domain name without it being used as part of a commercial enterprise. They can appeal to the domain name registry's dispute resolution office.

KEY POINTS

- website development costs are tax deductible as capital (qualifying for CAs) or revenue expenses
- running costs of a website are tax deductible as revenue expenses
- up to £50,000 of capital expenses, e.g. hardware and software can be written-off against tax in a single year using the AIA
- profits for selling a domain will be liable to Corporation Tax for companies and Capital Gains Tax for partners and individuals
- don't accept the Taxman's argument to disallow website set-up costs.

VAT - UK ASPECTS

Is there a business for VAT purposes?

Many people buy and sell items using the internet on auction sites like "ebay" and "Amazon Marketplace" but they are not necessarily in business for UK VAT or tax purposes. They may be just selling on second hand items. So, the Taxman looks for indicators to determine whether an activity is a business that should be registered for VAT. Essentially these boil down to whether the activity is being run commercially and consistently over a period. Liability to VAT is unlike income tax. The need to register for income tax requires that your activity should be for making a profit. On the other hand, VAT only requires that there is some economic activity. That is, someone supplies goods or services in return for some value. So, even if the transactions don't make you a profit they can still be subject to VAT if they exceed a certain value in total, see below.

Trap. The Taxman is now using a "web robot" to identify internet traders using websites such as eBay who have not registered for VAT.

Should I register for VAT?

Individuals and established businesses that sell goods or services over the Internet must register for VAT if the sales are made in the course or furtherance of a business, and the total sales made in twelve consecutive months exceed the VAT compulsory registration turnover threshold. This threshold is £68,000 from May 1 2009, and it generally increases every year. If your business turnover for the next 30 days is expected to exceed the VAT registration threshold, you must register your business for VAT.

TIP

Even though your business turnover may not reach the registration limit you can register for VAT on a voluntary basis. The main benefit of this is that you can reclaim the VAT you pay on all your purchases for the business. This will reduce your costs.

Goods or services, why is the difference important?

An important question to answer is whether you are selling goods or services. It sounds simple but it's not always obvious, and the difference is important because it can affect the rate of VAT you charge your customers.

Example

Newsletters, books etc. are zero-rated in the UK, so no VAT is chargeable if you're selling these to your customers. But if the newsletter is transmitted to the customer in electronic form, or the customer reads the book online, this will be an "electronically supplied service" (ESS) which is subject to VAT (the standard rate in the UK is 15% until January 1 2010, when it's due to revert to 17.5%).

How can I tell the difference between goods and services?

Goods are generally anything you can physically hold. For VAT purposes, everything else is a service. Where you supply items electronically, such as music, software or other information-based services, you are generally providing an electronically supplied service, not goods. If the same data/music/information is supplied in a physical form, such as on a CD or as a printed newsletter, you are supplying goods.

You need to be clear about whether your business is selling an ESS, and providing that service internationally. When the service is supplied to customers in other countries, the VAT treatment is subject to further rules.

What are electronically supplied services?

The Taxman defines an “electronically supplied service” (ESS) as one which is:

- delivered over the Internet, or an electronic work which is reliant on the Internet or similar network for its provision; and
- the type of the service that’s heavily dependent on information technology for its supply and is mainly automated, involving minimal human intervention and in the absence of information technology couldn’t exist.

There are categories of service which are not ESSs for VAT purposes, although you might think they should be from the above definition. These include:

- telecommunications and radio and television broadcasting services
- the use of Internet or other electronic networks by parties to communicate with respect to transactions, or to help or improve trading.

TIP

Discussing transactions and transmitting documents by e-mail does not change the underlying service into an ESS. **Example.** An architect provides a design service and sends drawings electronically to his client to approve. He also uses various websites to gather information about the proposed building site. The architect’s service is not an ESS.

KEY POINTS

- selling goods or services over the Internet counts as turnover for VAT
- you’ll need to register for VAT if the value of your sales exceed £68,000 in the previous twelve months or the next 30 days
- some supplies, e.g. books, that would be zero-rated if supplied in print are standard rated if delivered over the Internet
- communicating with your customers by e-mail is not an electronically supplied service for VAT.

INTERNATIONAL TRADE - GENERAL TAX ASPECTS

What tax considerations are there regarding international trade?

One of the benefits of having a website is that it opens up your business to customers in other countries. But this has tax consequences, as do purchases you may make from overseas suppliers.

These international transactions probably mean you'll have to think about additional tax and legal issues. For example, in certain countries your ability to make sales may be restricted by governments who wish to protect their citizens by, say, imposing certain consumer rights and protection. In France, for instance, consumer contracts completed there must be concluded in French. So you may need the services of a translator.

The tax issues tend to fall into three areas:

- (1) Taxes on business profits based on a presence in the country.
- (2) Sales taxes such as VAT.
- (3) Customs duties and VAT on exports.

TIP

If you have no existing experience of trading in another country, it's sensible to do some research on the trade and tax rules that could affect you. A good starting place might be the International Chambers of Commerce. Their UK website address is <http://www.iccuk.net/>.

INTERNATIONAL TRADE - INCOME AND CORPORATION TAX ASPECTS

Will I pay tax on overseas profits?

If you have foreign customers, where will you be liable to pay tax on any profits you make from trading with them? This can be a tricky question to answer but in essence it works like this.

Your business may be based in the UK but it could also be treated as being tax resident in another country. If it is then you may have to pay tax in that foreign country on any profits you make from trading there. As your business is based in the UK HMRC will also charge you UK tax. This will usually be reduced by the amount of foreign tax paid, this is called "Double Taxation Relief" (DTR). Nevertheless, overall your business will end up paying more tax if the amount due in the foreign country is greater than that due in the UK. So, establishing whether your business will be treated as tax resident in a foreign country is important.

Where is my trade based?

Most countries have similar rules to determine if a business is resident there for tax purposes. The UK has drawn up agreements (double taxation treaties) with many countries on how to tax businesses that trade internationally.

A UK business may be treated as trading in another country if it sells goods or services over the Internet to customers who live in or run a business there. But your profits from the overseas trade will be liable to tax in the foreign country only if your business is treated as tax resident there. This is where the double taxation agreements come into play. They have a set of rules for working out in which of the two countries involved a business is resident and therefore liable under its tax rules. And as it's possible for a business to be tax resident in two or more countries the agreements stop it from being liable for tax twice on the same profits.

What do the rules say about residence?

If you trade through a limited company, you will only be regarded as being resident in another country if you carry on a trade through a "permanent establishment" in the other country. If your business isn't run through a company, i.e. as a sole trader or partnership, then there are similar rules that apply, although the wording in the double taxation treaty is slightly different.

TIP

If you want to avoid having to deal with overseas tax authorities, as a general rule, if your business does not have a base of operations or permanent establishment in the country where your customers are, then the profits from the trade will arise wholly in the UK, and so be liable only to the UK tax rules.

What's a permanent establishment?

Under UK tax law "permanent establishment" is defined as:

- (1) "A fixed place of business through which the business of the company is wholly or partly carried on"; or
- (2) "an agent acting on behalf of the company that has and habitually exercises the authority to do business on behalf of the company".

Having an agent does not necessarily mean your business has a permanent establishment, as the law says that a company will not have a permanent establishment in the UK simply by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of their business.

What's a fixed place of business?

A fixed place of business is defined as including:

- a place of management
- a branch
- an office
- a factory; or
- a workshop.

It does not mention websites or the servers that host the websites.

What about the location of servers?

Many UK businesses use the services of offshore ISPs for cost saving, so it's worth looking into these. But this could raise foreign tax problems. The tax authorities in other countries may take the view that your server, that is the computer holding your website data, could represent a permanent establishment in their country if it is located there for a sufficient period of time.

TIP

If you are thinking of using an overseas ISP, check the tax position of the country where the server is located. Will it be treated as a permanent establishment? If so, you may want to consider a different ISP to avoid involvement with a foreign tax authority.

KEY POINTS

- selling to foreign customers counts as income for UK tax purposes
- you may be liable to foreign tax on services and goods you supply abroad
- you can get foreign tax you pay deducted from your UK tax bill
- your business is usually treated as resident in the country it's controlled from
- if the computer your website is held on is located abroad you may have to pay tax in the country in which it is based.

INTERNATIONAL TRADE - VAT ASPECTS

What do I need to consider if I'm selling to overseas customers?

If your website has attracted foreign customers you'll need to deal with the special VAT rules that apply to exports. These are quite different for services you supply over the Internet, compared with say selling a physical item and delivering it to your customer. There are also differences in the VAT treatment depending on whether your customer is located inside or outside the EU.

How does VAT work for international services?

If you are making electronically supplied services (ESSs) over the Internet and your customer is overseas, you're supplying "international services" for VAT purposes.

In the UK, and many other countries, the basic rule is that VAT (or the equivalent) is charged by the supplier of services at the rate, and under the rules, applicable to the country where they belong. This is known as the "place of supply rule". However, there are exceptions to this basic rule and one of these is ESSs. These are deemed to be supplied where they are received. How do the VAT rules apply in this situation?

When are "services treated as supplied where received"?

Certain types of service are treated as taking place where your customer belongs, rather than where your business is based. These are known by the Taxman as "Schedule 5" services (see **Appendix B**). All ESSs and telecommunications are Schedule 5 services.

If you supply a Schedule 5 service to any customer outside the EU, or to a business customer within the EU (except the UK), you should not charge VAT on that service.

If your customer is in business in another EU country, and is registered for the equivalent of VAT there, they are required to charge themselves VAT on the services you supply them under the "reverse-charge rules". The same principle applies if you buy a service in from a business based in another EU country.

Example

You're a UK VAT-registered business. You buy Internet telephone services from a German company. It won't charge you German VAT on the service it sells you. Instead you'll be required to charge yourself UK VAT on that purchase under the reverse charge rules. Usually, you can then reclaim the VAT you've charged yourself. You may then think, why bother to charge yourself VAT if you're just going to reclaim it? But your business could be one of the many that isn't allowed to reclaim all the VAT it pays, e.g. a dentist or insurance company. So, as far as the Taxman is concerned there's a good reason for the reverse charge rules.

TIP

As there are exemptions even within each category, check whether the services you supply fall into one of the Schedule 5 categories. Take advice from a VAT expert (not the HMRC helpline!) to clarify your VAT position before you start trading online.

How do I know where the customer belongs?

Just because you're making a supply to another country it doesn't mean the business belongs there. It could just be the head office of a company that's actually located and trades elsewhere. So, it's not always obvious where your customer belongs. The rules are:

- (1) If the recipient is an individual, and receives the service in their private capacity and not for the purposes of their business, they are treated as belonging in the country where they're usually resident.
- (2) If the recipient is a business, they are treated as belonging in a country (C) if:
 - they have a **business establishment**, or some other **fixed establishment** in C; but if
 - they have no such establishment in C or anywhere else, but their usual place of residence is C; or
 - they have business or other fixed establishments in C and in another country but the services are most directly connected with C.

business establishment - for VAT is:

"The principal place of business which is usually the head office, headquarters or "seat" from which the business is run. There can be only one such place which may be an office, showroom or factory." (VAT Notice 741, para 2.3.)

fixed establishment - for VAT is:

"An establishment other than the business establishment, which has both the technical and human resources necessary for providing or receiving services permanently present. A business may have several fixed establishments, including a branch of a business or an agency."

Many businesses will have more than one fixed establishment in different countries. If this is the case, the Taxman advises that where an establishment is actually providing or receiving the supply of services, it is normally that establishment which is most directly connected with the supply, even if the contractual position is different.

Trap. If you're selling the service, the onus is on you to decide where your customer belongs. If in doubt you may need to ask a VAT expert for advice because you will be liable to any underpayment of VAT if you get it wrong.

What are the VAT reverse-charge rules?

The reverse-charge rules have been put in place to eliminate economic distortions on trade with countries within and outside the EU.

When you, as a UK-based business, supply a service to a business customer that belongs outside of the EU, or to a business customer in another EU country, you should not add VAT to that sale. The supply is treated as being outside the scope of VAT, but the effect for you is the same as if the sale were zero-rated. You can reclaim the VAT you have paid on purchases associated with that sale.

Where a business customer buys a Schedule 5 service from a supplier that belongs in another EU country, it must apply a reverse charge to collect VAT at the rate that is due in its own country. The customer is treated as if it has both supplied and received the item for VAT purposes, and must effectively charge

itself VAT and recover that VAT on its own VAT return. The reverse-charged VAT is recoverable by the VAT-registered customer on its own VAT return under the normal rules.

Note. The reverse-charge rules for Schedule 5 services do not apply to customers who are not in business. Such non-business customers have no VAT return on which to charge the VAT due, so they must pay VAT on the service at the rate applicable in the country from which the customer buys the service.

Trap. You must find out whether your customer who is based in another EU country is a business registered for VAT, or a private individual not registered for VAT. The best way to do this is to ask for your customer's VAT number before the sale is completed. If your customer is a private individual you must apply VAT at UK rates to the services you are supplying, where those services are Schedule 5 services.

TIP

Check whether the VAT number your customer gives you is valid by entering the number on this website: http://ec.europa.eu/taxation_customs/vies/vieshome.do.

What's the VAT position on goods ordered from my website and exported?

In tax terms, "export of goods" means the goods are transported to a destination outside the EU, but "removal of goods" means the goods are transported to a destination within the EU. The difference is important, as there are different VAT rules to comply with whether the goods are *removed* within the EU or *exported* to a non-EU country. Remember this only applies to the export of physical goods; it does not apply to services which have their own special rules, see above.

Exports within the EU

Where you sell goods to a business located and VAT registered in another EU country, you can zero-rate the sale. You must obtain your customer's VAT number for the other EU country before the goods are shipped. If the goods are ordered by another UK business, you must apply VAT at the standard rate even if those goods are transported out of the UK.

As there are no customs barriers within the EU, there will be no official evidence of removal of the goods to another EU country. However, you must retain evidence that the goods have left the UK. This can be difficult to obtain if your customer arranges shipment. Without evidence of removal, the goods should not be zero-rated. Copies of transport documents alone will not be sufficient. A list of the type the Taxman will accept as evidence is set out in Appendix C of this report.

If you export goods there's some additional administration to deal with. You'll have to complete the following returns to report the sale of goods:

- your VAT return (VAT 100) must report, in box 8, the value of goods sold to customers in the EU
- a separate EC sales list (VAT 101) reporting sales of goods to customers within the EU (this does not yet apply to the sales of services); and
- "intrastat supplementary declarations" (Form C1501) if your total sales or purchases in the year exceed the intrastat threshold for the calendar year. The threshold for 2009 is £270,000

- a separate declaration giving details of how you valued your exports for the intrastat is needed if their total value exceeds the “delivery terms threshold”. For 2009 is £16 million.

Exports outside the EU

Where goods, as opposed to services, are exported from the UK (for VAT that includes the Isle of Man), those sales should be zero-rated for VAT purposes as long as the following conditions are met:

- proof of export is obtained within a certain time limit; and
- the goods are actually exported from the UK within a specified time limit.

You must normally obtain evidence of export of the goods within three months of the date of supply. But goods which you deliver to within the UK for processing or incorporation into other goods, which are then exported, have a six-month time limit.

Trap. The Taxman treats proof of export very seriously. He will charge you VAT as if you had sold the goods to a UK customer if you do not hold proof.

What do I need to do if I am exporting goods by post?

Goods with a value of less than £2,000. When you send a package to a non-EU country, you must complete a Customs declaration on form CN22 or CN23. You can obtain these from the Post Office or online at <http://www.royalmail.com/portal/rm/content1?catId=5200006&mediaId=400362>.

Goods with a value of more than £2,000. These require a full export document known as a Single Administrative Document. It must be completed and sent to HMRC. The form can be downloaded from the HMRC website:

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&pageLabel=pageImport_Forms&propertyType=document&id=HMCE_CL_000465.

What's the National Export System?

If you are not exporting your goods by post you can use the National Export System (NES) to report exports to HMRC. The NES therefore only applies to goods destined for countries outside the EU. It is a computer-based method of declaring goods intended for export to HMRC. NES information may be given to customs directly by you or, more commonly the freight agents actually transporting the goods.

Export declarations may be made to HMRC electronically through the NES. Large businesses may link to NES directly and provide export declarations through a direct electronic route. Smaller businesses will use export agents to provide the information on their behalf.

The export declaration must be validated by the tax office before the goods are given permission to progress. They should issue an export reference number in the form of a Declaration Unique Consignment Reference or an Export Entry Reference which you should retain as part of the proof of export. Further guidance about NES can be found in the HMRC Public Notice 275 (see Appendix A).

You are also expected to retain a number of other details to prove that the transaction has taken place and goods have been exported from the UK. Full details of the information the Taxman requires can be found in **VAT Notice 703** (see Appendix A).

Trap. In the past, it was often possible to negotiate with the local VAT office for an extended period within which the evidence of export could be produced before an assessment was issued, this allowed time to obtain the necessary evidence from shippers and freight forwarders. However, the Taxman has become far less lenient in this regard, making the timely obtaining of evidence more crucial.

What if I take a deposit in advance of an export?

If you receive progress payments in advance of the export of goods, these will be zero-rated as long as the appropriate evidence of export is ultimately received and any other conditions are fulfilled. If the goods are not eventually exported, or the evidence of export is not held, VAT will be due at the standard rate on the total consideration for the supply of goods, including the progress payments. However, if no supply of goods actually takes place, the progress payments will be outside the scope of VAT.

TIP

If you need to rely on your customer to provide evidence of export, consider taking a deposit from them equal to the rate of VAT which would have to be accounted on a sale within the UK. This is in case satisfactory proof of export is not received.

KEY POINTS

- all exports of goods or services outside the EU are subject to VAT
- you don't have to charge VAT on exports to business customers in the EU
- some services you provide are treated as being made where your customer belongs
- there are extra reporting requirements for selling goods or services abroad
- if you can't provide documentary proof of export the Taxman will charge you VAT as if you made the supply in the UK
- you don't have to pay VAT on deposits you receive in respect of exports.

APPENDIX A - WHERE TO GO FOR FURTHER INFORMATION

HMRC Internal Manuals

- Business Income Manual, para BIM35850
- Capital Allowance Manual, para CA23410.

VAT notices and information sheets

- Information sheet 03/04: Electronically Supplied Services: EU Enlargement
- Notice 60: Intrastat general guide
- Notice 275: Export procedures
- Notice 700: The VAT guide, para 33.2
- Notice 703: VAT export of goods from the UK
- Notice 741: Place of supply of services.

All of the above Notices and Manuals can be download from the HMRC website at <http://www.hmrc.gov.uk/library.htm>.

Useful websites

- for an introduction to Import and export: http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&_pageLabel=pagelImport_InfoGuides&columns=1&id=INTRODUCTION_TO_IMPEXP
- and http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pagelImport_Home
- to register as self-employed go to: <http://www.hmrc.gov.uk/selfemployed/iwtregister-as-self-employed.htm>.

APPENDIX B - SCHEDULE 5 SERVICES - TREATED AS SUPPLIED WHERE RECEIVED

Para Type of service

- 1 Transfers and assignments of copyrights, patents, licences, trademarks and similar rights.
- 2 Advertising services.
- 3 Services of consultants, engineers, consultancy bureaux, lawyers, accountants and other similar services; data processing and provision of information, excluding services relating to land.
- 4 Accepting an obligation not to pursue a business activity or to exploit rights within para 1 above.
- 5 Banking, financial and insurance services including reinsurance but not safe deposit facilities.
- 5A The provision of access to and of transport or transmission through, natural gas and electricity distribution systems and the provision of other directly linked services.
- 6 The supply of staff.
- 7 The hire of goods - except for means of transport.
- 7A Telecommunications services.
- 7B Radio and television broadcasting services.
- 7C Electronically supplied services.
- 8 Agency services in procuring for another person any of the above services.

APPENDIX C - EVIDENCE TO SHOW THE GOODS HAVE LEFT THE UK

The information held must identify the date and route of the movement of goods and the mode of transport involved. It should include the following:

1. Written order from your customer, which shows their name, address and EC VAT number and the address where the goods are to be delivered.
2. Copy sales invoice showing customer's name, EC VAT number, a description of the goods and an invoice number.
3. Date of departure of goods from your premises and from the UK.
4. Name and address of the haulier collecting the goods.
5. Registration number of the vehicle collecting the goods and the name and signature of the driver and, where the goods are to be taken out of the UK by a different haulier or vehicle, the name and address of that haulier, that vehicle registration number and a signature for the goods.
6. Route, for example, Channel Tunnel, port of exit.
7. Copy of travel tickets.
8. Name of ferry or shipping company and date of sailing or airway number and airport.
9. Trailer number (if applicable).
10. Full container number (if applicable).
11. Name and address for consolidation, groupage, or processing (if applicable).