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Agenda

- Transfer Pricing and Indirect Tax
- UK Indirect Tax Update

Interaction of Transfer Pricing with Indirect Tax

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HWFisher

TP/IT

Contents

1. TP adjustments and customs/import VAT

2. TP adjustments and VAT

3. Cases / VAT Committee / VAT Expert Group

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TP/IP

What is Transfer Pricing : The EU Context

Transfer pricing refers to the terms and conditions surrounding transactions within a multi-national company. It concerns the prices charged between associated enterprises established in different countries for their inter-company transactions, i.e. transfer of goods and services. Since the prices are set by non independent associates within the multi-national, it may be the prices do not reflect an independent market price. This is a major concern for tax authorities who worry that multi-national entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction. This has led to the rise of transfer pricing regulations and enforcement, making transfer pricing a **major tax compliance issue**.

TP/IT

IMPACT ON CUSTOMS DUTIES AND IMPORT VAT

TP corrections have a direct impact on Customs duties and import VAT:

In case of an upward adjustment:

Customs duties were under-declared and additional duties shall be payable

Import VAT was under-declared and additional import VAT shall be paid.

In case of a downward adjustment:

Extra Customs duties have been paid and should be reimbursed – remission claim under UCC

Extra import VAT have been paid and, since it had been deduced, it is not necessary to claim for reimbursement. Partially exempt or exempt taxpayer.

Customs Value

Customs Authorities will be more vigilant when the imported goods are subjected to Customs duties since:

Customs duties are allocated to the EU's Budget and local Customs Authorities are accountable

For import VAT, reverse-charge mechanism becomes widespread and, in any case, import VAT is deductible as far as the taxable person is generally entitled to input VAT deduction.

Customs Value

Union Customs Code proposes two different procedures in order to adjust the Customs value on the basis of TP:

The **provisional value procedure** (article 166 of UCC) – 2 step process

The **adjustment procedure** (article 73 of UCC) – needs a special authorisation around the PVP generating ***disproportionate administration cost***

Adjustment procedure was initially applicable **only** to elements which are to be added to the price actually paid or payable (royalties, marketing costs, etc.) which were not quantifiable at the time of import.

The UCC altered article 73 to **the price actually paid or payable**.

Customs Value

Conclusions

- Logically a TP adjustment implies a Customs value adjustment
- Such adjustments will create a consistent administrative burden for the operator notably when the imported goods are dutiable. Therefore, full traceability is necessary.
- On the other hand, such adjustments may also represent a financial opportunity if the reimbursement of the Customs duties paid can be obtained.
- Key point of Customs value management in the coming years.

VAT

Corrections?

- **2 types of International corrections addressed:**
- **‘Primary correction’** where Tax Authority corrects taxable profit, and
- **‘Secondary correction’** where a related company compensates taxable profit for primary correction in another jurisdiction.

- **Mere primary correction triggers a change in the VAT taxable amount?**
- **Upward correction supplier level** → additional taxable supply?
- **Downward correction supplier level** → no change in financial flows, just correction in CIT base.

VAT

Correction?

- **Open market value; art. 80 VAT-directive**
- “In order to prevent tax evasion or avoidance… the taxable amount is to be the open market value”
- Article 80 is optional

Cases

The Courts and the Interaction of TP/IP

EU case law currently provides little guidance on the relationship between VAT and TP charges, though this is likely to change following three separate cases referred to the Court of Justice of the European Union (CJEU)

Weatherford Atlas C-527/23 – relates to specific costs being recharged (IT, marketing, accounting), with the tax authorities (amongst others) arguing that such services would not have been acquired if the company was not part of a group (and hence the services are not necessary in the Romanian tax authorities' view). It is not clear from the facts given whether the charges are supported by sound TP documentation.

Arcomet Towercranes C-726/23 – relates to a guaranteed profit margin supported by TP documentation. The Romanian tax authorities challenge whether a service has been rendered (though seems to take the position that in any case reverse charged VAT is due) and that insofar a service has been rendered, documentation is lacking to support the exact scope / use of the services.

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Cases

The Courts and the Interaction of TP/IP

Högkullen - C-808/23 – relates to a company not fully entitled to VAT recovery due to VAT exempt activity receiving services from a group company. The parent company rendering the services argues that the remuneration is based on a cost-plus method and an allocation key to allocate the costs to the various subsidiaries, and that shareholder costs (e.g. maintaining bank accounts, audit, general meeting of shareholders) are not to be included in the cost base. The Swedish tax authorities take the view that the remuneration charged is lower than the open market value, that there are no similar services on the open market and as such the value should be based on all costs incurred.

Article 80 of the EU VAT Directive allows Member States to apply an open market value in specific cases, in particular where the transactions are within a group and the recipient is not fully entitled to recover VAT on costs. Article 72 of the EU VAT Directive defines the open market value, referring (amongst others) to the “full cost to the taxable person of providing the service”

Cases

VAT Committee and VAT Expert Group

- There are working papers on the topic from the **VAT committee** (2017) and the **VAT Expert Group** (most recent 2018).

- These papers acknowledge that there is no generally accepted view yet and that the VAT treatments may depend on the type of TP charge (e.g., difference between a variable price for a product and a guaranteed profit margin).

- The VAT Expert Group in saying "*When defining the VAT treatment of a Transfer Pricing Adjustment, the VAT neutrality principle should be recognized, meaning that neither businesses nor tax administrations should suffer negative consequences from the proposed treatment*."

- Sensible position but this may be different in cases where Article 80 of the EU VAT Directive applies.

UK Indirect Tax Update

UK VAT Update

Cases - *Derby Quad Limited v HMRC [2023] TC08972*

- Derby Quad is an arts hub, housing an art gallery, visual and media spaces and a cinema.
- As part of its cinema offering, Derby Quad contracted with both NT Live and the RSC to screen live theatrical performances taking place elsewhere in the country.
- On the assumption that the screenings were supplies by an eligible body to a right of admission to a theatrical performance, no VAT was charged. These supplies are exempt under Item 2, Group 13, VATA 1994.
- It was agreed by all that the Quad was an eligible body. HMRC believed the screenings were not live performances and so standard rated and issued assessments.

The FTT found that:

- Up until a ruling by the CJEU in 2016, cinematic screenings were covered by the exemption. After the ruling, HMRC were able to specifically exclude these from the exemption.
- Repeated screenings of the live performance, taking place after the event, were cinematic screenings.

UK VAT Update

- The ‘always speaking’ doctrine regarding statutory interpretation was used to establish whether the presence of the audience at the performance could be via connectivity or whether it needed to be in person i.e. the real-time live screening was not a cinematic screening as the audience felt they were experiencing a live performance.
- Despite all of this, the doctrine had to be applied narrowly as place was essential to a live theatrical performance.
- Having the audience at the venue where the performance was taking place crucially allowed for audience/performer interaction. The FTT considered audience feedback to be critical for a theatrical performance.

UK VAT Update

JPMorgan Chase Bank, NA v HMRC [2023] TC8957

No VAT exemption for indivisible intra-group supplies

- the First Tier Tribunal (FTT) found that support and business services supplies were one single supply not qualifying as exempt from VAT. The intra-group supply exemption was disapplied due to elements coming from overseas, meaning all elements had to be standard-rated.
- JPMorgan Chase Bank NA (CBNA) and JPMorgan Securities Plc (SPLC) were part of the same global corporate group and same UK VAT Group.
- CBNA supplied 'support services' and 'business delivery services' to SPLC. Support services were more administrative in nature, including legal, HR, compliance and finance. Business delivery services provided a trading infrastructure, including technology, operations and market risk, without which SPLC could not trade. Provided under a master services agreement and billed as a lump sum.
- These services would ordinarily be disregarded between UK VAT group companies.
- It was confirmed that SPLC would not have been able to decline any of the services, as they ensured standardisation across the global group.

UK VAT Update

- In order to supply some of the services, CBNA bought overseas services in order to make supplies to SPLC.
- HMRC argued that this disapplied the intra-group exemption, as per s.43 (2A) and (2B) VATA 1994.
- CBNA accepted that the support services were subject to VAT.
- As part of ongoing wider enquiries into the JPMorgan business, HMRC raised protective assessments which included disapplying the intra-group exemption, treating all services as a single supply and subject to standard-rated VAT.

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- The FTT found that:
- The services agreement did reflect economic reality at the time.
- All of the services were required by SPLC in order for it to trade, so no distinction could be drawn between the support services and the business delivery services.
- All elements of the supply were closely linked and not available separately.
- This and the wording of the agreement indicated one single supply of all the services provided.
- Despite the test in Gray & Farrar International, it was not possible to identify a principal element of the supply, all elements were equally necessary. As such, the supply as a whole had to be standard-rated.
- The FTT decided that there was one single supply of services that was not to be disregarded as an intra-group supply and was not exempt as a supply of financial services. The appeal was dismissed.

UK VAT Update

Simple Energy Limited v HMRC [2023] TC08995

- The First Tier Tribunal (FTT) found that credits awarded to customers under a refer-a-friend scheme amounted to a non-monetary consideration for the supply of energy. Output VAT was due on the value of the credits.
- Simple Energy Limited was the representative member of the VAT Group of which Bulb Energy Limited (Bulb) was a member.
- Bulb, an energy supplier, operated a refer-a-friend scheme whereby existing customers were provided with a personalised electronic referral link which they could pass to potential new customers.
- Where the refer-a-friend link successfully signed up a new customer, both the existing customer (the referrer) and the new customer received a credit of between £25 and £75 against their energy charges.
- Bulb treated the referrals as the performance of a contingency which resulted in a discount, reducing the value of the energy supply made by Bulb to the referrer.
- Bulb accounted for output VAT based on the payments it received from its customers, net of the refer-a-friend credits.

UK VAT Update

- HMRC disagreed, arguing that a successful referral under the refer-a-friend scheme was the provision of a service by the referrer, to Bulb viewing this as non-monetary consideration.
- The FTT found that:
- How existing customers referred Bulb under the refer-a-friend scheme was sufficient to meet the requirement that something was provided by those customers, by way of consideration, notwithstanding that at the point of referral nothing was done for or provided to Bulb.
- There was a direct legal link between what was required of referrers participating in the refer-a-friend scheme and Bulb's obligation to reward customers who successfully used their referral link. There was a direct link between the referrers' actions and the refer-a-friend credits. There was a direct relationship between the benefits which Bulb obtained from the actions of referrers and the amount Bulb was willing to pay.
- This contrasted with the position of the referrer, who received something different. Referrers received a reduction in their energy costs as a reward for doing something additional to what was required of them simply as a Bulb customer.
- The services provided to Bulb by referrers, when successfully referring Bulb and thereby earning a refer-a-friend credit, were non-monetary considerations.

Thank you and Questions?