

VAT on inter-company transactions and management charges and other day to day transactions

Dealing with VAT on transactions with associated businesses and much more

Introduction

Most businesses are pretty good at dealing with VAT on their main business activity; knowing when to charge VAT to customers and when they can claim VAT on costs. But it's those non-core issues that often cause problems.

HMRC VAT officers often find errors in the VAT accounting of such transactions, meaning that the business owners have to spend a disproportionate amount of time (and sometimes professional costs) sorting out non-core VAT issues, sometimes where the amount of money involved is a tiny fraction of the VAT on their core business activities.

I've run www.vatexchange.co.uk since 2008. EVERY SINGLE MONTH the most commonly visited page on the site is an article about VAT and management charges/intra-company payments and reimbursements. The VAT liability of such payments is also the most common sources of the queries I receive from clients and on the website forums, e.g. "do I add VAT when I charge for a share of staff costs?" or "I need to invoice for some telephone bills and directors costs - is it okay to call it a management charge and add VAT?".

To answer the question you need to satisfy two criteria:

- You can only charge for services if the payment; or consideration, is for a supply of goods or services that are liable to VAT.
- You can only claim VAT on costs if you're using the goods and/or services to make taxable supplies and if the goods and/or services are cost components in making those supplies.

I appreciate that the above clauses include technical terminology, but there's really no other way of explaining the criteria without losing something in the translation. I'll discuss these terms in the context of transactions with associated businesses throughout the book.

There is one other very important point: the act of "**raising a management charge**" *doesn't mean that services have been provided*. And issuing a VAT invoice for such "charges" could be fraudulent if services have not been provided or if the value of the services is misrepresented.

Payments between associated parties can be made for a number of reasons; including payment for supplies, contributions towards costs, reimbursements for goods or services bought on behalf of the other party or even a profit share.

Either way, if the businesses are separate legal entities, you MUST define the VAT liability of any payments made between the parties before issuing a VAT invoice.

Once you're certain that the payment IS consideration for a supply of goods or services, THEN you have to consider a number of issues:

- Is the charge made in the course or furtherance of a business? Charges made by holding companies to subsidiaries may not be regarded as being made "in the course of business".

- What is the nature of that supply; e.g. management services, consultancy services or administration services?
- Can you provide evidence of the work carried out?
- Is there a written agreement? Does the agreement CORRECTLY represent the arrangements?

HMRC are increasingly vigilant about situations where associated businesses issue invoices and the effect of the transactions gives a cashflow benefit due to the timing of VAT returns. You can understand why HMRC pay attention to these situations when you consider that the businesses are owned or controlled by the same individual or company. So it's important that the parties can demonstrate that services have been supplied as though the transactions were between independent third parties.

Terminology: Supplier Co and Recipient Co.

In this book, the reference to "associated businesses" means transactions between separate legal entities who are connected or related in some way, whether sole proprietors, partnership, companies, limited liability partnerships, trusts etc. I've discussed this concept in more detail on page 19.

For ease of reference I'll use the following references to the example question throughout the book:

- the business that wants to raise a charge and claim VAT on office costs and legal bills is "Supplier Co"; and
- the associated business, that would pay the charge, is "Recipient Co".

VAT liability?

Once you've established that supplies have been made, you then follow normal VAT rules to establish whether the service is liable to VAT at 20%, 5%, 0% or exempt under VAT law, which apply whether the parties are related or not.

You might assume that the easiest approach is to charge VAT in any situation - you avoid the risk of under-declaring VAT and HMRC don't usually complain if they get overpaid! But unfortunately, it's not that simple. ***If you don't establish the correct VAT liability right from the start, you can end up with unexpected VAT assessments or irrecoverable VAT that could have been avoided.***

This book explains when such payments are liable to VAT and discusses practical ways to avoid mistakes so that you can concentrate on generating profit on your core business activities. It also explains when special rules apply to payments - such as property costs, staff costs, motoring costs and cross-border transactions, as discussed in [Chapters 7 to 12](#).

What's a contract?

I'm not a solicitor, but I think it's important to consider the concept of "contract" in the context of transactions between associated businesses.

My Oxford dictionary defines contract as: "a written or spoken agreement intended to be enforceable by law". We'll discuss this issue throughout the book and [Chapter 15](#) discusses in more detail what you might include in a contract for VAT purposes.

As I said in the Preface, you're not legally required to have written contracts for VAT purposes. But the reason that solicitors, accountants, VAT consultants and other professionals usually recommend having written contracts is to properly establish the arrangements for transactions between separate legal entities, whether associated parties or third parties and prevent confusion when dealing with HMRC or other third parties.

The difference between "intra" and "inter"

As I've discussed in Chapter 3, there's often confusion about relations between associated businesses and sometimes this is because people get their terminology mixed up.

"Inter-company" means between separate companies; e.g. parent company to subsidiary.

"Intra-company" means within a single company; e.g. the sharing of head office costs between separate divisions of the company.

Supplier Co and VAT recovery

The answer to the question: *"Can we claim VAT on our office costs and legal bills if we raise a management charge to our associated company?"* depends on whether Supplier Co is providing taxable services to Recipient Co. However Supplier Co can also claim VAT if it uses the services to make any other taxable supplies to third parties.

This means that you can't just look at the arrangements between Supplier Co and Recipient Co in isolation; Supplier Co's entitlement to claim VAT on its costs depends on whether and to what extent it makes taxable supplies to BOTH Recipient Co and any other parties, whether associated businesses or third parties. We'll discuss the main principles in [Chapters 1 - 4](#) of the book.

We'll also consider whether Recipient Co can claim VAT on charges from Supplier Co. If Recipient Co makes exempt supplies or carries out non-business activities, then it may not be able to claim VAT charged by Supplier Co and therefore the VAT is simply an additional cost, so it's also important to consider Recipient Co's VAT recovery situation.

How does the book work?

The book is in three main parts as follows:

PART 1: INTRODUCTION TO VAT: IS IT CONSIDERATION FOR A TAXABLE SUPPLY?

To begin with, you need to understand the basic concepts of VAT, which are explained in [Chapter 1](#). Please take the time to read [Chapter 1](#) even if you're an accountant or otherwise familiar with the main VAT rules. It's important to know the basic principles to understand how they apply in specific circumstances.

In [Chapter 2](#), I've discussed the concept of supplies of services, when they occur and how to demonstrate that services have been supplied. In [Chapter 3](#), I've discussed different reasons for making payments that don't represent payment for a supply. [Chapter 4](#) discusses what to do when you have established that taxable supplies have been made, with more practical information about issuing VAT invoices, when to charge VAT and answers to some of the most frequently asked questions.

[Chapter 5](#) explains when income from such transactions counts towards VAT registration limit and certain other VAT registration issues that can affect the VAT liability of these payments. [Chapter 6](#) explains some practical cashflow planning ideas for dealing VAT on supplies between associated businesses. It also discusses the implications that can arise if HMRC do not accept that supplies have been made.

[Chapters 5](#) and [6](#) also discuss the benefits of VAT group registrations for connected companies and how this is a practical way to minimize administration AND VAT on inter-company transactions.

PART 2: VAT LIABILITY OF SPECIFIC CHARGES

In [Chapters 7](#) and [8](#), I discuss the types of services that are often defined in contracts as business services and management services, where the value is often based on costs plus a mark-up, including specific reference to holding companies.

[Chapters 9 – 11](#) discuss specific rules that can apply to people costs, motoring costs and property costs. These chapters discuss a range of issues from dealing with day to day staff expenses, director's costs and when charges for the use of property are exempt from VAT.

International transactions

[Chapter 12](#) discusses the VAT liability of cross-border payments. This is one of most complex areas of VAT, because it involves a whole new set of rules and terminology. I've also discussed the potential VAT implications from a typical query involving a set of transactions between associated businesses in the UK, the USA and various EU countries.

PART 3: PLANNING TO MINIMIZE VAT COSTS AND WHEN IT'S AVOIDANCE

[Chapter 13](#) explains how to minimize the VAT on charges to recipients who can't claim VAT because their business is exempt or partly exempt; or they're not registered for VAT. The chapter doesn't include any clever schemes or arrangements; it simply summarizes the most common ways of keeping VAT cost low using normal VAT accounting arrangements.

[Chapter 14](#) explains when anti-avoidance rules can affect apply to transactions; which is often when they are between associated businesses and where Recipient Co of the service can't recover any or all of the VAT charged.

[Chapter 15](#) discusses whether or not you should have written contracts and the information that you'd need to include for VAT purposes.

Isn't the simplest thing to charge VAT on everything?

No, because the payer can only ever claim VAT that is "correctly charged", as explained in [Chapter 2](#). HMRC do not ignore such situations even when the "supplying" party has included the VAT charged on its VAT return.

Worked examples

There are two worked examples after this introduction which show how the VAT liability of day to day charges can apply in three scenarios;

- implications for a sole trader providing office and administration services whose income is just below the VAT registration limit;
- the supply of management services between associated companies with separate VAT registrations; and
- the supply of management services between associated companies registered in a VAT group registration.

The examples ***demonstrate the effect of adding VAT to charges for supplies which consume VAT free "cost components", including staff costs, insurance and exempt property costs.***

I've discussed the implications of these scenarios in a little more detail in Chapter 5, which deals with the implications for transactions according to the VAT registration status of the parties involved.

I have come across similar situations on many occasions, so the examples deal with the most common issues.

Do you have to add a markup for VAT purposes?

No, not in principle. However, HMRC normally expect that the value of services is at least *at cost* to demonstrate that the activities are carried out "in the course or furtherance of a business".

Generally speaking, if the value of services is based on cost plus a mark-up, then this should be satisfactory for VAT purposes, but of course you should take advice from your accountant to be sure that the VAT treatment doesn't affect other tax or commercial issues.

Appealing against HMRC's decisions

I must also mention the ***difficulty and cost of dealing with HMRC decisions.***

You probably know that you can ask HMRC to carry out an internal review of their decision and; if the original decision is upheld, that you can appeal to the Tax Tribunal.

You can also consider the "Alternative Disputes Resolution" where the formal appeals process is put on hold while you try to resolve the issue by negotiation, which can help if you think that HMRC hasn't fully understood the facts or if there is some genuine misunderstanding between the parties. Either way, these procedures are time-consuming and it's frustrating waiting for decisions. And if the internal review and/or ADR isn't successful, then you have to appeal to the Tribunal. The timescale for getting a listing at the Tribunal is around six months and you may have to wait another month or so for the Tribunal's decision.

And as if this isn't bad enough, **you have to fund your own costs EVEN IF THE TRIBUNAL RULES IN YOUR FAVOUR.**

You DO NOT want to end up in this situation because you haven't taken the time or care to arrange transactions with associated businesses correctly. So please take the time to review your existing arrangements and make whatever changes are necessary to ensure that you don't have to appeal against a decision against HMRC in the first place.

Further information

There are links to HMRC's guidance throughout the book if you want to look for more information about specific subjects and you can always contact HMRC's VAT helpline <http://tinyurl.com/nj59f4j> if you want help about a specific issue.

Finally, you may see certain subjects discussed in two or more chapters; for example the subject of proving that services have been supplied; VAT group registrations, single or multiple supply; anti-avoidance rules. I've tried to avoid repetition as much as possible; but often particular technical issues arise in a number of commercial situations so I have to explain the technical issue in each context. I'd also rather include too much information than too little so that you don't have to keep referring back to different sections of the book.

Either way, please remember that this is a practical guide to the subject. It's not a detailed textbook, nor does it replace formal advice about specific situations.

But if you understand the principles explained in this book, they will help you to identify and avoid potential problems when dealing with transactions between associated businesses so that you can focus your time and effort on making money through your main business activities.

Marie
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