



McCleary & Company Ltd.

Chartered Accountants & Registered Auditors

VAT and three-party transactions

A guide to the VAT implications of having three entities involved in a transaction.

VAT can get very complicated when there are three parties involved in a transaction.

This may happen in an agency situation where one party is arranging for the supply of goods or services in return for a commission, but it can also occur in other circumstances which are not so easy to recognise.

The key to the correct VAT treatment is to understand which role each party plays: **principal**, **agent** or **customer**.

If the roles of the parties are confused, the wrong person may reclaim the VAT or the VAT liability may be missed by all parties.

This may result in potential penalties and interest on the late paid VAT when the error is discovered.

The principal

There are two ways of looking at this issue – and evidence from both should be considered.

Contracts

What do the written trading conditions and terms of engagement between the various parties actually say? These may make it clear who the principal is.

If not, then look for clues, such as who would the customer complain to if they had a problem with the goods or services?

Customer perception

Who does the customer think they are dealing with? This will be the principal.

In this digital age, where transactions are agreed online, the terms and conditions and other details provided by the website should contain the answer.



Example 1

Staging a musical concert involves three relevant parties:

- A: the venue
- B: the production company organising the show
- C: members of the public who buy the tickets.

The customer is clearly C but the principal, who is responsible for charging VAT on the ticket sales, could be A or B.

It is essential the agreement between A and B makes it clear whether A is hiring B to put on a show, and A is the principal, or whether B is leasing the venue and B is the principal.

Conflicts

What happens if there is a contradiction between the commercial reality of a transaction and what the contracts say?

In such cases, it should always be the commercial reality that takes priority and this is the approach taken by HMRC.

The customer

This is not always as clear, especially where a third-party adviser has commissioned work on behalf of their client.



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Example 2

A landmark case on this point involved travel company Airtours Holidays Transport Ltd, its bank and an accountancy firm.

The bank insisted on a major review of Airtours' financial and trading operations to be carried out by the accountancy firm.

Did the accountants supply their services to Airtours or to the bank? Airtours paid the bill for the accountancy services and reclaimed the VAT charged on those fees.

The invoices were made out to Airtours, but that doesn't mean it was the recipient of the accountancy services.

The Supreme Court decided the accountants were working for the bank because it was the bank who had ordered the work to be carried out and specified details of the review. The VAT claimed by Airtours was disallowed.

The bank could not reclaim the VAT as it was not VAT registered. The supplies made by banks generally fall into Group 5 of Schedule 9 (Finance) of the VAT Act 1994, and are exempt from VAT. A business which makes wholly exempt supplies is not eligible to register for VAT.

Tip

Consider VAT issues at the planning stage rather than when the goods or services have been supplied. Also, ensure the economic reality of a transaction is consistent with the contractual position.

Special rules for agents

An agent sells on behalf of the principal. Where an agency contract exists there are two supplies – one of goods or services by the principal and one of agency services by the agent who receives payment in the form of commission. The VAT treatment of these supplies may differ.

Example 3

An agent sells physical books on behalf of the principal publisher for £1,000 and receives a 10% commission (£100), which he deducts from the gross receipts.

The books are zero-rated, but the commission for selling the books is standard-rated for VAT.

The £100 commission is inclusive of 20% VAT. If the agent is VAT registered, he should invoice the publisher for £83.33 plus 20% VAT of £16.67.

Not an agent

In some cases, a business may call itself an agent but does not behave like an agent for VAT purposes. For instance, car dealers may call themselves 'agents' but in reality they buy and resell vehicles.

Hidden agents

Where a service provider supplies services to non-business customers who can't reclaim VAT, it is important to identify whether an agency arrangement exists.

A common example is a self-employed taxi driver who drives for a larger taxi firm.

Where the taxi firm is the principal and the taxi driver is an agent or sub-contractor, VAT must be charged on the entire taxi fare if the firm's total turnover exceeds the VAT registration threshold (£85,000 in 2017/18).

Where the taxi driver is the principal and the taxi firm is the agent supplying support services to the driver, the taxi fare may be free from VAT.

This will be the case where the taxi driver's annual turnover is less than the VAT registration threshold, so he is not VAT registered.

It is important to note that a self-employed driver can be a principal or a sub-contractor agent; the distinction will depend on the facts.

Undisclosed agents

An undisclosed agent acts in their own name, so the supplier and the customer do not know each other's identity.

This sort of arrangement is often used to avoid the parties directly doing a deal in order to exclude the agent.

If the supply is of goods, the agent is regarded as buying and selling those goods himself. VAT is charged on the full output value of the sale and the agent must account to HMRC for the full VAT charged.

There are special "commissionaire" rules where the supplier in this situation is in another EU state.

Such cross-border transactions can be complicated, so talk to us for advice specific to your situation.

Informing the customer

In antique shops, it is common for the items to be sold by the shop owner acting as an agent for the supplier of those items.

In such cases a notice in the shop should inform the customer of the agent/principal arrangement, and the invoice should clearly state the identity of the supplier.

Failure to spell out the agency arrangement can mean the shop owner is caught by the undisclosed agency rules and must charge and declare VAT on the full price of the goods.

An alternative is for the agent to agree to buy the goods from the supplier at the price he sells them on to the final customer, less the agreed commission.

This works for goods where the price is negotiated with each customer or varies with demand.

Employment agencies

From 1 April 2009, employment agencies must charge VAT on the full salary of any staff supplied to the final customer, including the value of the commission.

There is a very limited concession where an employment agency supplies nurses or nursing auxiliaries to nursing homes or similar institutions they only need to account for VAT on the commission.

If the employment agency acts as the principal and is registered with the Care Quality Commission, the supply of those nurses is treated as exempt from VAT.

Contact us to discuss complex VAT issues.