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Tax	VAT: Supplies of staff	Sarah Kay

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VAT: Supplies of staff

1. Introduction

1.1 Key questions

There are two questions to ask when identifying whether or not a supply of staff has been made:

1. *Who are the individuals concerned employed by?*

i.e which legal entity is identified on their contract of employment as the employer? This is a question of fact which should be determined by reference to the relevant paperwork.

2. *Under whose direction do those individuals work?*

i.e which entity controls the day to day working life of the individual. This question can be harder to answer than the first and requires an in-depth understanding of the practical arrangements between the parties.

1.2 HMRC Guidance

HMRC's Public Notice (700/34) para 2.1 states that:

You make a supply of staff for VAT purposes if, for a consideration, you provide another person with the use of an individual who is:

- contractually employed or otherwise engaged by you
- is a director of your company

....and goes on to say that..... What is important is that the staff are not contractually employed by the recipient of the supply, but come under the direction of that person.

Therefore the key aspects of a supply of staff are that:

- the individual staff member is, contractually, employed by one party but works for another;
- the recipient pays (i.e provides consideration) for the use of the individual; and
- the individual comes under the control and management of the recipient of the supply.

1.3 Case law example

It is important to distinguish between a supply of staff and a supply of services by the business. For example, if a legal firm provides a client with the work of a lawyer it will be providing legal services, if a construction firm provides a client with the work of a plasterer or electrician it will be providing construction work etc.

This is illustrated by the University of Glasgow case (University Court of the University of Glasgow [2005] BVC 2583)

This may be summarised as follows:

- Academic staff employed by the University also worked as consultants at the local NHS Trust.
- The University charged the NHS Trust a fee and the question was whether the University was supplying staff (taxable) or medical services (exempt).
- The FTT concluded that the University was making taxable supplies of staff. It noted that:
 - The consultants were employed by the University; and
 - The consultants worked under the control of the NHS Trust.
- The FTT stated that “The Trust controls the individual’s working arrangements while he is acting as their consultant..... and as a matter of reality [the University] has no concern with what it is that the individual does.”

2. Recharged Payroll

When payroll costs are recharged between group entities, correctly identifying whether or a supply of staff has been made between related companies is important for two reasons:

- If the receiving company is partially exempt it may not be able to recover VAT charged in full, thus making staff more expensive; and
- If the supplying company does not charge VAT appropriately it is at risk of receiving assessments for underpaid VAT, interest and penalties.

2.1 Group Payroll Company

Staff may have their payroll processed by one group company (normally to save on administration expenditure), this is sometimes referred to as a paymaster arrangement.

If all staff working for a group have their payroll processed centrally by one company the VAT treatment of charges made by that company is as follows:

- Charges made for running payroll are standard rated;
- Treatment of wages recharge depends upon which entity, contractually, employs the staff: If the employer is:
 - the ‘payroll company’, it is standard rated;
 - the ‘receiving company’, it is outside the scope of VAT.

If the ‘payroll company’ is the employer it has put its staff at the disposal of the ‘receiving company’ and therefore it is making a taxable supply of staff. If the ‘receiving company’ is the employer, the ‘payroll company’ is discharging its liability to pay its staff and the recharged wages are a disbursement.

For an example of this in practice, see *C & E Commrs v Tarmac Roadstone Holdings Ltd* (1987) 3 BVC 91. This case went all the way to the Court of Appeal. Tarmac recharged wages costs of staff who were on its payroll but working for a subsidiary (which made VAT exempt supplies and so couldn't recover VAT charged to its). Tarmac treated the recharged wages as non-VATable but the Court of Appeal upheld HMRC's assessment that they were VATable. The court held that, because Tarmac was clearly identified as the employer on the staff employment contracts, it was making a supply of staff on which VAT should be accounted for at the standard rate.

2.2 'Shared employees'

Employees may be 'shared' for many reasons. For example a full time employee may work part time for different group companies, an employee may be seconded between companies or an employee may have a corporate role which involves working across the group (e.g companies sharing an office may share an receptionist).

Normally one company pays the employee and then the wages costs is recharged. The VAT treatment of recharged wage costs determined by which company is:

- contractually the employer; and
- responsible for directing individual's work?

If the 'supplier' is the employer', the question of under whose direction the employees work must be resolved, if individuals work under the:

- direction of receiving company – a taxable supply of staff has been made and the wages recharge is subject to VAT;
- direction of 'supplying' company – a supply of other services made and they will have their own VAT liability.

If the 'recipient' is the employer', the wages recharge by company responsible for payroll outside the scope of VAT, because it has settled the employer's liability to its employee as a form of disbursement.

2.3 Temporary suspension of employment contract

An employee transferred to another group company, e.g on secondment for a specific period of time may have their contract of employment suspended for that period.

If the first employer continues to pay the individual's wages the recharged costs is not subject to VAT (because a supply of staff has not been made) if the following conditions are met:

- the temporary post is organised on the employee's own initiative
- the second employer issues to the employee a new contract or letter of appointment.

If these conditions are not met, HMRC would consider that a supply of staff has been made and the recharge will be subject to VAT.

2.4 Joint employment

It is possible to have a joint contract of employment, i.e for one individual to be employed by more than one entity.

If 'shared employees' work for more than one entity under a joint employment contract the wages recharged by the 'payroll entity' are outside the scope of VAT because the employers are sharing responsibility for their joint liability to that individual.

Joint employment contracts can achieve VAT savings, particularly if the entities involved are partially exempt. However they are rare in practice.

Joint employment contracts have been used in the outsourcing industry to avoid VAT charges on wages, particularly when outsourced services are supplied to VAT sensitive customers such as banks and insurance companies.

For an example of an arrangement where a joint contract of employment did not avoid VAT being added to a wages recharge, see CGI Group (Europe) Ltd [2011] TC 00678. Very briefly a bank outsourced its IT department to CGI and the bank's employees were moved onto joint employment contracts with the bank and CGI. The aim of the joint employment contract was to avoid the bank incurring irrecoverable VAT on the wages element of CGI's charge. However, the FTT concluded that the employees were working under the direction of CGI, i.e when working for the bank they were acting as CGI employees, not bank employees. Thus CGI was making a taxable supply of IT services, not sharing a joint liability to pay the individual's wages.

2.5 Directors

Individuals are often directors or more than one company.

If the individual's directorships are personal appointments, the wages costs recharged between the companies are outside the scope of VAT, i.e directors are treated as though they have a joint contract of employment.

If an individual is supplied by another business (whether they are director of that business or not) to act as director, a supply of staff has been made and the charge for their services is subject to VAT.

3. Employment Businesses

An employment business provides staff to its clients. The fee charged usually comprises two elements:

- A recharge of the individual's salary cost (i.e the bureaux's cost of sale); and
- A service fee or commission (i.e the bureaux's gross profit)

There are two questions to ask when considering an employment business:

- Is it providing staff or services?; and
- If it is providing staff, is it acting as agent or principle?

3.1. Staff or Services?

As discussed in the introduction, this question is answered by reference to under whose direction the individuals are working.

If the individuals are working under the direction of the supplier there is a supply of services, e.g

- A supplier of construction workers is supplying building services;
- A supplier of registered nurses is supplying medical care.

If the individuals are working under the direction of the customers there is a supply of staff.

As discussed at 1.3 above this question was crucial in the University of Glasgow case and it was also addressed in these cases:

1. Moher (t/a Premier Dental Agency) [2012] BVC 1613

- Moher provided qualified dental nurses to dental practices;
- The Upper Tribunal confirmed that it was required to account for VAT on its supplies of staff;
- The nurses worked under the direction of the practices with which they were placed therefore Moher could not be said to be supplying exempt dental services.

2. Medacy Ltd [2019] TC 07370

- Supplied pharmacists to GP practices in order to provide what it described as 'pharmacist led clinical services'
- HMRC argued that a taxable supply of staff was being made, but Medacy maintained that it was supplying clinical services, not staff.
- The FTT analysed the contractual relationships between the parties and allowed Medacy's appeal because Medacy exercised considerable control over the pharmacists.
- The FTT looked at the arrangements in detail and concluded that although Medacy was supplying services the case was 'very close to the dividing line'.

3.2. Agent or Principle?

If an employment bureaux is supplying staff as principle the VAT position is as follows:

- The bureaux is supplying its own staff to its customers;
- The entire fee charged to the customer is payment for this supply and is subject to VAT

If an employment bureaux is supplying staff as agent the VAT position is as follows:

- The bureaux is introducing individuals to its customers;
- Those individuals contract with the customer to provide their labour;
- The bureaux pays the individuals as agent for the customer, therefore the wages recharge is a non-VATable disbursement;

- The bureaux's commission is a VATable charge for its agency service.

HMRC have confirmed that normal rules apply when answering the agent vs principle question (see Information Sheet 03/09 and Business Brief). Thus the issue is determined by reference to the contractual relationship between parties.

When looking at the contractual relationship it is important to consider form as well as substance; and to look at the worker's contract as well as the bureaux-client contract, remembering that the worker's contract is defined by reference to employment law.

The most recent case law on this issue is the Court of Appeal decision in *Adecco UK Ltd* [2018] BVC 39:

- Adecco placed temporary workers with clients, the temps were not employed by Adecco but nonetheless the court agreed that staff were being supplied as principle and therefore VAT was due on the entire fee charged.
- The court analysed the written contracts and noted that:
 - the contract effectively obliged Adecco to pay the workers even when not paid by the client;
 - the contract said nothing amounting to a declaration of acting as an agent;
 - the temp never entered into a contract with the client company.
- The court also looked at the practical arrangements. It concluded that both contractually and as a matter of economic and commercial reality Adecco was acting as a principle in the supply chain.

NOTE:

- The Adecco case is detailed and complex. The above notes provide only a brief flavour of the arguments presented and factors considered by the court; and
- Previous advice received from HMRC or advisors and cases which predate the Adecco case may no longer apply. This is for a variety of reasons, which include the fact that employment law has been updated over the years, until 1 April 2009 HMRC operated a 'staff hire concession' which has now ended, and prominent FTT decisions have been criticised by higher courts in subsequent cases, e.g *Reed Employment Ltd* [2011] TC 01069 should not be relied upon.

3.3 Nursing agencies concession

By concession bureaux can exempt the supply of nurses, midwives and other health professionals This alleviates the irrecoverable VAT incurred by customers in the health and care sector, e.g care homes which use agency nurses.

The concession is set out in section 6 VAT Notice 701/57. It is subject to various specific requirements. Nursing agencies should consult the VAT Notice to confirm whether or not the conditions apply.

4. Planning Points

Consideration of whether a supply of staff has been made must be given whenever wages are recharged to avoid unexpected VAT costs. Wages are a significant cost to business and mistakes can lead to the assessment of large sums of VAT, interest and significant penalty charges.

VAT grouping can avoid VAT on recharges between related companies

HMRC (and the courts) review the substance of the relations between the parties as well as the written contracts, so it is not sufficient to have excellent paperwork. The paperwork must reflect the true economic and commercial reality.

***In Tandem Resources Ltd* [2019] TC 07399 provides a vivid illustration of the costs which can accrue if mistakes are made:**

- In Tandem identified employee benefits available to larger companies at a much lower cost than to smaller companies.
- It aggregated the employees from smaller companies under the In Tandem banner, which enabled the benefits to be accessed at the lower cost.
- Employees were transferred to In Tandem under the TUPE regulations.
- Because In Tandem was the employer of the staff, its supplies to the participators were supplies of staff and VAT was due on the full consideration paid.
- The VAT assessed on the company was over £10 million, interest was assessed and penalties of over £2,5million were upheld by the FTT.