The Tour Operators Margin Scheme
HBAA White Paper

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1 Introduction

The HBAA became increasingly involved in VAT issues affecting its members during the course of 2009. This demonstrates that there is a need for guidance on a number of VAT issues and the purpose of this is paper is to set out the main issues which members should be aware of and to explain some ideas which can help members achieve an acceptable VAT position.

On 1 January 2010, there were far-reaching changes to the VAT rules in the UK.

The changes of most consequences to HBAA members were changes to the Tour Operators' Margin Scheme ("TOMS") and changes to the place of supply of services rules. This paper is concerned with both.

A crucial consideration for members is whether some or all of their activities are conducted in such a way that the TOMS must be used. Changes to the rules in January this year make it more likely that TOMS applies to some at least of the business conducted. As a general rule, it would be unhelpful to hotel booking agents and event management companies to apply TOMS to their activities. An analysis of TOMS and its effects is set out in section 2 below.

The place of supply of services rules are equally important as they establish the place where all service transactions are subject to VAT. It is imperative, therefore, that members have a good understanding of how these rules apply to their business. These rules are explained later in this document.

2 The Tour Operators' Margin Scheme: A Brief Guide

2.1 What is TOMS?

The Tour Operators' Margin Scheme ("TOMS") is a European scheme applied in nearly all EU member states. It is essentially a simplification, relieving many suppliers of travel services of the VAT obligations they would otherwise have. In many circumstances, its use is compulsory. It does not apply just to tour operators, but rather must be used by any business supplying travel in the designated circumstances. For the purposes of this Paper, the term "tour operator" should, therefore, be taken to mean any business selling travel.

The scheme works by imposing a VAT charge on the gross margin made by the tour operator. This VAT is paid by the tour operator in the member state in which he is conducting his business. No recovery of VAT on the costs of the travel supplied to the tour operator is possible. In this way, total VAT revenue generated by the tour operator's transactions is shared between the member state in which the operator is based and those in which the services it supplies take place.

Although the scheme is based on EU law, there are numerous differences in application between member states which lead to considerable uncertainty and instances of non-taxation or double taxation. The European Commission has made proposals for an overhaul of the scheme but these have not yet been accepted. The Commission has also recently announced that it is taking legal action against a number of member states which

in the view of the Commission do not apply TOMS correctly. It is likely, therefore, that within a couple of years substantial changes will have been made to the scheme. More detail on these issues can be found in section 4.

2.2 When does TOMS apply?

In the UK, TOMS is compulsory when the following conditions are all satisfied:

1 there is a supply of "travel services";

2 the supplier is acting in its own name;

3 the travel services are acquired from a third party;

4 the services are supplied without "material alteration" or "further processing"; and

5 the services are supplied for "the benefit of a traveller".

The term "travel services" is not defined by law but it is convenient to use the terms "primary travel facilities" and "secondary travel facilities". The supply of a primary travel facility will always fall within TOMS if the other conditions above are satisfied. Primary travel facilities are:

- accommodation;
- passenger transport;
- the hire of means of transport;
- the use of airport lounges;
- tour guides; and
- trips and excursions.

In addition, other services are TOMS supplies if supplied as part of a package with primary travel facilities. These secondary travel facilities include sports tickets and facilities, theatre tickets and catering. In practice, there tends to be relatively few arguments about the meaning of travel services.

Far more contentious is the second condition. The acting in own name condition is normally taken to mean that the supplier must act as principal or as an undisclosed agent to fall within TOMS. A supply made on a disclosed agency basis cannot be within the scheme. The distinction between a disclosed and undisclosed agent can be very difficult and many travel businesses display certain characteristics of an undisclosed agent but, at the same time, resemble a disclosed agent in other respects. There is often great uncertainty and considerable scope exists for disputes with HMRC. Appendix 1 looks at the factors which need to be considered in this context.

An example of this uncertainty in practice is the treatment of hotel billbacks – more on this can be found in section 2.4.1. It is also highly relevant to event organisation. The Tax

Tribunal has very recently considered the meaning of disclosed agency in a hotel booking context in the Med Hotels case. The Tribunal decided that Med should not be seen to be a disclosed agent when selling accommodation and accordingly that TOMS must be applied to the commission or profit made on the sale. This is an important decision for both retail and business hotel agents.

TOMS does not apply to services provided from own resources. For example, transport on a coach owned by the tour operator cannot be a TOMS supply.

Equally, the services must be supplied in the same form as when supplied to the tour operator, i.e. there must be no material alteration or processing applied by the tour operator.

The final condition limits TOMS to supplies made for "the benefit of a traveller". Supplies can be seen to fall into one of the following three categories:

- Supplies to private individuals for their use - TOMS applies;

- Supplies to a business customer (a "business consumer") for the use of that customer, i.e. by an employee etc of the company - this also satisfies the test and TOMS applies. Examples include hotel bookings, incentive travel, conferences, meetings etc.

- Supplies to a business customer for re-sale by that business - these are regularly referred to as wholesale supplies and do not fall within TOMS as they are too far removed from the user of the service to be seen to satisfy the benefit of a traveller test.

There used to be two trade facilitation measures which introduced a considerable degree of flexibility. The first such measure allowed a supplier of travel services to a business consumer to opt the supply out of TOMS provided it could demonstrate that it was paying VAT on the supply under the normal rules. This allowed the business consumer to recover VAT and was a valuable rule which helped ensure that VAT costs were not created artificially. The second measure applied to wholesale supplies and allowed the supplier to opt to use TOMS, which could be easier and could also be cost effective in some circumstances. Both of these measures were withdrawn at the end of 2009 and the consequences are considered in 2.4 below.

2.3 Calculation of VAT due

Where TOMS does apply, VAT is paid on the gross margin made in the member state in which the tour operator is located. The margin on travel enjoyed in the EU is standard rated; that made on travel outside the EU is zero rated. No regard can be taken to the nature of the service supplied by the tour operator: no zero rating is possible, therefore, for the supply of passenger transport (which is normally zero rated when supplied by airlines, rail companies, coach operators etc). However, there are three schemes agreed by ABTA and HMRC which allow a tour operator to avoid paying VAT on passenger transport. The schemes are the transport company scheme, the agency scheme and the charter scheme. The schemes are routinely used by the vast majority of UK holiday companies but their use is far less widespread in the business travel sector.

The form of calculation adopted to calculate VAT due on the margin is prescribed by law. The tour operator does just one TOMS calculation each year - at its financial year end and based on the figures for the year. VAT is paid provisionally on an estimated basis during each financial year based on the results of the preceding year's calculation.

2.4 Impact of the loss of the TOMS trade facilitation measures

The TOMS opt-out trade facilitation measure was of particular use to events companies and many HBAs as it allowed the events company / HBA to recover VAT on costs incurred and to issue a VAT invoice to the client against which the client could recover VAT. The outcome was, in many circumstances, that the VAT cost could be removed.

Unfortunately, due to action by the European Commission, the UK has had to remove the TOMS opt-out (and also the TOMS opt-in, which was a useful measure for wholesale tour operators). The loss of the TOMS opt-out means that TOMS must be used in more circumstances and two possible effects of this on HBAs and event companies are analysed below.

2.4.1 *Bill-back*

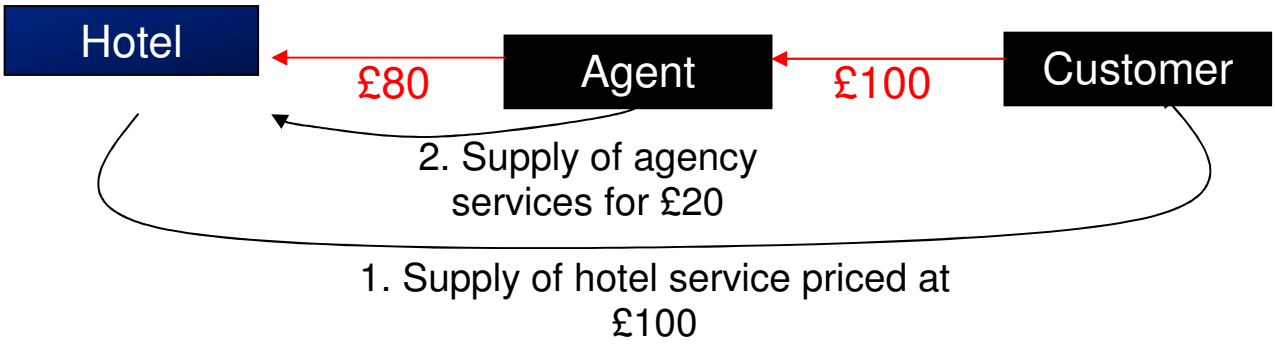
As can be seen from the guidance in 2.2 above, one of the conditions for the application of TOMS is that the business in question acts in its own name. There is a risk with hotel bill-backs that the effect of the invoicing arrangements is such that the HBA is seen to be acting in its own name.

Where an HBAA is acting as disclosed agent in the making of a hotel booking, TOMS does not apply. The hotel accommodation is supplied direct by the hotel to the client. Assuming that the client is able to recover input VAT and that he has adequate evidence (ie, normally a VAT invoice) from the hotel, he will be able to recover the VAT on the hotel cost. Please see Appendix 1 for an analysis of the factors important in determining whether an HBA is a "disclosed agent".

However, if the HBA is not a disclosed agent, there is a real risk that TOMS applies. We have been negotiating on behalf of members with HMRC in an attempt to reach agreement that TOMS should not apply, or at least to find a way that members can work around the TOMS problem to protect VAT recovery by clients without creating a huge upheaval in procedures.

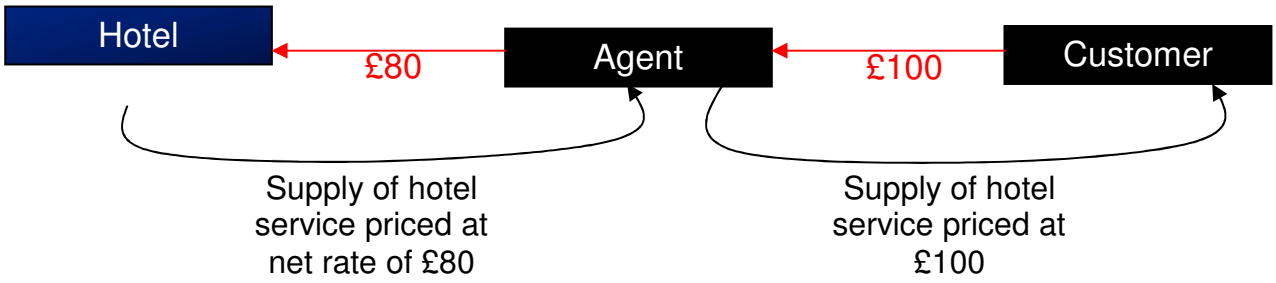
The two examples below illustrate the differing effects of disclosed agency on the one hand and undisclosed agency / principal status on the other.

Fig 1: Disclosed agency model



- VAT due from hotel on £100 under normal rules
- VAT due from agent on £20 but supply will be outside the scope of UK VAT if the hotel is outside of the UK
- Customer can recover VAT on £100 subject to having a proper VAT invoice from the hotel

Fig 2: Principal model



- VAT due from hotel on £80 under normal rules
- VAT due from agent on £100 either under TOMS or normal rules
- Agent can recover VAT on the £80 unless TOMS applies
- Customer can recover VAT on the £100 if he has a VAT invoice from the agent. No recovery at all if the agent is in TOMS.

A typical hotel booking contract will establish agency relationships between the parties. If, however, an HBA agrees bill-back facilities with the client, and these bill-back facilities include the raising of invoices by the hotel in the name of the HBA and then by the HBA, again in its own name, to the client, there is then a risk of TOMS. Adopting the factors listed in Appendix 1, it seems clear that a typical HBA is an agent but the invoicing process may be seen to mean (particularly by HMRC) that the HBA is acting in its own name (and the other conditions in 2.2 are likely to be satisfied). There is no suggestion that the HBA becomes a principal to the contract and, therefore, we are not suggesting that the HBA takes on legal responsibility for the provision of the hotel facilities. Rather, the HBA may be classified to be an agent acting in its own name, which is sufficient to mean that TOMS must be used.

The problem with acting-in-own-name status is that the hotel accommodation is deemed to be supplied to the HBA and then supplied on by the HBA to the client. This is how many HBAs have accounted for VAT on hotel bill-backs until now but there has been no problem because of the TOMS opt-out (at least for UK hotel transactions). However, if TOMS now applies, the HBA is unable to recover VAT on the supply by the hotel and therefore needs to pass on a VAT-inclusive gross cost to the client. Furthermore, the HBA is unable to issue a VAT invoice and, accordingly, there is no VAT for the client to recover. In simple terms, the cost to the client becomes the VAT-inclusive hotel cost. In

the old days of the TOMS opt-out, or indeed now under disclosed agency, most clients are able to recover VAT on hotel costs. The effect of TOMS, therefore, is to increase the cost of UK accommodation by 17.5%. Clearly, this runs the risk of making bill-back operations economically unviable. If the VAT rate increases further, as expected, to perhaps 20%, the problem will, of course, become even more acute.

As described above, we have been negotiating on this point with HMRC. HMRC are committed to introducing the TOMS changes in a way which is as business-friendly as possible, but they are of course constrained to a degree by the various VAT regulations. It has therefore proven difficult to find a middle ground which HMRC can agree to and which is not disruptive to bill-back business models. Our starting point was that the nature of additional services provided in a bill-back environment meant that the HBA should be seen to apply a material alteration or further process to the hotel accommodation. As described in 2.2 above, one of the conditions for the use of TOMS is that there is no material alteration or further processing.

Therefore, if HMRC had agreed with our arguments in this respect, the effect would have been that bill-back could have continued, certainly for UK hotels, in the way in which it normally operated when the TOMS opt-out was available. Unfortunately, HMRC's lawyers were unable to agree that the typical range of bill-back services provided meant that there is a material alteration or further process. We have also argued that an HBA does not itself "acquire" any hotel services from the hotel – see TOMS condition 3 in section 2.2.

It remains open to any member to pursue these arguments with perhaps a legal challenge, if necessary. The HBAA, however, chose to focus on the disclosed agency route and discussed with HMRC the changes needed to bill-back operations in order to satisfy them that the HBA involved does not act in its own name and how the client's VAT recovery can be protected.

We believe we have reached a satisfactory solution although we still await written confirmation of the agreement from HMRC. To remain outside of TOMS, the HBA must arrange the accommodation on a disclosed agency basis. There was no specific agreement with HMRC on what is meant by disclosed agency in this context but it is clear that the decision in the Med case will be relevant and the factors listed in Appendix 1 need to be considered. On the client's input VAT recovery, HMRC have agreed that the hotel invoice to the agent can be adapted to support the client's recovery. The hotel invoice can still be addressed to the agent but should state "c/o the agent" and should include the client name (or a reference to the client name) perhaps in the booking reference. As a disclosed agent, the HBA must not issue a VAT invoice but can issue a statement or similar for the consolidated value of hotel bookings made for a client in a period and HMRC have agreed that this statement or similar can state the total VAT on the bookings and include a statement to the effect that the VAT indicated is the input VAT of the client which can be recovered subject to the client's status. The hotel invoices should also be available to the client in case a VAT inspector wishes to see the original documents. The HBA can retain these invoices and make them available if requested to do so by the client.

2.4.2 *Events companies*

The loss of the TOMS opt-out is a problem also for events companies. In a nutshell, the problem is that many events are considered to contain travel services (both primary and secondary travel facilities) and there is a danger, therefore, that TOMS will apply to the organisation of an event. As described for bill-backs above, the application of TOMS to an event means that the events company is unable to recover VAT on the cost of those services within TOMS and cannot issue a VAT invoice to the client. For the same reason, therefore, the cost of an event is increased substantially.

Most purchasers of events are business consumers and the old TOMS opt-out was therefore used by many events companies. A condition for the use of the opt-out was, however, that VAT was accounted for by the events company under the normal rules. In practice, therefore, this tended to restrict the use of the opt-out to events in the UK. Nevertheless, for such events the opt-out was of great significance and was widely used. Its loss is, therefore, again a problem.

There is no suggestion that all events fall within TOMS. Even where TOMS does apply, it may apply only to a number of the services incorporated into an event. The crucial point is the nature of services incorporated into the event. The most common services which may create a need for TOMS are overnight accommodation and passenger transport.

We believe there is a good argument that many travel services incorporated into events can be disregarded for TOMS purposes as they form an immaterial part of the event. In other words, they exist not as an end in themselves but merely as a means to an end. The rules in this respect are complex, however, and we understand that they are currently one of the matters under review by HMRC.

The increased likelihood of the application of TOMS is also causing many events companies to consider if they are, or can become, a disclosed agent in the organisation of an event. The factors in Appendix 1 are again relevant to this context. There are considerable complexities concerning the VAT treatment of events. Members involved in events organisation are advised to consider carefully their VAT position at an early stage in the planning process. There is a great need for clarification on a number of the points arising and we are liaising with Eventia, which is leading a negotiation with HMRC, the aim of which is to produce some much needed detailed guidance for events companies on the main issues arising.

3 The place of supply of services

The place of supply rules are fundamental to the functioning of the VAT system. These are the rules which determine within the jurisdiction of which member state each transaction should fall. It is a basic principle that each supply should have one place of supply.

The member states agreed a new place of supply regime which entered into force in every member state on 1 January 2010.

3.1 The general rules

There are now two general place of supply of services rules, one for B2B supplies and one for B2C supplies. There is then a long list of exceptions to the general rules and many

services do fall within one of the exceptions. The appropriate general rule only applies if an exception is not relevant to the service in question. The general rules are, therefore, the fallback position which only applies if there is not a relevant exception.

The place of supply under the general rules for B2B supplies is the place of establishment of the customer. In contrast, the place of supply for a B2C transaction is the place of establishment of the supplier.

3.2 The exceptions

As mentioned above, however, there is a long list of exceptions. The purpose of this paper is not to cover all of the exceptions in detail - this Paper is primarily concerned with the exceptions which are considered most likely to apply to members:

- **Services connected to immovable property** – The place of supply of all such services is the location of the property itself. Included within this group is hotel accommodation.

- **Passenger transport** – The place of supply of all forms of passenger transport is where the transport actually takes place.

- **Services of an intermediary** – The place of supply of an intermediary when acting for a non-business customer is the place where the underlying transaction (ie, the supply being arranged by the intermediary) is considered to be made. Please note there is no exception for intermediary services supplied to a business customer and such services therefore fall within the B2B general rule described above.

- **Cultural, educational, entertainment, scientific, sporting and similar services, including ancillary services** – These services are all characterised by a physical performance and the place of supply accordingly is where that physical performance takes place. Many services supplied both to and by events management companies fall within this heading. It is important to note that there will be a change to the place of supply of services within this group on 1 January 2011. From that date, many services, when supplied to a business customer, will fall under the B2B general rule described above. Any such services supplied on a B2C basis will continue to be subject to VAT where the physical performance takes place. There will also be an exception for B2C supplies which involve admission to an event and such services will be subject to VAT where the event is held. Nevertheless, from 1 January 2011, there will be a significant change for many events-related services.

- **TOMS** – The detail of TOMS is, of course, explained elsewhere in this paper but it should be remembered that TOMS is, above all else, a place of supply rule. The place of supply for all services falling within the scheme is the place of establishment of the supplier.

3.3 Hotel agency booking services

There has been considerable uncertainty as to whether a hotel agency booking service should fall within the service of an intermediary heading or whether it should be treated as connected to immovable property. If classified as an intermediary service, then certainly,

as far as B2B transactions are concerned, the agent's place of supply will always be the place of establishment of his customer. If, however, falling within the immovable property heading, an agency booking service will always be supplied in the member state in which the hotel is located. This latter test applies equally in a B2B and B2C environment.

It is important that rules such as this are interpreted in the same way in every member state. Accordingly, there were a number of meetings in which the member states tried to reach agreement on the appropriate interpretation. Unfortunately, no unanimous agreement has yet been reached but the majority of member states did agree that the intermediary approach should be adopted. The UK is one of these member states and, therefore, from 1 January this year, the UK expects all hotel agents to apply the intermediary approach. This means that UK VAT must be charged whenever the intermediary's B2B customer is in the UK. This applies equally to commissions earned from hotels and fees or similar charged to business clients. Accordingly, agency commissions earned from hotels are subject to VAT whenever the hotel is in the UK. Similarly, fees charged to business clients are subject to VAT whenever the client is in the UK and the hotel is itself in the UK or elsewhere in the EU.

Commissions earned from non-UK hotels are, therefore, not subject to UK VAT, but remember that the place of supply is the place of establishment of the hotel. This means it is very likely that VAT is due in the member state in which the hotel is situated. Fortunately, it is not the responsibility of the agent to charge the foreign VAT as the hotel is responsible for this declaration. In a similar fashion, fees charged to a non-UK client are not subject to UK VAT but, where the client is based in another member state, it is to be expected that the client will account for VAT in its own member state. The process by which the recipient of the supply becomes responsible for the payment of the VAT due on that supply is the reverse charge.

As described above, the agreement on the treatment of hotel agency booking services is not unanimous. It is to be expected, therefore, that some member states will apply the immovable property rule. Germany is understood to be one of these countries but the situation is not yet clear. There is a risk, therefore, that booking agents selling hotels located in Germany (assuming Germany does indeed fall within this category), and any other member states taking a similar view, will be expected to register in that country. HMRC have acknowledged this danger and have indicated that any agent running into any such problem should notify them of that fact.

Please note that the above only applies where the booking service is performed on a disclosed agency basis. If the considerations discussed in the bill-back section mean that an agent is considered to be supplying the accommodation itself (ie, it is acting in its own name), the above place of supply rules do not apply (and the TOMS place of supply does apply).

4 The future of TOMS

As discussed briefly in section 1, there is a strong likelihood of change within the next few years to the operation of TOMS.

The European Commission put forward proposals in 2002 for an amended scheme. No agreement was reached and, in response to the failure of the member states to reach agreement, the European Commission launched legal proceedings against nine member states for their alleged failure to implement the current TOMS rules properly. The

proposed legal actions relate to the application of TOMS in the countries involved to wholesale supplies. (As can be seen from section 2, wholesale supplies in the UK are excluded from TOMS but the same approach is not taken everywhere. The European Commission believes that the UK interpretation is correct and some of the countries taking the opposite view are the subject of the proceedings.) If the cases proceed to Court and if the Court finds in favour of the European Commission, it would appear that there will be relatively little impact on the rules in the UK. If, however, the Court was to find against the Commission, it would be necessary to include wholesale supplies in TOMS in the UK in the same way as is currently the case in many countries.

However, it is thought unlikely that the cases will proceed to court. It is understood that the Commission's preferred process is a renegotiation of the scheme. Spain holds the Presidency of the EU for the first half of 2010 and has made it clear that it is its intention to start the process of a renegotiation during the course of its Presidency. A first meeting of the member states took place in February this year to explore the possibility of reform and, according to the Treasury, the tone of the meeting was positive and the member states agreed to meet again, most probably in May, to discuss the possible measures in more detail.

TOMS does not work well in a business consumer environment and therefore the prospect of reform should be welcomed by members. We believe there is an opportunity to influence the negotiations to enhance the prospects of B2B transactions being excluded from TOMS. We believe that, for many transactions entered into by members, an exclusion from TOMS would be beneficial. Now is the time, therefore, to be active in shaping policy over the coming years and HBAA intends to ensure that the voice of its members is heard during this process.

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April 2010

Appendix 1

Factors to take into account when assessing whether an HBA or event management company is a disclosed agent

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- VAT must be paid by some means on the commission earned by the agent. If no VAT was paid, it would mean that the general principle of avoiding the non-payment of VAT would not be satisfied.

- There must be evidence of a contract between the principal (eg, the hotel, venue, etc) and the client.

- There should be notification of any commission or profit to the principal. Failure to notify any commission or profit is a strong indicator that an agency relationship does not exist.

- Who fixes the selling price? If the price is fixed by the agent, this in itself does not invalidate an agency approach but the principal must be aware of the price set by the agent. A process of notification of the price must therefore be in place.

- In a similar vein, does the agent have the right to amend the price being charged without authorisation from the principal?

- To whom does the client owe its obligation to pay? Is the obligation to the agent or to the principal?

- Does the principal have any right to approach the client for payment?

- Who sets the deposit and payment terms?

- Who imposes the cancellation terms on the client? Is the agent liable to pay cancellation charges to the principal?

- Does the agent issue an invoice to the principal for its commission?

- Does the principal invoice the agent for what is due to the principal?

- If the accommodation or other service booked becomes unavailable, is it the responsibility of the principal or of the agent to find alternative accommodation or other service provider for the client?

- Is the agent liable to pay compensation to the client if the accommodation or other service does not meet expected standards?

- Does the principal have any obligations to the agent or just to the client?