TAXATION OF TRAVEL BUSINESSES

A position paper drafted by Deloitte

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On 31 March 2014 Deloitte, in partnership with ABTA, held a tax update for ABTA Members at Deloitte's offices in London. The seminar was chaired by Carolyn Watson, ABTA's Head of Finance, CRM and Corporate Services and featured speakers from The European Commission, ABTA, the legal profession and tax specialists from Deloitte. This paper summarises some of the key points discussed during the seminar and is intended to provide some useful background for travel businesses on travel taxation.

When does a travel business act as an agent or principal?

Please see ABTA's guidance note on Agent or Principal: how does your business trade?

The UK's Supreme Court has recently issued its judgement in the case of *Secret Hotels 2* (formerly MedHotels) which considered whether Secret Hotels was acting as a principal or disclosed agent in the sale of holiday accommodation. In addition to now being the definitive tax case on the principles that determine whether a travel business acts as a principal or agent, the judgement (given it is from the Supreme Court) has far wider legal and regulatory implications for travel businesses in determining their status in the supply chain.

Nicola Shaw Q.C., of Gray's Inn Tax Chambers, represented Secret Hotels in its case and joined the ABTA seminar. Nicola summarised the Secret Hotels case as follows:

The facts **–** Secret Hotels was an accommodation only provider which marketed around 2,500 resort hotels, villas and apartments in the Mediterranean and Caribbean through its website. There were two key legal agreements that Secret Hotels had: the first, its Booking Conditions with customers and the second, its contracts with accommodation providers. Both of these agreements clearly identified Secret Hotels as a disclosed agent. HM Revenue & Customs ("HMRC") argued, and the Court of Appeal had previously accepted, that Secret Hotels, however, did not act as an agent – for instance, it placed monies received from holiday makers in its own bank account, it dealt with customer complaints and paid compensation in its own name, it had its own reps in resort, made advance payments to hotels and, most importantly, set its own level of commission by taking a net rate from accommodation providers and then sold the accommodation for whatever price it achieved.

VAT treatment of transactions **–** If Secret Hotels acted as a principal in purchasing and reselling holiday accommodation (as HMRC argued was the case) then it would be required to account for UK VAT on its gross margin at a rate of 20%, under the Tour Operator's Margin Scheme (TOMS). However, if Secret Hotels acted as a disclosed agent (as it argued was the case) then its supply would be one of agency services supplied to the accommodation providers. Agents' commission is taxed outside of TOMS and, to the extent that agency services are supplied to overseas accommodation providers, falls outside the scope of UK VAT. Given this, if Secret Hotels acted as a principal it had to pay UK VAT.

However, if it acted as a disclosed agent then its agency commission from overseas hotels did not attract UK VAT.

The Supreme Court's judgement – The Supreme Court found in favour of Secret Hotels. Its reasoning was that the contracts clearly set out that Secret Hotels acted as a disclosed agent. There was nothing in the arrangements between the parties to suggest that the contracts were a "sham" and the parties had not departed from the contracts to the extent that they should be disregarded. This approach significantly differed from the prior judgement of the Court of Appeal which focused on six behaviours and concluded that they indicated that Secret Hotels was a principal.

The Supreme Court's judgement is hugely important for the travel sector as it sets out the factors that determine when a travel business acts as agent or principal. Clear contracts with both customers and accommodation providers (and other services providers) are the key to defining the status that the travel business has in the supply chain. It is clear that the subsequent behaviour of the parties impacts on whether the contracts remain the key documents in establishing the legal status of intermediaries. However, it is clear that holding customer monies, taking a net rate and marking it up, the absence of an obligation to promote the hotel, and dealing with complaints and compensation do not preclude a travel business from acting as a disclosed agent.

Where tax, the law and regulation meet

The Secret Hotels 2 judgement gives travel businesses some more clarity on how their business model will determine their tax treatment. We have outlined, below, the various tax treatments that apply to the main travel business models.

Business model 1 – principal or undisclosed agent (buy-sell model) – UK travel businesses that act as principals, or undisclosed agents, must account for VAT under TOMS. In the example outlined below, the UK Travel intermediary has gross profit of £10 and accounts for VAT on £10 under TOMS.

Business model 2 – disclosed agent (commission model) – UK travel businesses that act as disclosed agents receive commission income. If the agency services are supplied to a UK travel provider then VAT is due on the commission. However, if the agency services are supplied to an overseas travel provider, then the agent's services fall outside the scope of UK VAT. In this scenario the UK Travel intermediary has revenue of £10 and does not account for VAT under TOMS. If the hotelier is established outside of the UK then there is no UK VAT due on agency services, and the hotelier is likely to be required to self-account for VAT in its country of establishment.

The basic models outlined above demonstrate that the underlying VAT treatment of supplies made by a travel intermediary acting as principal is different to that made by a disclosed agent.

Business model 3 – non-EU principal – While EU principals account for VAT under TOMS, non-EU principals have no such requirement.

Travel intermediary has gross profit of £10 and accounts for VAT on £10 under TOMS

Travel intermediary has gross profit of £10 and does not account for EU VAT on this

The examples set out above demonstrate that the place of establishment of a travel principal can have a significant financial impact on the margins of a travel business.

A panel of legal, regulatory and tax specialists discussed these business models at the ABTA conference. The main pieces of legislation that will impact on business models are the Package Travel Directive (which will probably come into force in 2016) and new consumer rights regulations affecting payment surcharges and cancellations. The thrust of the changes is to increase the rights of consumers with regard to the companies that they purchase from. Therefore, the main business models outlined above need to be considered in the context of whether they will trigger more, less or the same responsibilities for the travel business under consumer law.

Tax case law update – VAT treatment of card processing fees

As many businesses in the travel sector will be aware, on the retail side it is common place for the supplier to charge the consumer a booking fee or payment processing fee when taking payment. Where the fee is charged by the same business that supplies the travel service (e.g. a tour operator

charging a credit card fee) then the fee is simply treated as additional consideration for the main supply. Therefore, a tour operator charging a credit card fee should include this additional income in its TOMS calculation. However, when the fee is charged by an intermediary that does not make the principal supply (e.g. a travel agent) the position is currently unclear. HMRC's stated position is that the fee is subject to VAT at the standard rate. However, recent case law suggests that this may not be correct.

The litigation on payment processing services stems back to the Court of Appeal decision in *Bookit* which was released in May 2006. The taxpayer won in this instance, and the booking fee fell within the exemption from VAT. Since then there have been a number of cases taken by HMRC where they challenge the scope for VAT exemption. These cases include *SEC* (taxpayer won), *T-mobile* (HMRC won, but can distinguish facts from this decision where the business is acting as a disclosed agent), *NEC* (taxpayer won), *DPAS* (taxpayer won) and *Way Ahead Group* (taxpayer won). Most of these cases were heard at the First Tier Tribunal and are therefore only persuasive, not binding. However, what is clear from these decisions is that despite HMRC's repeated attempts to challenge the scope of the exemption, the Courts continue to find in favour of taxpayers. As a result, there is merit in businesses reviewing their admin/booking fees to see whether there is scope for the service to be treated as VAT exempt, and if so, whether to file a reclaim with HMRC in respect of VAT paid in error.

A word of caution– in looking to apply the exemption, this will have an impact on the business' VAT recovery position. Therefore, any benefit gained by not charging VAT on the supply should be balanced against the loss on VAT recovery on certain costs and the increased administration as a result of being partially exempt for VAT purposes.

Please see ABTA's guidance note on VAT: Credit and debit card charges for further information.

Tax case law update – VAT treatment of travel agent funded discounts

In January 2014, the European Court issued its judgement in the case of *Ibero Tours*, which considered whether a travel agent funding a discount to a customer should account for VAT on the full amount of their receivable commission or whether to account for VAT on the lower amount of the receivable commission, less the discount that the travel agent grants to the customer.

Although the European Commission and the Advocate General to the court, set out their views that travel agents should account for VAT on the lower amount, the final court judgement was that travel agents should account for VAT on the full amount of their receivable commission and that any discount that they fund from their commission is merely third party consideration that they pay for the customer's holiday. Many UK travel agents had submitted claims, pending this case – the claims will now not be paid.

TOMS reform

The conference was joined by Arthur Kerrigan of the European Commission. This session of the conference focussed on the 2013 judgement of the European Court in EC v Spain providing that:

(i) wholesale supplies should be included within TOMS; and

(ii) TOMS should be calculated on a transaction by transaction basis.

At present the UK and many other EU Member States treat wholesale supplies as falling outside of TOMS. Following the CJEU's decision, HMRC issued a Business Brief which provides that until at least the 12 months to January 2015 the position is as follows;

- UK based wholesalers are not required to register for VAT when selling hotel accommodation in Spain, Portugal, France, Greece, Italy, Poland, Czech Republic or Finland;

- UK based wholesalers are required to register for VAT when selling hotel accommodation in other EU Member States, but may able to rely on the direct effect of European law and not register for VAT;

- UK retail tour operators can continue to use the transport company arrangements;

- UK retail tour operators are not required to account for VAT on a line by line basis;

- Non-EU established tour operators do not account for VAT under TOMS when selling European travel product; and

- Non-EU established agents do not account for VAT under TOMS when selling European travel product.

Given the above, reform of the TOMS system is now inevitable. The big question is the timeframe for TOMS reform. Without there being any guarantees it seems that:

(i) The European Commission will prioritise ending the current position which allows non-EU tour operators to sell European travel services without accounting for VAT, while European tour operators must account for VAT under TOMS. Our view is that pressure from the European travel sector will mean that the European Commission will act to end this two tier system, perhaps within the next two years;

(ii) The timeframe for further reform of TOMS is much less certain. In order to change European law all 28 EU Member States must agree to change. Obtaining agreement on issues such as whether wholesale supplies should fall within TOMS or whether the TOMS calculation should be undertaken on a transaction by transaction basis could take a significant period of time.

Summary

Hopefully this paper is helpful for ABTA Members in understanding the current tax environment for the travel sector. If you want to contact the main speakers, their details are below:

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