CHAPTER 34

TOUR OPERATORS MARGIN SCHEME

34.1 Introduction

The tour operators' margin scheme ('TOMS') is a special scheme for businesses that buy in and re-sell travel, accommodation and certain other services as principals or undisclosed agents (i.e. that act in their own name). In many cases, it enables VAT to be accounted for on travel supplies without businesses having to register and account for VAT in every EC country in which the services and goods are enjoyed. It does, however, apply to travel services enjoyed within the UK, within the EC but outside the UK, and wholly outside the EC.

Under the scheme:

- VAT cannot be reclaimed on margin scheme supplies bought in for resale. VAT on overheads outside the TOMS can be reclaimed in the normal way.
- A UK-based tour operator need only account for VAT on the margin, i.e. the difference between the amount received from customers (including any amounts paid on behalf of customers by third parties) and the amount paid to suppliers.
- There are special rules for determining the place, liability and time of margin scheme supplies.
- VAT invoices cannot be issued for margin scheme supplies.

VATA 1994, s.53
SI 1987/1806

- In-house supplies supplied on their own are not subject to the TOMS and are taxed under the normal VAT rules. But a mixture of in-house supplies and bought-in margin scheme supplies must all be accounted for within the TOMS.

The TOMS does not only apply to 'traditional' tour operators. It applies to anyone who is making the type of supplies detailed in 17.2 below, even if this is not their main business activity. For example, it must be used by

- hoteliers who buy in coach passenger transport to collect their guests at the start and end of their stay;
- coach operators who buy in hotel accommodation in order to put together a package; and
- companies that arrange conferences, including providing hotel accommodation for delegates.

The CJEC have confirmed that to make the application of the TOMS depend upon whether a trader was formally classified as a travel agent or tour operator would create distortion of competition. Ancillary travel services which constitute 'a small proportion of the package price compared to accommodation' would not lead to a hotelier falling within the provisions but where, in return for a package price, a hotelier habitually offers his customers travel to the hotel from distant pick-up points in addition to accommodation, such services cannot be treated as purely ancillary. *TP Madgett & RM Baldwin (t/a Howden Court Hotel) v C & E Commrs*.

34.2 Supplies covered by TOMS

Subject to certain exclusions, the TOMS must be used by a person acting as a principal or undisclosed agent for

- 'margin scheme supplies'; and
- 'margin scheme packages' i.e. single transactions which include one or more margin scheme supplies possibly with other types of supplies (e.g. in-house supplies).

'Margin scheme supplies ' are those supplies which are

- bought in for the purpose of the business, and
- supplied for the benefit of a 'traveller' without material alteration or further processing

by a tour operator in an EC country in which he has established his business or has a fixed establishment.

A '*traveller*' is a person, including a business or local authority, who receives supplies of transport and/or accommodation, other than for the purpose of re-supply.

Examples

If meeting the above conditions, the following are **always** treated as margin scheme supplies.

- Accommodation
- Passenger transport
- Hire of means of transport
- Use of special lounges at airports
- Trips or excursions
- Services of tour guides

Other supplies meeting the above conditions **may** be treated as margin scheme supplies but only if provided as part of a package with one or more of the supplies listed above. These include

- Catering
- Theatre tickets
- Sports facilities

In *Beheersmaatschappij Van Ginkel Waddinxveen BV & Others v Inspecteur de Omzetbelasting Utrecht*, the CJEC ruled that what is now *Directive 2006/112/EC, Arts 306–310* applies to cases where only accommodation is provided, and is not restricted to cases where transport is also provided.

In *Aer Lingus plc* vouchers for accommodation or car hire provided to executive class passengers were held not integral or incidental to the supply of air transport and therefore fell within the margin scheme.

In *Virgin Atlantic Airways Ltd* chauffeur-driven car services provided to certain passengers on international flights were held to fall outside the scheme.

In *Finanzamt Heidelberg v IST Internationale Sprach-und Studienreisen GmbH,* the CJEC held that what is now *Directive 2006/112/EC, Arts 306–310* applied to a trader who offered services involving the organisation of language and study trips abroad and which, in consideration of the payment of an all-inclusive sum, provided in its own name to its customers a stay abroad of three to ten months and which bought in services from other taxable persons for that purpose.

Finally it should be noted that the sale of a package of margin scheme supplies is treated as a single supply for VAT purposes. The nature of the services is that of putting together the package or organising the travel services. For example, if hotel accommodation and transport is bought in to provide a tour, the single supply of a tour is made, rather than two separate supplies of transport and accommodation.

34.3 Place of supply

The application of the normal place of supply rules are varied so that margin scheme supplies are treated as supplied

- in the EC country in which the tour operator has established his business, or
- if the supply was made from a fixed establishment, in the EC country in which the fixed establishment is situated.

The effect of this is as follows

(a) Where the supplier is established in the UK only, the place of supply is the UK.

(b) Where the supplier has an establishment in more than one country

- if the establishment from which the supplies are made is in the UK, the place of supply is the UK;
- if the establishment from which the supplies are made is in another EC country, the supply is outside the scope of UK VAT (but within the scope in that other EC country); and
- if the establishment from which the supplies are made is outside the EC, the supplies are not margin scheme supplies and the TOMS does not apply. The normal VAT place of supply rules apply.

Where margin scheme supplies are made from an establishment in another EC country, it may be necessary to register for VAT there.

34.4 Liability of TOMS supplies

If the tour is enjoyed within the EU, for example a holiday to France, then the supply is standard-rated.

If the holiday is enjoyed wholly outside the EU, then it is a zero-rated supply.

Illustration 1

In 2010 Quantum Tours sells a package for £3,000 (VAT – inclusive price) to the Simpson family. The elements of the package are:

	£
Flights in chartered aircraft	900
Local transport at holiday destination	100
Accommodation and food	1,100
	2,100
Profit	900
Package price	3,000

Under TOMS, the margin is treated as a single taxable supply regardless of the nature of the "components" which make up the tour.

- EU holiday — Standard-rated supply

  £900 x 7/47 = £134

- Non-EU holiday — Zero-rated supply

  £900 x 0/47 = £nil

If the Simpson holiday was to Spain, then the calculation of VAT under TOMS is the £900 margin times 7/47ths which equals £134. Whereas, a holiday to Florida contains VAT at 0% and thus the calculation of VAT under TOMS is the £900 margin times 0/47ths which equals £Nil.

Where a journey begins or ends outside the EU, and there are no stops within the EU, except for "comfort breaks", then the whole journey is treated as outside the EU. An example would be a coach tour of Switzerland (non-EU), which drives through France stopping only briefly at service stations. VAT Notice 709/5 para 3.7 Appendix H

If there are significant stops in the EU then a "fair and reasonable method of apportionment" must be used to split the EU and non-EU parts of the margin.

EU margin is standard-rated whereas non-EU margin is zero-rated. An example would be a coach tour of France and Switzerland.

Cruises, partly in and partly out of the EU, are always time apportioned, using the last point of departure as the location on any particular day.

34.5 "In-House" supplies

In-house supplies are supplies which are not margin scheme supplies or agency supplies. They therefore comprise supplies which are either

- made from own resources; or
- result from purchases which the business has materially altered or further processed so that what is supplied is substantially different from what was purchased.

Where in-house supplies are sold *without* margin scheme supplies, VAT must be accounted for outside the TOMS in the normal way.

Where in-house supplies are sold *with* margin scheme supplies as part of a package, the margin scheme calculations must be used to work out the value of all parts of the package. The income relating to in-house supplies is then accounted for under normal principles.

The place of supply of in-house supplies, whether or not they are part of a margin scheme package, is determined using the normal VAT rules. The place of supply will therefore depend upon the nature of the services provided. For example, passenger transport is supplied where it takes place whereas hotel accommodation is supplied where the accommodation is situated. As a result, if the place of supply is in another EC country, it may be necessary to register and account for VAT in that country.

Input tax on in-house supplies are recoverable in the normal way.

Examples of an in-house supply would include supplies where the tour operator owns a coach, an aircraft or a hotel.

34.6 Supplies to business customers

Whether supplies to business customers should be accounted for under the TOMS depends upon whether those supplies are for subsequent resale or for consumption by the business. VAT Notice 709/5/ para 2.3

a) Supplies to business customers for subsequent resale

These supplies are outside the scope of the TOMS and should be accounted for under the normal VAT rules.

Prior to 1 January 2010 an HMRC concession allowed tour operators who generally engage in normal holiday sales to the travelling public but occasionally sell to other travel businesses for onward resale the option of accounting for tax on the latter in the TOMS. This was intended to ease the administrative difficulties that operators might otherwise incur in having to use the normal VAT rules to account for occasional supplies of travel services to other businesses.

The UK has had to accept that the VAT Directive refers to supplies made to the "traveller". The "traveller" is the person who consumes the travel, and so the scheme should not be used when the travel service is sold to a person other than the traveller, such as when supplies are made to business customers for resale. Those tour operators affected had to change their practices from 1 January 2010 to account for the VAT due under the normal VAT rules. In some cases, this may give rise to a requirement to register for VAT in other Member States.

b) Supplies to business customers for their own consumption.

Supplies made to a business customer for use by that customer for the purposes of its business (e.g. for business travel) fall within the TOMS where they meet the definition of margin scheme supplies.

Prior to 1 January 2010, an HMRC concession allowed such supplies to be excluded from the TOMS and treated under normal VAT rules. In the case of supplies enjoyed in the UK, this enabled the tour operator, with the permission of HMRC, to issue VAT invoices to business customers. In the case of any supplies enjoyed in another EC country, it was a condition that VAT on those supplies had been paid to the VAT authority in that country and evidence of this was available for HMRC.

This meant that business customers have been able to recover VAT charged on those supplies subject to the normal rules. HMRC has also treated the provision of school trips as a non-business activity for VAT purposes and allowed them also to be excluded from the special scheme, enabling local authorities to recover the VAT charged in relation to Local Education Authority schools. From 1 January 2010 neither is possible.

34.7 Tax point

The **normal tax point rules do not apply to TOMS.**

A tour operator has a choice of two methods to work out the tax point of supplies made under TOMS. Once a method is chosen, it must be applied to all supplies. Exceptionally, HMRC may allow a tour operator to switch to the other method.

The two methods are as follows:

Method 1 is the **earlier of the date the journey commences or the date the accommodation is supplied.**

Method 2 is similar to "cash accounting", except that the receipt of a very small down payment does not trigger a tax point. **Only once over 20% is received in total, will a tax point be triggered** for all amounts received to date. Later sums received create their own tax point on receipt.

Thus for Method 2 the legislation states "the date payment is received by the operator which, when aggregated with any earlier payment in respect of the same supply, **exceeds** 20% of the total consideration, this date is the tax point for all monies received to date. The receipt of future sums creates it own tax point." A tax point cannot however be later than the date the journey commences.

Example 1

Fabulous France Limited organises holidays to France whereby flights, car hire and villa hire are included in a package sold to the UK customers for £2,500. A customer pays £100 on booking the holiday 12 months prior to departure. The customer then pays £1,000 6 months prior to departure, and then pays the balance 8 weeks prior to departure. State the tax point of the monies received if Method 2 applies.

34.8 Agency supplies

The TOMS does not cover:

(a) Supplies made by an agent or intermediary not packaged/supplied with margin scheme goods.

(b) Supplies made by a business acting as a disclosed agent in the making of margin scheme supplies (i.e. it names the provider of the margin scheme supplies). The commission and all monies for the supply arranged must be excluded from the TOMS.

But where a business acting as an agent must use the TOMS because it makes margin scheme supplies in its own name *and* it receives variable commission (or commission which is otherwise not readily identifiable) as a disclosed agent, it must include its agency income and directly-related costs in its TOMS calculations.

As a result of (*b*) above, a tour operator can use the 'agency option' scheme by entering into an agency arrangement, normally with a transport provider. Provided the conditions of the scheme are met, the supply of transport services is directly from the transport provider to the final customer. As the supply is not made by the tour operator, the transport services are not margin scheme supplies and fall outside the TOMS. Thus, whether supplied singly or as part of a package, the transport element and the tour operator's services of arranging the transport, are free of UK VAT (being either zero-rated or outside the scope).

Similar agency arrangements can be set up for the provision of accommodation and catering. However, as such supplies are subject to VAT at the standard rate, the related commission will normally be standard-rated and there will be no benefit in entering into these arrangements. Additionally, in respect of accommodation, if the accommodation is in another EC country and the commission is charged to a non-VAT registered person, this could give rise to a liability for the tour operator to be VAT-registered in that country. For these reasons, it is unlikely that the 'agency option' scheme should be adopted for such supplies.

34.9 Calculations of margins and output tax

Special calculations as laid down by HMRC are required under the TOMS to ensure that the correct amount of output tax is accounted.

As precise figures are not usually known at the time of preparing the VAT returns, the TOMS requires VAT to be accounted for each quarter (or month if monthly returns are made) using *provisional* figures. The final margins and output tax are based on an annual calculation and adjustment at the end of the '*financial year*', i.e. the year for which financial accounts are made up. This final calculation determines the output tax due for the preceding financial year and provides the percentage to calculate provisional output tax in the subsequent financial year. The year-end calculation must be done immediately after the financial year-end and any output tax adjustment entered on the VAT return for the first VAT period ending after financial year-end. Hence businesses using the TOMS tend to align their VAT returns with their financial year so as to give them the maximum possible time to prepare their year-end TOMS calculations.

Starting to use the scheme

Where a business is newly registered or an existing business starts to use the TOMS for the first time, it must calculate a provisional percentage to use during the first financial year under the scheme. Depending upon the circumstances, this may be based upon

- previous trading figures;
- projected costings and margins; or
- actual monthly/quarterly figures during the first year.

Whichever method is used, the first year-end calculation will correct any under or over payment of VAT arising in the year..

End of year calculation (annual adjustment)

From 1 January 2010, there are two TOMS accounting methods, the market value calculation and the cost-based calculation (previously calculations were based on cost). In principle, the market value method should be used where a market value can be established for a package. However, if the supplier is satisfied that the cost-based method is an accurate reflection of the structure of any package, that is, the same percentage mark-up is achieved on all components, they may use the cost-based method.

The market value calculation works on the basis of extracting from a package a selling value for the bought-in designated travel services. This is done by deducting the market value of in-house supplies from the full package price, leaving the selling value of the bought-in designated travel services on which a margin is then calculated using the cost-based calculation.

Under the cost based calculation the formula covers every type of supply which might be accountable for via the TOMS. The apportionment of the total margin calculated is based on the direct costs of supplies, that is, not indirect/overhead costs. It works on the principle that the same percentage margin is achieved on all the elements of the packages.

Illustration 2

Tropical Places Limited is a tour operator with a year end of 31 December. In the year to 31 December 2010 output tax of £17,000 was accounted for using their 2010 provisional TOMS percentage.

The actual results for the year ended 31 December 2010 were as follows:

	£	£
Sales of holidays		1,000,000
Costs of holidays		
Bought in EU holiday costs	500,000	
Bought in non-EU holiday costs	300,000	
		(800,000)
Total margin		200,000

All figures are VAT inclusive.

VAT will be due at the standard rate on the proportion of the margin that relates to the EU holidays. The margin that relates to EU holidays is £125,000 (500k/800k x 200k). Hence output VAT of £18,617 (£125,000 x 7/47) is payable for the year to 31 December 2010.

An annual adjustment of £1,617 is therefore required in the VAT return to 31 March 2011.

The provisional percentage to carry forward into 2011 is 12.5% (125,000/1,000,000 x 100). This percentage will be applied to each quarters turnover in 2011 to determine the provisional standard rated margin. The relevant VAT fraction will then be applied to determine the output tax due.

The market value calculations are not relevant for Tropical Places as there are no in-house supplies. If there were in-house supplies Tropical Places would simply deduct the market value of these supplies from the £1M above prior to working through the margin calculation. This would obviously result in a lower margin but the company would also need to account for any VAT on the in-house supply if standard rated in the UK under normal rules.

Answer 1

The £100 on booking the holiday is only 4% of the total sale price of the holiday. It is too small to trigger a tax point. When £1,000 is received 6 months prior to departure, £1,100 has been received to date. This totals 44% of the total sale price, which exceeds 20%. Thus, a tax point is triggered for the £1,100 received to date at this point.

Later receipts trigger their own tax point. So, the receipt of £1,400, eight weeks prior to departure, triggers a tax point then for the £1,400 received.