UK Property Accountants

A Complete Guide to

Mastering TOMS VAT



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Introduction to Tour Operators Margin Scheme (TOMS)

The Tour Operators Margin Scheme (TOMS) VAT is a special type of VAT scheme for businesses that buy in and sell travel services. TOMS VAT was first introduced when the UK was a member of the European Union (EU) as an obligatory measure for businesses within the EU. TOMS VAT was a requirement within the EU VAT directive. With Brexit, the UK did not have to continue with TOMS but decided to adopt it within their own law. So, TOMS VAT is now under the UK law VATA 1994, Section 53. However, much of the provisions fall under the VAT Notice 709/5.



TOMS is a VAT scheme applicable to businesses that buy in and resell travel, accommodation, and other specific services as part of a tour package to the traveller. This scheme enables qualifying businesses to compute VAT solely on the profit margin derived from the sale of these services rather than on the entire selling price. The TOMS VAT scheme of the UK mostly follows the principles of the EU TOMS.
TOMS VAT applies to travel services within and outside the UK. In addition, TOMS can apply to your business even if it is not your main business activity or you do not view yourself as a tour operator. One major landscape to look into is if you are a principal or agent. If you are buying or selling the services in your own name, you are a principal. However, if you are doing transactions for someone else, that makes you a disclosed agent. Here are a few examples of scenarios where TOMS may or may not apply:

Scenarios	Within or Outside TOMS
A hotel service provider buys a transport service to collect all their guests at the start and end of their stay.	Within TOMS
A hotel service provider that hires transport for guests occasionally and the income is less than 1% of gross annual turnover.	Outside TOMS
A transport service buys hotel accommodation and provides the service as a package.	Within TOMS
Supplies you have arranged as a disclosed agent or intermediary with your commission identifiable.	Outside TOMS
Supplies that are incidental to other supplies.	Outside TOMS

Eligibility and Scope

The TOMS VAT scheme generally applies to tour operators and to other business that falls under the requirements.

Here are the eligibility criteria for TOMS VAT:

1 Travel Service

If your business provides travel services for tourists, travellers, or visitors, you may fall under the TOMS schemes. These travel services include accommodation, transport, guides, trips or excursions, car hire, transport hire, access to airport lounges, and more.

2 Acting in Own Name

This means the supplier must act as a principal and not as an disclosed agent. For instance, the tour operator must package the supplies provided by the Hotel accommodation provider, travel facility provider and sell this supply under the tour operators' own name as a single supply.

3 Without Material Alteration

The supplier cannot further process or alter the services acquired from a third party. However, material alteration has not been properly defined. This means for the SA apartment, furnishing the apartment from its original state, an alteration that changes the structure of the apartment or property and adding key features to the apartment. However, decorative changes such as painting a wall will not count as material alteration. This has been affirmed by First Tier Tribunal (FTT) in Sonder Europe vs HMRC's case.

4 Benefit of the Traveller

The supplier must provide the services to the traveller for holiday purposes and not for the resell of such services. The traveller can be an individual, a business or a local authority.

The scope of the TOMS VAT scheme is:

- The supplier cannot recover input VAT on direct costs. For example, if you are a tour operator, one of your direct costs can be hotel costs. So, the VAT applied to the hotel costs cannot be recovered under TOMS.
- The VAT only applies to the margin rather than the VAT on sales.
- The supplier can recover VAT paid on the overhead costs which is not directly associated with generating sales. For example, VAT paid on the administrative expenses like accounting and legal expenses can be claimed back.
- If you sell travel services within the UK, the standard rate of VAT applies to your margin.
- If you sell travel services outside the UK, a zero rate of VAT applies to your margin. However, overseas provisions may apply.
- Also, you cannot provide VAT invoices to customers under TOMS. This can be a major disadvantage for business customers.

How is TOMS related to Serviced Accommodation?

TOMS and serviced accommodation are closely related. However, all serviced accommodation does not come under the TOMS VAT scheme. Serviced accommodations are fully furnished properties rented out on a short-term basis. TOMS VAT applies to serviced accommodations if you provide serviced accommodation with travel services as a package.



Calculating the Margin

The TOMS VAT calculation is done on a provisional basis on the Margin of services sold. TOMS VAT calculation is done on the basis of two conditions. The first is that VAT is calculated only on the margin, that is, the amount after subtracting direct expenses from revenue. For instance, if your revenue is £200,000 and direct expenses amount to £150,000. The margin becomes £50,000. The VAT is calculated on the £50,000 by multiplying it by 1/6th.

Under the normal scheme, the VAT will apply at a standard rate of 20%.

UNDER Normal VAT Scheme

S.N	Particulars	Total Amount (Inclusive of VAT)	VAT	Remarks
i.	Revenue	1,500,000	250,000	Output VAT
ii.	Rent	800,000	-----	No Input VAT
iii.	Other Direct Cost	300,000	50,000	Input VAT
iv.	Gross Overhead	200,000	33,333.33	Input VAT

VAT Liability [Output VAT-Input VAT] **£166,667**

UNDER TOMS VAT Scheme

S.N	Particulars	Total Amount (Inclusive of VAT)	VAT	Remarks
i.	Revenue	1,500,000	250,000	Output VAT
ii.	Rent	800,000	-----	No Input VAT
iii.	Other Direct Cost	300,000	50,000	Input VAT
-	Margin(i-ii-iii)	400,000	66,666.67	VAT on Margin (1/6)
iv.	Gross Overhead	200,000	33,333.33	Input VAT

VAT Liability **£33,333**

In the above example, VAT liability under the normal VAT scheme is £166,667 whereas under the TOMS scheme, VAT liability amounts to £33,333 thereby resulting in substantial VAT saving of £133,334.

Another condition is that the VAT is not paid on a trip-by-trip basis but on a provisional basis, according to last year's estimate. After the end of the accounting period, the VAT is calculated on the margin, and the calculations are adjusted. Here is a table explaining the provisional calculation.

Quarters	March	June	September	December	Total
Turnover	£3,000	£2,000	£1,000	£2,000	£7,000
Costs	£2,000	£500	£250	£2,500	£5,250
VAT paid provisionally (Turnover @ 1%)	£30	£20	£10	£20	£80
Margin (Turnover - Costs)					£1,750
VAT (Margin x $\frac{1}{6}$)					£291
Annual Adjustments					£211

During the year, the provisional payments of each quarter are done. Then, after the year ends the TOMS VAT calculation is done on the margin. In our case, we have paid £80 in a year and are due £211.



VAT Treatment under TOMS

Unlike the standard VAT scheme, where VAT is calculated on the entire selling price of a service or product, TOMS allows businesses to compute VAT solely on the gross profit margin—the difference between the sales price to the customer and the purchase cost or other direct cost of the services provided.

TOMS simplifies VAT calculations by focusing only on the margin. This is important for businesses that deal with multiple suppliers and complex pricing structures. By calculating VAT on the margin, businesses can avoid the cumbersome process of tracking and reclaiming VAT on numerous transactions. This simplification not only reduces administrative burdens but also minimises the risk of errors and non-compliance with VAT regulations.

VAT on Margin Calculation

Under TOMS, VAT is calculated based on the margin. The margin is determined by subtracting the cost of direct supplies such as hotel bookings, flights, and other travel related expenses from the total sale price charged to the customer. The VAT rate applied to this margin is 1/6th, which corresponds to the standard VAT rate of 20% applied to the gross margin. For example, if a tour operator sells a package for £1,200 and the cost of providing the service is £1,000, the margin is £200. VAT would then be calculated as £200 divided by six, resulting in a VAT charge of approximately £33.33.

This method of calculating VAT offers a significant advantage over the standard VAT scheme, where output VAT would be calculated on the full £1,200 selling price. By focusing on the margin, TOMS ensures that VAT is only paid on the actual profit made by the business, leading to potentially lower tax payments and better cash flow management.





VAT on Purchases and VAT on Sales

In the standard VAT scheme, businesses charge Output VAT on their sales and can reclaim Input VAT on their purchases. Input VAT is the VAT paid on goods and services used by the business, while Output VAT is the VAT charged on sales made by the business. However, under TOMS, businesses cannot reclaim Input VAT on travel services they purchase and then resell as part of a package. This is because TOMS is designed to simplify VAT accounting by eliminating the need to track and reclaim VAT on multiple transactions.

Instead, VAT is charged only on the margin—the difference between the selling price and the cost of the supplies. This means that businesses under TOMS do not charge Output VAT on the full selling price but only on the profit margin. This simplified approach reduces the administrative burden of managing VAT and helps businesses avoid the complexities associated with tracking and reclaiming Input VAT on numerous purchases.

Benefits of TOMS

The primary benefit of TOMS is the simplification of VAT accounting, which reduces the administrative burden on businesses. By focusing on the margin rather than the entire sales price, TOMS makes it easier for businesses to calculate their VAT liabilities. This is particularly advantageous for businesses that deal with multiple suppliers and complex pricing structures. The simplified VAT calculation process not only saves time and resources but also reduces the risk of errors and non-compliance with VAT regulations.

Another significant benefit of TOMS is the potential for substantial VAT savings. For businesses with high costs and low margins, TOMS can lead to a significantly lower VAT liability compared to the standard VAT scheme. By calculating VAT only on the profit margin, businesses can reduce their overall tax payments, improve cash flow, and increase profitability. This makes TOMS an attractive option for many tour operators and travel agents.

Limitations of TOMS

Despite its benefits, TOMS has certain limitations. Not all businesses in the travel sector qualify for TOMS; they must meet specific criteria to be eligible. These criteria include dealing in their own name and using supplies provided by other taxable persons without material alteration. Businesses that do not meet these criteria cannot benefit from the simplified VAT accounting and potential tax savings offered by TOMS.
Another limitation is that the supplier cannot issue VAT invoices to its customers. This creates an issue for business customers who typically require a VAT invoice. Additionally, ensuring compliance with TOMS regulations can be complex, requiring a thorough understanding of the scheme's requirements and careful accounting practices to avoid errors and potential penalties.

Comparative Analysis (TOMS vs Standard VAT vs Flat Rate Scheme)

Understanding the differences between TOMS and other VAT schemes, such as the standard VAT scheme and the Flat Rate Scheme, is crucial for recognising the benefits of TOMS. It's important to note that if a business is eligible for TOMS, it must apply the scheme compulsorily; it is not an optional choice.

Each scheme has its own set of rules, benefits, and drawbacks.

Standard VAT Scheme

The standard VAT scheme requires businesses to charge VAT on the full selling price of their goods and services, while also allowing them to reclaim VAT on their purchases (Input VAT). This approach is straightforward for most businesses and is suitable for those with significant reclaimable expenses. For example, a business with £150,000 in revenue would charge VAT on this full amount and reclaim VAT on its purchases. This means keeping detailed records of both Output VAT (VAT charged on sales) and Input VAT (VAT paid on purchases).

However, the standard VAT scheme involves a higher administrative burden due to the need to track and report both Output VAT and Input VAT accurately. Businesses must ensure they comply with VAT regulations and avoid errors in their VAT returns, which can be time-consuming and complex.

TOMS

Under TOMS, VAT is calculated only on the margin—the difference between the selling price and the cost of supplies. This method simplifies the accounting process and can lead to substantial VAT savings, particularly for businesses with high costs and low profit margins. For example, a business with £150,000 in revenue and £110,000 in costs would have a margin of £40,000. VAT would be calculated on this margin, resulting in a significantly lower VAT liability compared to the standard VAT scheme. In the given example, the VAT liability would be £6,666.67.

A major drawback of TOMS is that businesses cannot reclaim Input VAT on travel services they buy and resell. This means that while the VAT liability on the margin is lower, businesses cannot offset their VAT costs on purchases.



Flat Rate Scheme

The Flat Rate Scheme simplifies VAT accounting by allowing businesses to pay a fixed percentage of their total turnover as VAT. This percentage varies by industry and your business type. To join the scheme the VAT turnover must be £150,000 or less (excluding VAT), and it must apply to HMRC.

While the Flat Rate Scheme reduces the administrative burden and provides predictable VAT payments, it does not allow for reclaiming Input VAT. This can result in a higher VAT liability for businesses with significant expenses. For example, if a business has £110,000 in costs, it cannot reclaim VAT on these expenses under the Flat Rate Scheme.

You can only reclaim the VAT that you have been charged on a single purchase of capital expenditure if you use the Flat Rate Scheme. To be eligible for this, your amount of purchase, including VAT, should be £2,000 or more. For this, you claim the input tax in Box 4 of your VAT return as these goods are dealt with outside the Flat Rate Scheme.

It is important to note that if the total value of your income for the year amounts to more than £230,000, you will no longer be eligible to use the scheme. However, as long as HMRC is convinced that the total value of your income in the coming 12 months does not exceed £191,500, you may continue to stay in the scheme.

Comparative Analysis

To illustrate the VAT computational difference between TOMS, Normal VAT Scheme and Flat Rate Scheme, consider an example with a total revenue of £120,000, with direct cost being £80,000 (inclusive of VAT) and other administrative expenses being £10,000 (inclusive of VAT). The table below shows the VAT treatment in normal VAT scheme, TOMS VAT and Flat Rate Scheme:



Scheme	Particulars	Amount
Normal VAT Scheme	Sales	£120,000
	Output VAT (A) @ 20%	£24,000
	Direct Cost	£80,000
	Indirect Cost	£10,000
	Total Cost	£90,000
	Input VAT (B)	£15,000
	Net VAT (A-B)	**£9,000**
TOMS Scheme	Sales	£120,000
	Direct Cost	£80,000
	Margin	£40,000
	Output VAT (A)	£6,667
	Indirect Cost	£10,000
	Input VAT (B)	£1,667
	Net VAT (A-B)	**£5,000**
Flat Rate Scheme	Sales	£120,000
	Flat Rate Percentage Applicable	10.5%
	Net VAT	**£12,600**

As shown above, the VAT payable under normal VAT scheme is £9,000 whereas the VAT payable under TOMS is £5,000. Since there is no eligible capital expenditure for which input VAT can be claimed, the VAT under Flat rate scheme is £12,600.

Disclaimer

It is to be noted that TOMS is not an optional scheme. If the business qualifies for TOMS, the business has to compulsorily account for VAT under TOMS. The above comparision is to illustrate the financial advance TOMS has over Standard VAT Scheme and Flat Rate Scheme.

Recent Legal Developments in TOMS

Case Study 1: Sonder Europe vs. HMRC



Background

The case of Sonder Europe Limited versus HMRC is a landmark case that provides significant insights into the application of TOMS. Sonder, a company providing serviced accommodations, disputed HMRC's assessment that it did not qualify for TOMS. This case centred around the interpretation of TOMS regulations and whether Sonder's business model met the necessary criteria. The dispute highlighted the complexities of TOMS and the importance of understanding its specific requirements.

Arguments

Sonder argued that their operations, which involved leasing properties and providing them as part of a broader accommodation service, qualified for TOMS. They contended that their business model fit the scheme's requirements as they were dealing in their own name and providing travel related services. On the other hand, HMRC maintained that Sonder did not meet the TOMS criteria, particularly questioning the nature of their operations and the contracts involved.

Sonder's defence was based on the assertion that their business model involved minimal alterations to the properties and that they were providing accommodation services directly to travellers. They emphasised that their contracts with property owners allowed them to sublet the properties, thereby dealing in their own name. HMRC, however, argued that Sonder's model was more akin to a property rental business, which would not qualify for TOMS.

Court Decision

The court ultimately ruled in favour of Sonder, confirming their eligibility for TOMS. The decision was based on a detailed analysis of Sonder's business practices, including their contracts and the way they provided accommodation services. The ruling clarified that Sonder's model met the key criteria for TOMS, including dealing in their own name and providing direct benefit to the traveller without material alteration or futher processing. This decision provided valuable precedent for other businesses in the serviced accommodation sector.

The court's ruling was significant because it set a precedent for how TOMS regulations should be interpreted and applied. It underscored the importance of the contractual arrangements and the nature of the services provided. For businesses in the serviced accommodation sector, this ruling provided clarity on how they could structure their operations to qualify for TOMS and benefit from the scheme's advantages.

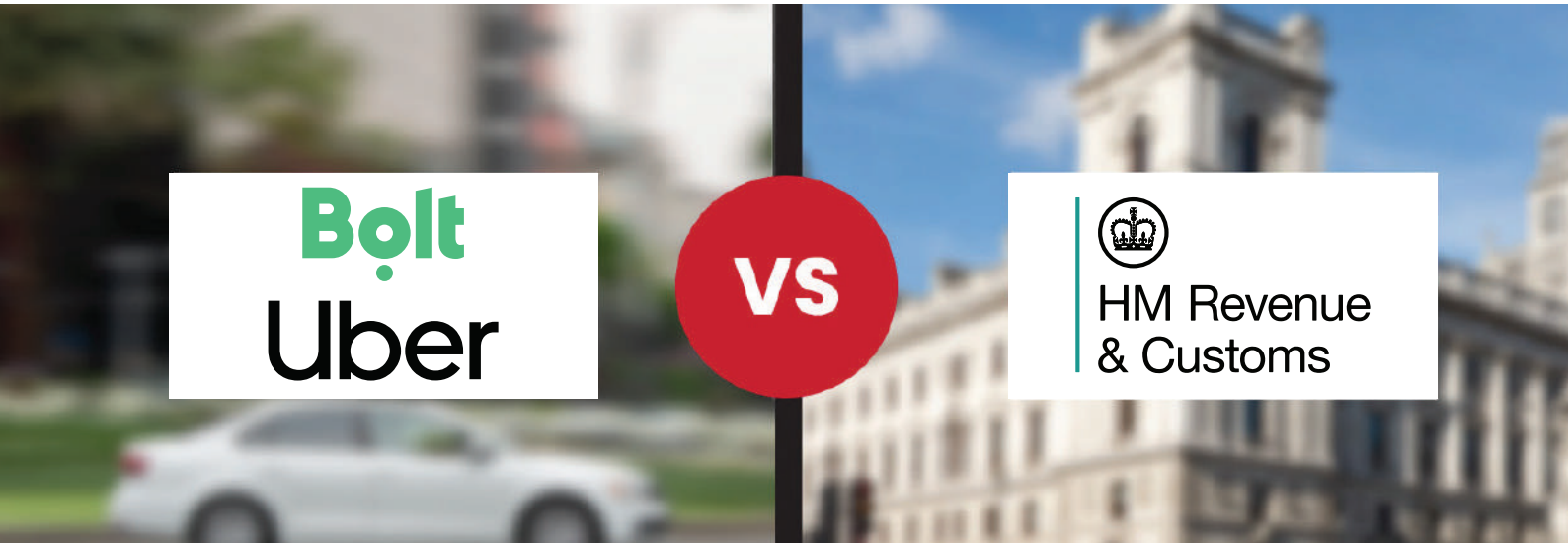
Implications for Businesses

The Sonder case has significant implications for businesses seeking to apply TOMS. It underscores the importance of understanding and correctly applying TOMS criteria to ensure eligibility. The ruling also provides clarity and guidance on how similar businesses can structure their operations to qualify for TOMS, potentially leading to substantial VAT savings. This case highlights the need for careful legal and tax planning to navigate the complexities of VAT regulations effectively.

For businesses in the travel and accommodation sectors, the Sonder ruling offers a valuable example of how to meet TOMS criteria. By ensuring that they deal in their own name and provide travel related services directly to travellers, businesses can benefit from the simplified VAT accounting and potential tax savings offered by TOMS. However, it also emphasises the need for meticulous record keeping and careful structuring of contracts to avoid disputes with tax authorities.



Case Study 2: Bolt and Uber vs. HMRC



Bolt vs. HMRC

Bolt Ltd.'s legal battle with HMRC revolves on whether their ride-hailing services qualified for TOMS. Bolt argued that their services met the TOMS criteria by providing travel related services directly to customers. HMRC contended that Bolt's operations did not fall within TOMS' scope. The court ruled in favour of Bolt, broadening TOMS' application to include ride-hailing services. This decision offers significant VAT savings for similar businesses by allowing them to calculate VAT on the margin rather than the full selling price.

HMRC vs. Uber

In another significant case, HMRC pursued Uber for a £386 million VAT bill, arguing that Uber acted as a principal in providing transportation services. Uber maintained that they were intermediaries, only liable for VAT on their commission. The outcome of this case is still pending, but it could have far-reaching implications for digital platforms in the gig economy. A ruling against Uber could lead to increased VAT liabilities for similar businesses.

Potential Repayment for Uber

Following Bolt's victory, Uber might also benefit if they can argue that their business model qualifies for TOMS. A successful claim could result in a substantial VAT repayment from HMRC, potentially amounting to £500 million. This case underscores the evolving interpretation of TOMS and its applicability to modern business models.

Summary

These recent legal cases illustrate the complexities of TOMS and its potential benefits for businesses in the travel and transportation sectors. The decisions in favour of Bolt and the pending outcome for Uber highlight the importance of understanding VAT regulations and their application to different business models. Staying informed about these legal developments can help businesses optimise their VAT strategies and ensure compliance.

Conclusion

In conclusion, the Tour Operators' Margin Scheme (TOMS) provides simplification of the VAT treatment of travel agents' activity. By focusing on the margin rather than the entire sales price, TOMS can reduce the overall VAT liability, especially for businesses with high costs and low margins. The comparative analysis with the standard VAT scheme and the Flat Rate Scheme demonstrates the advantages of TOMS in terms of reduced administrative burden and potential financial benefits.

Recommendations

For businesses operating in the travel and accommodation sectors, it is essential to assess eligibility for TOMS carefully. Understanding the key criteria and potential VAT savings can help businesses make informed decisions about their VAT accounting practices. Accountants and tax advisors should provide detailed guidance to clients on TOMS regulations, ensuring compliance and optimising VAT positions.

Businesses should also consider the implications of the Sonder case when structuring their operations. By ensuring that their business model aligns with TOMS criteria, they can benefit from the scheme's advantages. Additionally, maintaining accurate records and seeking professional advice can help businesses navigate the complexities of VAT regulations and avoid disputes with tax authorities.

Future Outlook

Looking ahead, businesses must stay updated on any regulatory changes that might impact TOMS. Continuous review and optimisation of VAT accounting practices will help maintain compliance and maximise savings. The case study of Sonder versus HMRC serves as a valuable example of how businesses can navigate the complexities of VAT regulations and benefit from TOMS. By adopting best practices and seeking professional advice, businesses can effectively manage their VAT obligations and enhance their financial performance.

In summary, TOMS offers a simplified and beneficial VAT accounting method for eligible businesses. By understanding the scheme's requirements and advantages, businesses can make informed decisions, optimise their VAT positions, and improve their overall financial health.

Businesses should also consider the implications of the Sonder case when structuring their operations. By ensuring that their business model aligns with TOMS criteria, they can benefit from the scheme's advantages. Additionally, maintaining accurate records and seeking professional advice can help businesses navigate the complexities of VAT regulations and avoid disputes with tax authorities.



FAQs

1 **What is TOMS VAT?**

Tour Operators Margin Scheme (TOMS) is a special type of VAT scheme for businesses that buy in or resell travel accommodation.

2 **Who is Eligible for TOMS VAT?**

Any business that buys in or sells travel services and accommodation is eligible for TOMS VAT. The businesses eligible for TOMS must mandatorily register for the VAT scheme with HMRC.

3 **Would my business be eligible for TOMS VAT scheme if I carry out furnishings and maintenance work in the leased property that I am renting out?**

If you carry out maintenance and furnishings in the leased property that changes the structure of the property and is more than just a cosmetic change, this can be considered as material alteration on the property. In this case, the supply of accommodation does not fall within the TOMS VAT scheme.

5 **Can the Landlord of the Property supplying Serviced Accommodation for short-term letting apply TOMS VAT?**

If you own the property that you are renting out to travellers you cannot apply TOMS while accounting for VAT as you are not directly purchasing and reselling the travel, accommodation, and specific services.

6 **How does the lease agreement impact whether my business is subject to TOMS VAT?**

Your lease agreement with the landlord should give you the right to sublet the properties under your name. Without the right to sublet the property, you may be unable to supply the serviced accommodation as a Principal or undisclosed agent. Additionally, other lease agreement terms need consideration to ascertain if your supplies are eligible for VAT accounting under TOMS.

7 **How does the lease agreement impact whether my business is subject to TOMS VAT?**

Paying the utility bills for the property could be seen as material alteration to the property from HMRC point of view. However, as per the recent case on Sonder Europe vs HMRC, FTT did not comment on this and this is yet to be tested in the court of law.

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Let's Talk

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