Summary: Intervention & Options

Department /Agency:	Title:	
HMRC	Impact Assessment of implementation of the new VAT refund Procedure	
Stage: Final	**Version:** 1.0	**Date:** 12 March 2009
Related Publications: Council Directive 2008/9/EC and Council Regulation (EC) No 143/2008		

Available to view or download at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0001:0006:EN:PDF

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What is the problem under consideration? Why is government intervention necessary?

In early 2008, the EU Council of Ministers formally adopted a series of changes to the EU VAT rules, known collectively as the VAT package. This included the reform of the cross-border refund procedure which enables EU businesses registered in one Member State to claim VAT incurred in another. The current system is a burdensome paper-based system. Many EU businesses experience considerable delays, with valid claims being paid late or not at all. This system is to be replaced by a new electronic one, which is planned to go live across the EU with effect from 1 /1/ 2010.

What are the policy objectives and the intended effects?

The EU and UK objective is to improve the current procedure from a business perspective, through the use of technology. An electronic system will be implemented in every Member State through which business in that country can make claims to recover VAT incurred in every other Member State. Shorter, fixed and more certain time limits will apply with interest payments if those are not met and the right of appeal against decisions made by the tax authorities.

What policy options have been considered? Please justify any preferred option.

UK Ministers have already agreed to the changes in EU VAT rules and are required to implement the changes into UK legislation. The only policy option is therefore to transpose the EU VAT rules into UK legislation, establish the necessary EU compatible, UK interface, and ensure UK businesses have sufficient notice to enable them to make any necessary changes in order to comply with the requirements of the new electronic cross-border refund system.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

HMRC intends to review the policy to establish the actual costs and benefits and achievments of the desired effects within three years.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that, (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible Minister:

Stephen Timms

.... Date: 1 April 2009

Summary: Analysis & Evidence

Policy Option: 1	Description: Transpose Directive into UK law and bring UK law into line with Recast VAT Directive

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	1. Most of the one-off costs will be borne by HMRC. Early indicative costs are that HMRC will incur £15.7m to design and implement an IT system, plus annual maintenance costs of £0.6m. It may be possible to reduce these costs. 2. An estimated 30,000 UK businesses and agents will face one-off costs of £1.9m for familiarisation and setting up compatible IT.
£ 17.6 million	1	
Average Annual Cost (excluding one-off)		
£ 0.6 million	15	**Total Cost** (PV) **£ 24 million**

Other **key non-monetised costs** by 'main affected groups' Some businesses currently without IT knowledge and/or electronic means of communications will have to acquire these - this might include taking IT lessons and/or subscribing to internet providers.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	1. An estimated 30,000 businesses who are established in the EU and expected to claim VAT in the UK will benefit from the changes. 2. A similar number of UK businesses are expected to use the UK interface.
£ 0		
Average Annual Benefit		
£ 2.4 million	15	**Total Benefit** (PV) **£ 30 million**

Other **key non-monetised benefits** by 'main affected groups'

Electronic notification of claim progress, standardised expense codes, reduction in language difficulties, queries to be raised electronically, interest is payable if processing time limits are exceeded, additional time allowed for claims to be submitted, requested invoices to be sent electronically.

Key Assumptions/Sensitivities/Risks Reliable data for UK businesses claiming abroad is unknown; there is uncertainty about the extent to which businesses currently choosing not to claim will do and the extent of the effect from place of supply changes (see http://www.hmrc.gov.uk/ria/vat-supply-services.pdf) is unclear.

Price Base Year 2009	Time Period Years 15	**Net Benefit Range** (NPV)	**NET BENEFIT** (NPV Best estimate) **+£6 million**

What is the geographic coverage of the policy/option?			All Member States	
On what date will the policy be implemented?			1/1/2010	
Which organisation(s) will enforce the policy?			EC and HMRC	
What is the total annual cost of enforcement for these organisations?			£ not quantified	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro Negligible	Small Negligible	Medium Negligible	Large Negligible
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ 0	Decrease of £ 2.1 million	**Net Impact**	-£ 2.1 million

Key: Annual costs and benefits: Constant Prices | (Net) Present Value

Evidence Base (for summary sheets)

1 The Issue

1.1 In December 2007, the Finance Ministers of all the Member States of the EU agreed a series of changes to the EU VAT rules, known collectively as the VAT package. The VAT package was then formally adopted by the EU Council of Ministers in early 2008 and some key elements are due to come into effect from 1 January 2010. This includes a revised cross-border refund system. The cross-border refund system enables a business that incurs input VAT on expenditure in a Member State where it is not established and makes no supplies, to recover that VAT. The VAT cannot be recovered through the VAT return in the normal way. Instead the business must claim it directly from the Member State where the VAT was incurred (the Member State of Refund). The current system requires hard copy original invoices, a certificate of status and a claim form to be submitted to the Member State of Refund. Refunds are then to be made within six months of receipt of a complete and correct form, together with all the necessary documents.

1.2 This paper-based system is burdensome for businesses. Details of the tax system and the VAT rules of other Member States needed to make a claim are not readily accessible. There are language difficulties in making claims, as each Member State uses forms written in its native language. The time limits for making refunds are frequently exceeded on the basis that the tax administration has not been provided with all the necessary documentation on which to base a decision to make a refund. Nor do many Member States pay interest on late claims or give the business the opportunity to appeal against decisions. As a result of these difficulties, many EU businesses choose to appoint agents to make claims on their behalf, or choose simply not to claim at all.

1.3 This paper-based system is to be replaced by a new electronic one, which is planned to go live across the EU with effect from 1 January 2010, using the existing EU technological infrastructure, the VAT Information Exchange System (VIES), as a platform. Under the new system, requests for refunds will continue, as now, to be dealt with by the Member State of Refund. The amount refundable will also continue to be determined under the VAT rules of the Member State of Refund and the relevant repayment will be made directly by that Member State to the business. However, the new procedure will be an electronic system with every Member State making available an electronic interface to its national businesses through which those businesses can submit claims to other EU Member States and through which it will receive claims, via the EU VIES interface, for VAT incurred by businesses in other EU Member States. This EU-wide electronic refund scheme results in a number of key benefits, including:

- information will be sent by the business to the Member State of Refund, via a web-portal in the business's own tax authority (the Member State of Establishment).
- all refund applications will have standard fields of information. In addition the input VAT restrictions of the individual Member States and description of the business activity may be coded (in a standardised format). Standard fields and coding will enable the claim to be completed almost entirely in the business's own language and although there may be some free text on occasion, Member States can allow businesses to use a language other than that of the Member State of Refund (and many will allow English as an alternative).
- additional time for businesses to submit claims, moving from the current time limit of within six months of the end of the year to within nine months of the end of the year of the claim period.
- businesses can check on the progress of the refund claim throughout the process through notification initially from the Member State of Establishment and thereafter notifications from the Member State of Refund at key stages.
- there are shorter, fixed and certain time limits for processing of claims, with appeals procedures and interest payable to the business if the time limits are not met.

1.4 The Directive requires all Member States to implement the new system to the same deadline with effect from 1 January 2010. This requires changes to existing UK legislation including primary legislation to cover the high level general principles and secondary legislation to cover the detail of the new procedure. In addition, it requires the development of a UK interface to access the EU VIES platform in order to send claims on behalf of UK businesses and receive claims from businesses in other Member States. This Impact Assessment covers these UK requirements and the associated benefits to EU businesses claiming VAT under the new system from the UK and the associated costs for UK business having to familiarise themselves and introduce any changes to use the new claims procedure.

2 Policy Objectives and Intended Effects

2.1 The policy objective is to implement an EU-wide simplified refund procedure so that all EU businesses may more easily claim the VAT to which they are entitled, that they are able to do so at a reduced administrative cost, that they have greater certainty over timescales, and that they are financially compensated (through an interest regime) where timescales are not met.

2.2 The changes should ensure a faster and more efficient processing for EU tax administrations.

3 The Options

3.1 UK Ministers have already agreed to the changes in EU VAT rules and are required to implement the changes into UK legislation to support the EU-wide system. The only policy option is therefore to transpose the EU VAT rules into UK legislation, establish the necessary EU compatible, UK interface, and ensure UK businesses have sufficient notice to enable them to make any necessary changes they need to make in order to comply with the requirements of the new electronic cross-border refund system.

4 Consultation

4.1 HMRC has been carrying out some informal consultations with business over the course of 2008. We now intend making the draft legislation available to businesses and advisers more widely in order to informally obtain their views on whether the legislation works as intended and to check for unintended consequences. There are no options on which a full, formal consultation could be undertaken.

5 Costs and benefits analysis – working assumptions

5.1 HMRC receives about 20,000 claims from EU businesses annually. The Commission estimates that more than 50% of large businesses do not claim refunds to which they are entitled because of current difficulties. This Impact Assessment tentatively assumes about 20,000 eligible claims are not being sent and the likelihood is that most are potentially from small businesses because the current cost of claiming outweighs the benefit. It is therefore assumed there will be a total of 40,000 claims from businesses established in other Member States sent to HMRC per year when the changes take place.

5.2 Data on the number of businesses sending claims to HMRC from other Member States is also limited. Based on some limited data, about 17,000 EU businesses claimed refunds from HMRC between January 2008 and July 2008 i.e. over a period of about 7 months. Based on that number and the number of claims per year, it is assumed at most 20,000 businesses claim annually. This Impact Assessment assumes 10,000 more businesses established in other Member States are currently not claiming and will start claiming after the changes – bringing the total number of businesses claiming after the changes to 30,000. HMRC invites submission of quantitative evidence that will enable more robust estimates to be made in this area.

5.3 There is also no comprehensive data on the number of UK businesses claiming VAT from other Member States because they are currently not required to provide any data to HMRC. Again, the Department would welcome submission of quantitative evidence in this area. HMRC has, however, obtained some indicative data from the Irish Tax Authority, which states that just over 10,000 UK businesses claimed refunds in Ireland during 2008. Using that number as a benchmark, this Impact Assessment assumes that an estimated 30,000 UK businesses will be claiming refunds for transactions in other Member States after the changes have taken place (this estimate includes those businesses not currently claiming but likely to start claiming after the changes).

5.4 The place of supply changes (see http://www.hmrc.gov.uk/ria/vat-supply-services.pdf) are likely to reduce the number of claims processed via the refund procedure.

5.5 Data on the number of agents claiming on behalf of UK businesses is also very limited. There are an estimated 100,000 UK agents used by UK businesses for Self Assessment purposes. This

Impact Assessment assumes the same agents are available for providing VAT services. Given that the 30,000 UK businesses estimated to be affected by the changes account for about 2% of the VAT registered population, this Impact Assessment assumes no more than 2,000 (= 2% x 100,000) UK agents claim on behalf of UK businesses.

5.6 Estimates in this Impact Assessment assume that for each business the changes will reduce the time spent and cost on claiming a refund by 50%. No change in businesses' behaviour with respect to the use of agents is assumed and therefore businesses currently using agents will continue doing so but for agents to keep providing the service (i.e. in order for the agents to keep the businesses) this Impact Assessment assumes the agents' fees for providing the service will fall by 50% in future. It is however acknowledged that some businesses currently outsourcing this service might bring it in-house.

5.7 The economic trend between now and 1 January 2010 has not been factored into any of these working assumptions and estimates on the number of businesses affected provided in this Impact Assessment should be viewed as indicative.

5.8 HMRC welcomes further representations from interested parties, particularly with a view to submissions of quantitative evidence on any of the above.

Costs

5.9 These sections examine costs only and unless otherwise stated one-off compliance costs are in 2009 prices and annual admin burden costs are in 2005 prices. The net present value figures have been calculated using an annual discount rate of 3.5% and over a period of 15 years. This period has been chosen to give a full picture of the interaction between the one-off costs and the ongoing benefits.

5.10 Admin burden cost figures are informed by data within the Standard Cost Model administrative burden baseline which is a report commissioned by HMRC. The modelling of costs in this Impact Assessment has been based on limited data. Therefore the figures should be viewed as tentative. A brief outline of the Standard Cost Model is in the annex to this Impact Assessment. The report to HMRC is available online at: http://www.hmrc.gov.uk/better-regulation/kpmg1.pdf

5.11 The cost burden is mainly faced by HMRC and the benefits are mainly accruing to businesses.

Costs to UK businesses – one-off compliance costs

5.12 The estimated 30,000 UK businesses and 2,000 UK agents expected to claim after the changes will need to spend about two hours familiarising themselves with the changes at an hourly cost of £20 (in wages). This gives an estimated one-off compliance cost of about £1.2 million or £40 per business.

5.13 Because HMRC intends to provide clear guidance, the rest of UK businesses and agents whose business activities will not require thorough knowledge of the changes are assumed to spend an insignificant amount time checking the changes. The cost is likely to be an insignificant one-off compliance since it will be clear to most that the changes do not affect them.

5.14 Currently UK businesses claiming VAT in other Member States do not have to contact HMRC. After the changes UK businesses will be required to file their claims electronically via HMRC's Gateway, a change that will shift the 'claiming obligation' for UK businesses from EU Member States to HMRC.

5.15 The following will incur one-off compliance costs for gaining access to the Gateway;

- an estimated 900 UK businesses that are estimated not to have the necessary IT but incurring VAT in other MS will face a total one-off cost of just under £0.3 million (about £320 per business) for acquiring the necessary computers, software and internet access compatible with the Gateway technology. Most of these businesses are likely to be smaller.
- to be able to use the new procedures claimants will need to be registered on the Gateway. This Impact Assessment assumes that this will take about half an hour at cost of £20 per hour in wages. The estimated 30,000 UK businesses and 2,000 agents will face a total one-off registration cost of about £0.4 million – or about £10 per business. This cost is likely to be mitigated by the requirements under the Carter mandation to file VAT returns on-line by 1 April 2010 – some businesses will already have registered on the Gateway.

5.16 Some businesses currently not electronically connected or computerised will need to acquire some basic IT skills, set-up electronic contact addresses etc. Because of lack of data these costs have not been quantified and HMRC invites quantitative evidence.

5.17 No additional admin burden costs to businesses over and above the current are expected after the changes.

5.18 All UK businesses affected are expected to face about £1.9 million one-off compliance costs associated with the changes.

Costs to HMRC

5.19 Currently UK businesses claiming VAT incurred in other Member States do not have to go through HMRC. To implement the new refund system all Member States must provide an electronic interface connected to the European Commission infrastructure, which will allow applications from their own businesses to be seamlessly passed on to any of the other 26 Member States. The system will also need to be able to receive and process electronic claims originating from the other 26 Member States.

- Early indications are that HMRC will face project costs of £15.7 million of designing and implementing the UK system and £0.6 million annual maintenance costs although it is hoped that these can be reduced. Full details of the cost breakdown will be provided in the impact assessment accompanying the secondary implementing legislation.

Other costs not quantified

5.20 Although HMRC intends to redeploy staff assigned to process the current Directive claims, there are additional expected impacts on HMRC in relation to the introduction of these changes. HMRC will bear additional resource costs in the following areas:

- this being a new system HMRC will face some staff-training costs,
- publicising of the requirements to businesses;
- production of tailored guidance;
- running and maintaining the computerised system,
- dealing with queries from businesses on the new requirements;
- dealing with incorrect claims within the stipulated timescales.

These costs have not yet been quantified but it is expected that most resource costs will be on a one-off basis, particularly for the first three bullet points. HMRC is in the process of quantifying these costs.

5.21 The current claiming procedure does not require Member States to pay interest on late payments whereas there will be a requirement to do so after the changes. HMRC will face additional costs in interest payments when such delays occur. Estimates of these costs are still being quantified.

5.22 There will be additional revenue costs (other than interest payments) arising from businesses currently foregoing their refunds when they start claiming this revenue once the system is simpler.

6. **Benefits**

6.1 The aim is to simplify the system so that businesses may more easily claim the VAT to which they are entitled, that they do so at a reduced administrative cost, that they have greater certainty over timescales, and that they are financially compensated where timescales are not met.

6.2 Currently HMRC obliges businesses based in other Member States to claim VAT incurred in the UK by sending claim forms and evidence of entitlement to claim in hard copy format.

6.3 The changes when introduced will benefit these non-UK businesses through;

- savings on postage costs – claims will be electronically transmitted,
- time saving in claiming and following up their claims – HMRC will notify businesses about the progress of their claims,
- faster processing of refunds which will give cash flow benefits,

- and simplification will allow those businesses currently not making claims to do so under the new system.

6.4 UK businesses should derive similar benefits from the implementation of the changes in other Member States.

Benefits to businesses

6.5 The Standard Cost Model admin burden baseline for the 8th Directive refund is £4.4 million in 2005 prices (or £5.0 million in 2009 prices). This is the annual admin burden cost for the 20,000 businesses in other Member States for claiming their refunds from HMRC. This Impact Assessment assumes the time spent in the claiming process by businesses will be 50% less and agents will also cut their fees by 50% after the changes. Based on these assumptions, businesses in other Member States will save an estimated £2.1 million annually in 2005 prices (or £2.4 million in 2009 prices) in admin burden costs.

6.6 Similar savings should be achieved by UK businesses making claims to other EU Member States, but as these savings will not be due to changes in HMRC's tax obligations they are not counted in this Impact Assessment.

Other benefits not quantified

6.7 A simpler claiming system may enable some businesses to make claims themselves, rather than using agents to make a claim on their behalf. This will save such businesses paying an agents fee.

6.8 The certainty of interest payments on late refunds will benefit businesses.

6.9 All EU businesses will also benefit from claiming via a system that predominantly uses their native language – an unquantifiable but significant benefit.

6.10 There will also be a benefit to HMRC as a result of receiving standardised electronic claims where the tax authority in the Member State of the claimant has undertaken initial verification checks

7 Cost and Benefit summary

7.1 The table below provides costs summary in 2009 prices and bracketed figures are in 2005 prices.

	One-off implementation costs £m / expected magnitude	Annual continuing costs £m / expected magnitude
	Quantified costs to businesses	
Familiarisation costs for UK businesses affected by the changes	1.2	-
UK businesses IT upgrading	0.3	-
Gateway registration costs	0.4	-
Total	1.9	-
	Quantified costs to HMRC	
IT	15.3	-
Staff	0.4	-
System maintenance costs	-	0.6
Total	15.7	0.6
Grand Total (costs)	**17.6**	**0.6**
	Quantified benefits	
Time admin burden saving	**-**	**2.4 (2.1)**
	Unquantified benefits	
Businesses processing the claims in-house instead of using agents	Unquantified	Unquantified
Using native languages	Unquantified	Unquantified
Interest payments	Unquantified	Unquantified
HMRC using a computerised system	Unquantified	Unquantified

7.2 The costs and benefits of this change have been evaluated over a period of 15 years in order to give an indication of how the one-off, up front costs are offset over time by the ongoing benefits. In fact, parity between all costs and benefits is achieved after 10 years, although the overall costs to *businesses* will be outweighed by the benefits after only one year.

7.3 Over the 15 year period, and using a discount rate of 3.5% per year, the one-off costs of £17.6m and the ongoing cost of £0.6m have a present value of £24m. In contrast, the benefits in terms of the ongoing saving in administrative burden of £2.4m p.a. (2009 prices) have a present value of £30m over the 15 years.

7.4 The benefits are permanent and will continue beyond 15 years. To illustrate the effect of this HMRC have also calculated a present value over an infinite timeframe, and this gives a total cost of about £35m, while the overall benefit totals about £68m. This leads to a net benefit of about £33m.

8 Implementation plan

8.1 HMRC's implementation plan comprises legislative changes, development of the IT system, and production of guidance for businesses and operational staff. Informal consultation took place with some business representatives during 2008 to inform this process. A Q&A briefing, together with draft legislation and this Impact Assessment will be exposed more widely to business and other stakeholders for further comment.

Implementation stage

8.2 The UK legislative changes will be included in Finance Bill 2009 and subsequent Statutory Instruments. A further impact assessment will be issued with the secondary implementing legislation.

8.3 Once available the draft legislation will be exposed to businesses and advisers in order to informally obtain their views on the potential impact. It is not anticipated that a full consultation will be undertaken.

8.4 EU Ministers agreed the changes will come into effect from 1 January 2010

9. Impact tests

9.1 The changes will impact on all businesses in UK which incur business costs in other Member States and all businesses in the EU who incur business costs in the UK.

9.2 HMRC considers that these changes will be more cost effective for small businesses to claim when they do incur VAT costs in other Member States. Small business representatives have already formed part of the informal consultation process. We are now releasing further information to advise businesses, trade bodies and representatives about the changes to the refunds system along with a draft of the revised legislation.

9.3 The same applies when examining the potential impacts on competition. The electronic cross-border refund system changes potentially affect all EU businesses that incur costs in Member States where they are not established in the course of their business. No particular group is put at a disadvantage.

9.4 The changes will apply to all UK businesses that incur business expenditure in other member states. It is not expected that these changes would have any significant impact on legal aid.

9.5 The changes will be in accordance with the principles of sustainable development and will have no significant impact on emissions of greenhouse gases or other environmental impacts. They are compatible with the Human Rights Act. They will not have a significantly different effect in rural areas.

Neither would they significantly impact on:

- Health and well being;
- Race equality;
- Disability equality; or
- Gender equality.

10. Caveats and risks

10.1 The key caveat is that many of the administrative burden and compliance cost estimates are based on assumptions. These are informed by evidence where possible, but the status of many estimates is tentative. However, they are believed to be broadly indicative of expected impacts.

10.2 HMRC welcomes further representations from interested parties, particularly with a view to submissions of quantitative evidence.

11. Monitoring and evaluation

11.1 Impact Assessment guidance on the BERR website recommends that the date for post-implementation review should tie in with the timetable of the Commission’s own review of the legislation, in order that the UK can feed in its findings to the Commission. HMRC proposes to coordinate its evaluation of the resulting changes with the Commission’s review.

11.2 The guidance also suggests that implementation practices should be compared with at least two other major Member States to draw lessons on methods of implementation and enforcement in line with Commission’s review of the Directive.

11.3 For all policy changes, compliance costs are routinely reviewed one to three years after implementation.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

The 'Standard Cost Model' (SCM) has been used to derive an estimate of the costs to business of complying with HMRC obligations in this area to disclose information to HMRC or to third parties. The SCM considers which activities a business has to undertake to comply with HMRC obligations and requirements, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens which apply to different sizes of business and by whether they outsource their compliance activities. It also differentiates between businesses which use e-solutions and those which do not.

The SCM estimates the costs of using agents and other external providers; the costs of undertaking work in-house, using a pre-defined set of activities; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs of a change in policy. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation or requirement not existed. It considers the costs which apply to a normally efficient business. The SCM does not consider any wider compliance cost issues, such as the costs of business uncertainty or cash flow costs. The SCM figures are based on wage rates, prices and populations which existed in May 2005.