

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (AMENDMENT) (NO. 5) REGULATIONS 2007

2007 No. 2085

- 1.** This explanatory memorandum has been prepared by HM Revenue & Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 These regulations amend the Value Added Tax Regulations 1995 (S.I. 1995/2518) (“the Principal Regulations”).

2.2 Regulations 3 to 5 amend regulation 6 of the Principal Regulations and are consequential to changes made to sections 49 and 94 of, and Schedules 1 and 4 to, the Value Added Tax Act 1994 (“the VAT Act”) by section 100 of the Finance Act 2007 (c.11) in respect of the VAT arrangements for transfers of businesses as going concerns (TOGCs).

2.3 The changes to regulation 6 of the Principal Regulations have two purposes. Firstly, they clarify that, where reference is made to the transfer of a business as a going concern, it includes the transfer of a part of a business which is to continue to operate as a going concern following its transfer. Secondly, although by virtue of the amended section 49 the seller of a business will retain his business records, regulation 6 will require that, where the buyer of the business is registered for VAT with the same VAT registration number that was previously allocated to the seller, the records of the business must be preserved by the buyer, unless the Commissioners of HMRC (“the Commissioners”), at the request of the seller, otherwise direct.

2.4 Regulations 6 to 10 amend regulations 13, 14, and 17 to 19 of the Principal Regulations and deal with the rules relating to when a registered person is obliged to issue a VAT invoice, what information such an invoice must contain and in particular what information invoices issued to and by persons belonging in other member States must contain.

3. Matters of special interest to the Select Committee on Statutory Instruments

None.

4. Legislative Background to regulations 3 to 5

4.1 Although the power to make regulations under section 49(2) of the VAT Act (as further elucidated by section 49(3) of the VAT Act) have been exercised in S.I.s 1995/2518, 1997/1086 and 2004/1675, these regulations are the first use of the power since section 49(2A) of the Act was inserted by section 100(4) of the Finance Act 2007.

4.2 Special VAT rules apply where a person acquires a business, or a part of a business, and its assets as a going concern and that person intends to continue operating the business. Section 49(1)(b) of the VAT Act requires that the business records of the seller must be preserved by the transferee. This VAT rule is at odds with direct tax, company law and insolvency law rules, all of which require the transferor to keep his records.

4.3 Section 100 of the Finance Act 2007 changes the law with effect from 1st September 2007 by omitting section 49(1)(b) of the VAT Act. In order for a transferee of a business to fulfil his VAT obligations, it is likely that he will require information contained in the records of the business before the transfer occurred. Section 100(6) of the Finance Act 2007 inserts section 49(4), (5) and (6) into the VAT Act so that he may require the seller to provide the information he needs in order to meet his VAT obligations or, where the information is already held by the Commissioners, for it to be disclosed to him.

4.4 Section 49(1)(a) of the VAT Act provides that, for the purposes of determining whether the purchaser of a business is liable to be registered for VAT (which is determined by virtue of section 3 and Schedule 1 to 3A of the VAT Act according to the amount of taxable supplies made or to be made by the business), the person to whom the business is transferred is treated as having carried on the business before as well as after the transfer.

4.5 Section 49(1)(a) does not transfer the seller's VAT registration and he remains responsible in respect of his obligations arising in connection with the business before its transfer. However, section 49(2) and (3) affords the Commissioners power to make regulations whereby the transferee of the business may be registered for VAT in substitution for the seller and for the liabilities and duties of the seller to become those of the transferee.

4.6 The power has been exercised by regulation 6 of the Principal Regulations so that, upon a joint application by the seller and transferee of a business, the VAT registration of the seller may be cancelled and the transferee registered for VAT with the same VAT registration number as the seller in substitution for him with the consequential assumption by the transferee of the VAT liabilities and duties etc. of the seller. Where a VAT registration is transferred in this way, it is reasonable for the transferee to assume responsibility for preserving the records of the business prior to the transfer. Regulation 6(3)(f) of the Principal Regulations (which is inserted by regulation 4(d) of these regulations) makes provision for this, subject to the power of the Commissioners to direct otherwise upon the application of the seller.

4.7 These regulations also amend regulation 6 of the Principal Regulations to clarify that that regulation applies where a part of a business is transferred as a going concern in the same way as the VAT Act has been amended by section 100 of the Finance Act 2007.

Legislative Background to regulations 6 to 10

4.8 Paragraph 2A of Schedule 11 to the VAT Act ("Schedule 11") allows the Commissioners to make regulations to require a taxable person who supplies goods or services to provide a VAT invoice to the person supplied and, further, to prescribe certain

particulars which must be included on such an invoice as well as certain conditions which will apply in specified cases. Such regulations may be framed so as to apply only in prescribed cases or only in relation to supplies made by persons of prescribed descriptions and may make different provision for different circumstances.

4.9 Paragraph 2B of Schedule 11 makes provision in relation to self billed invoices and paragraph 3 of that Schedule makes provision in relation to electronic invoices

4.10 These Regulations make provision for a number of changes to the Principal Regulations.

4.11 Regulation 6 makes it clear that a registered person is required to issue an invoice to a business customer in another member State except where the supply is an exempt supply and the member State of receipt does not require an invoice to be issued for such a supply.

4.12 Regulation 7 prescribes additional requirements for the contents of a VAT invoice where a margin scheme applies, where the supply is subject to the reverse charge and where the supply is exempt or zero-rated.

4.13 Regulation 8 removes one of the prescribed requirements for invoices issued in relation to supplies to persons belonging in other member States.

4.14 Regulation 9 removes one of the prescribed requirements for invoices issued in relation to supplies made by intermediate suppliers.

4.15 Regulation 10 removes one of the prescribed requirements for invoices issued in relation to supplies made by persons who belong in other member States.

4.16 A Transposition Note prepared in relation to this Instrument is attached at Annex A. This note sets out the relevant EU provisions which this instrument is implementing. Other relevant provisions have already been implemented in UK law.

4.17 An EM for what became Council Directive 2001/115/EC amending Council Directive 77/388/EEC was signed by the Paymaster General and submitted to the House of Commons European Scrutiny Committee (“the Committee”) on 19/12/2000. In its Report dated 17/01/2001, that Committee requested further information including a Regulatory Impact Assessment and details of the views expressed by business interests in the UK. A revised EM dated 29/10/2001 and a SEM dated 14/11/2001 providing the information requested were signed by the Paymaster General and submitted to the Committee. The proposed Directive was assessed by the Committee to be politically important and was cleared on 21 November 2001. It was not considered by the House of Lords European Scrutiny Committee having been cleared from scrutiny at the Chairman’s siff of 16/01/2001.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background to regulations 3 to 5

7.1 The requirement imposed by section 49(1)(b) of the VAT Act that the seller of a business or part of a business should transfer the business records to the buyer is at odds with direct tax, company law and insolvency law rules, all of which require the transferor to keep his records.

7.2 During an extended consultation by HMRC on the VAT rules for TOGCs, businesses and advisers indicated that they wanted section 49(1)(b) of the VAT Act to be changed to align VAT law with the requirements of direct tax, company law and insolvency law rules so that the seller of the business which is transferred as a going concern should retain the records of the business. Section 100 of the Finance Act 2007 changes the law to this effect from 1st September 2007 by omitting section 49(1)(b). However, where the liability etc. for the VAT affairs of a business arising before the transfer of the business are also transferred pursuant to regulation 6 of the Principal Regulations, it is considered beneficial for all the records of the business to be preserved by the transferee but this is subject to a power for the Commissioners to direct otherwise where the seller requests. It is anticipated that sellers who are required to retain records to meet regulatory obligations are likely to apply to the Commissioners for a direction that they should retain the records of the business.

7.3 The intention to change the record keeping requirements was announced at PBR 2006. HMRC informally exposed the draft Finance Bill clause and an early draft of the relevant part of this instrument to interested parties prior to publication of the Finance Bill. No issues were raised that necessitated any significant changes to the legislation as drafted.

7.4 Budget Notice 58/2007 announced these changes. Further guidance for taxpayers on the VAT arrangements for TOGCs can be found in Notice 700/9 and VAT Guidance V1-10. These publications will be amended to reflect these changes to the arrangements for the preservation of records following the transfer of a business.

7.5 Although there have been many amendments to the Principal Regulations, there are no current plans to amend the regulations in respect of TOGCs further. The Principal Regulations can be viewed at http://www.opsi.gov.uk/si/si1995/Uksi_19952518_en_1.htm.

Policy background to regulations 6 to 10

7.6 The amendments made by this instrument are designed to ensure that the UK law relating to invoicing is in accordance with EU law and properly implements the invoicing requirements in Council Directive 2006/112/EC (“the Principal VAT Directive”). The UK has been the subject of infraction proceedings initiated by the Commission which have been stayed on the basis that it makes such changes as are necessary to its invoicing provisions so as to ensure conformity with the relevant provisions of the Principal VAT Directive (Articles 217-240).

7.7 The instrument comprises a number of changes that were the subject of a recent consultation with representatives from affected industries and businesses.

7.8 The first set of changes (regulation 6) will require registered persons to issue invoices in relation to exempt supplies made to persons in other member States where that member State requires an invoice for such a supply. Previously the UK did not require invoices to be issued in relation to any exempt supplies made to a person in another member State.

7.9 The second set of changes (regulations 7 to 10) relates to the information which a VAT invoice must contain. These changes are designed to ensure that VAT invoices issued under UK law contain all the information which is prescribed by the Principal VAT Directive and that UK law does not require additional information which is not so prescribed.

7.10 There was widespread acceptance of the need for the changes and some amendments have been made to reduce business costs following consultation. A more detailed analysis can be found in the Impact Assessment Attached at Annex C. The changes are legally important in ensuring that UK VAT legislation is in accordance with the Principal VAT Directive.

8. Impact

8.1 A full Regulatory Impact Assessment was produced in March 2007 on the combined impact of the amendments made by regulations 3 to 5, and those made by the Finance Bill 2007 to section 49 of the VAT Act 1994. The text of the RIA is attached to this memorandum at Annex B and can also be found at <http://www.hmrc.gov.uk/ria/3-transfer-of-going-concerns.pdf>.

8.2 An Impact Assessment relating to the effects of the revised invoicing requirements is attached to this memorandum at Annex C and can also be found at www.hmrc.gov.uk.

8.3 There is no impact on the public sector.

9. Contact

9.1 Ian Allen at HM Revenue and Customs Tel: 020 7147 0009 or e-mail: ian.allen@hmrc.gsi.gov.uk can answer any queries regarding regulations 3 to 5 of this instrument.

9.2 John Brandwood at HM Revenue and Customs Tel: 0151 703 8657 or e-mail: john.brandwood@hmrc.gsi.gov.uk can answer any queries regarding regulations 6 to 10 of this instrument.

ANNEX A

TRANSPOSITION NOTE

Chapter 3 of Title XI (Articles 217-240) of the VAT Directive (Council Directive 2006/112/EC) contains the invoicing requirements from 01 January 2007. (The VAT Directive is a re-cast of Directive 77/388 as amended, paragraphs (3) and (9) of Article 22 of which contained invoicing requirements.)

This Transposition Note details the relationship between Articles 220, 221 and 226 of the VAT Directive and those regulations in the Value Added Tax (Amendment) (No.5) Regulations 2007 (SI 2007/xxxx) which come into effect on 01 October 2007. Articles 217-219, 222-225, 227-240 and the parts of Articles 220, 221 and 226 where, in this note, no action is required were implemented into UK law on or before 01 January 2004 via Regulations 13-20 of the Value Added Tax Regulations 1995 (SI 1995/2518 as variously amended).

Article	Objective	Implementation	Responsibility
220	Obligation on businesses to issue invoices for specific supplies of goods and services	Reg 6(a)	Her Majesty's Revenue & Customs (HMRC)
221.1	Discretion for member States to require invoices for supplies not within A220	No action required	HMRC
221.2	Discretion for Member States to release businesses from invoicing obligations for certain supplies	Reg 6(b)	HMRC
226	Mandatory details to be included on tax invoices	See below	HMRC
226(1)	Date of invoice	No action required	HMRC
226(2)	Unique sequential number	Reg 7(a)	HMRC
226(3)	Supplier's VAT number	No action required	HMRC
226(4)	Customer's VAT number in certain circumstances	No action required	HMRC
226(5)	Name and address of supplier and customer	No action required	HMRC
226(6)	Quantity and nature of goods and services supplied	No action required	HMRC
226(7)	Time of supply	No action required	HMRC
226(8)	Unit price and total amount per rate or exemption	No action required	HMRC
226(9)	VAT rate	No action required	HMRC
226(10)	VAT amount payable	No action required	HMRC
226(11)	An indication that an exemption or reverse charge has been applied	Regs 7(b) [part], 7(c) [part], 7(d-g).	HMRC
226(12)	Characteristics for new means of transport	No action required	HMRC

226(13)	An indication that Tour Operators Margin Scheme has been applied	Regs 7(b) [part], 7(c) [part], 7(d-g).	HMRC
226(14)	An indication that the Margin Scheme for second-hand goods, antiques and collectors' items has been applied	Regs 7(b) [part], 7(c) [part], 7(d-g).	HMRC
226(15)	Tax representative's VAT number	No action required	HMRC

ANNEX B

REGULATORY IMPACT ASSESSMENT

VAT: TRANSFER OF GOING CONCERN - RETENTION OF RECORDS

1. PURPOSE AND INTENDED EFFECT

i) Objective

To simplify VAT record-keeping rules when a business is transferred as a going concern (TOGC) with effect from 1 September 2007.

ii) Background

Special VAT rules apply where a person acquires a business and its assets as a going concern, and they intend to continue operating the business. In these circumstances, VAT law prescribes that the business records of the seller must be transferred to the buyer.

However, there are two common situations when this does not happen:

- (a) Where on application from the seller HMRC directs that the records can be retained by the seller;
- (b) Where the seller or buyer and their advisers are unaware of the VAT rule.

HMRC estimates that there are around 50,000 TOGCs per year. Business advisors tell HMRC that in practice, many businesses are unaware of the rules and that the proposed changes will create greater certainty for them.

Requiring the records to be transferred to the buyer is at odds with direct tax, company law and insolvency law rules, which all require the seller to keep their records. In addition, there are a number of areas where the buyer needs to obtain certain information from the seller to enable them to comply with their VAT obligations. Thus the current rule does not tally with other regulatory regimes.

2. CONSULTATION

During an extended consultation (which was delayed pending a decision in the *Zita Modes Sarl* European Court of Justice case (C-497/01), which arrived at the end of 2003) businesses and advisers have consistently told us that they wanted HMRC to change the law so that the seller was allowed to retain his records following a TOGC, and that this was their main aspiration for the review.

Following announcement at PBR 2006 of the intention to change the record keeping requirements, HMRC informally consulted interested parties on the draft legislation. No issues were raised that necessitate any significant changes in the legislation as drafted.

3. OPTIONS

Option 1: Do Nothing

This option maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer.

Option 2: Change the law so that records are retained by the seller

Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Option 3: Seller retains records even where the VAT registration number is transferred

Amend VAT law so that;

- The seller will keep the business records in all cases
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

4. COSTS AND BENEFITS

i) Sectors and groups affected

Some 100,000 businesses are expected to fall under these TOGC rules each year by buying or selling a business and over 99% of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

ii) Analysis of costs and benefits

Option 1: Do Nothing

This option has no costs as it maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer. Requiring records to be transferred to the buyer under the TOGC rules, especially for small businesses, was top of the list of concerns that came out during the review. It causes uncertainty plus an unnecessary administrative burden on sellers who wish to retain their records and have to apply to HMRC to do so. As such, this option offers no direct benefits to businesses.

Option 2: Change the law so that records are retained by the seller

Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

The proposed simplifications relate to three main areas:

- **Transfer of Records**

This option removes the requirement for the seller to transfer business records to the buyer and provides the major benefit to businesses. A transfer of full records does not happen in all cases of TOGC (such as where on application from the seller HMRC directs that the records can be retained by the seller or where the seller or buyer and their advisers are unaware of the VAT rule). However, where records are transferred the time involved to produce the relevant records will vary. Sellers will normally have to examine records to make sure they are not needed for other purposes and this is likely to take many of them, or their agent or accountant, an hour or more. Assuming that across all 50,000 TOGCs each year it takes sellers on average at least one hour to transfer business records, the current administrative burden is estimated at around £760,000, of which around 99% relates to small businesses.

Businesses will welcome the removal of this obligation, which will end the uncertainty for sellers that wish to retain their records and reduce the administrative burdens from costs incurred by some sellers in having to apply to HMRC for confirmation that they can keep the records.

This option will also set out in the law that information must be transferred to the buyer, so that they can comply with their taxpayer obligations. It had been intended originally that the information that must be passed to the buyer would be set down in the law. However, this has not been possible because of the variety of information that would need to be covered. Therefore, the seller will be required to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994. Also, HMRC will be able disclose such information to the buyer where the seller fails to provide it to the buyer. The information that must be passed to the buyer is expected to be readily accessible from the seller's records and sellers should not need to spend much time finding and sending information to the buyer. Assuming that extracting the specific information and sending it to their buyers will save 50,000 sellers over 50 minutes compared with the assumed time required for the current rules suggests that their administrative burden might be reduced by at least **£650,000** a year.

- **Retention of VAT records**

Under the current rules, at the request of the seller, HMRC may allow it to retain the VAT records of the business. HMRC estimate that requesting permission to retain their records each year costs businesses around £200,000, 99% of which is borne by small businesses. By removing this obligation, businesses will no longer incur administrative

burden costs of having to request permission from HMRC to retain their business records.

It is expected that businesses will welcome the removal of this requirement to seek permission and reduce the administrative burdens by around **£200,000** from costs incurred in having to apply to HMRC for direction.

When the seller's VAT registration number is transferred to the buyer, the records will continue to be passed to the buyer. The seller will be able to seek permission from HMRC for the records to be retained. However, this is likely to affect very few businesses because transfer of VAT number usually occurs only where a business merely changes its legal status (and so it is essentially the same business).

- **Obligations of Transferee**

To meet their VAT obligations following a TOGC, buyers will usually need to access and use information about the business before they take ownership. This is currently assumed to involve around 15 minutes of a buyer's time at an annual cost of over £190,000. Replacing the requirement for sellers to transfer all the business records with a requirement to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994, will make it much easier for buyers to fulfil their obligations. Although the exact information buyers will receive will vary according to the nature of business, the requirement is expected to ensure direct access to the information commonly needed by buyers and cut the amount of time they need to spend in obtaining information about the businesses before they take ownership. Assuming this will reduce the amount of time involved by 10 minutes indicates an administrative burden saving of around **£125,000** a year.

The total savings in administrative burdens from this option in these three areas is estimated at around £1 million a year. The majority of businesses affected are small businesses, who are often confused by the perceived complexity of the rules or are totally unaware of them. By increasing certainty about the VAT treatment of TOGCs, this option provides a significant benefit to such businesses. As businesses tend to fall within TOGC rules on an occasional basis only, no initial set-up costs are anticipated.

Representatives of business and their advisors tell us that these proposed changes will reduce the administrative burden associated with a TOGC. Additional compliance costs for representatives and advisers are unlikely to be significant being restricted to a brief familiarisation with the new simpler rules.

Businesses will see other additional benefits from regularising the position with other regulatory regimes. The proposed changes will clarify the law and bring record keeping into line with other tax and regulatory regimes in that the seller will keep his business records in all but a few specific cases and legislation will require that the seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act.

Option 3: Seller retains records even where the VAT registration number is transferred

Amend VAT law so that;

- The seller will keep the business records in all cases, and
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act , and
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

This option would similarly relate to three main areas:

- **Transfer of Records**

As for Option 2. However, under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. There would be a requirement that the seller make available to the buyer the information he needs to comply with his duties under the VAT Act. Although this is expected to apply to very few TOGCs, as the transfer of a VAT number usually occurs only where a business merely changes its legal status, it presents a revenue risk, since the buyer takes on the liabilities and obligations of the seller.

- **Retention of VAT records**

As for Option 2, with the caveat in the above paragraph.

- **Obligations of Transferee**

As for Option 2.

5. SMALL FIRMS IMPACT TEST

Small businesses were consulted as part of the review, which commenced in 2000. Some 100,000 businesses are expected to fall under these TOGC rules each year when they buy or sell a business and over 99% of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

The proposed changes will be of benefit because the current rules cause difficulties by being at odds with other regulatory regimes. The clearer rules will reduce administrative burdens by saving time, particularly for the smallest businesses.

6. COMPETITION ASSESSMENT

The competition filter test has been applied and the changes passed. The changes will not impact directly on any particular markets as TOGC is used across all business sectors by mainly small local businesses. Sectors where TOGC is particularly common include restaurants, cafés and small retailers. These simplifications are not expected to have any significant effects on competition in any sector although they will make it easier for those businesses that change ownership and fall under these rules.

7. ENFORCEMENT, SANCTIONS AND MONITORING

We do not expect any enforcement, sanctions or monitoring issues because these changes release businesses from current requirements.

HMRC staff, as part of the assurance of the businesses affected, will monitor compliance with the law. Those businesses will be subject to the usual enforcement procedures for VAT registered businesses. No additional cost is envisaged as a result.

Options 2 and 3 should have an administrative saving for HMRC who will no longer need to grant permission for records to be retained by the seller.

8. IMPLEMENTATION AND DELIVERY PLAN

The intended changes will be effective for contracts entered into on or after 1 September 2007. Prior to the effective date, VAT Notice 700/9 and HMRC guidance will be revised to reflect the changes.

9. POST-IMPLEMENTATION PLAN

HMRC will carry out a post-implementation review as soon as the change has bedded in and suitable data are available. This is expected to be within 3 years of implementation, but developments will be monitored to ensure that any review is neither premature, nor unnecessarily delayed. The findings will be used to enhance the policy-making process – both in this area and across HMRC in general.

10. SUMMARY AND RECOMMENDATION

The measure is intended to simplify the VAT record-keeping rules and reduce administrative burdens for businesses when a business is transferred as a going concern. The current rules are poorly understood, and out of step with other tax and regulatory regimes.

The options are;

- Do nothing (Option 1). This would maintain the current rules so that the business records of the seller must be transferred to the buyer. This would be unwelcome by business and at odds with direct tax, company law and insolvency law rules, which all require the seller to keep his records.
- Change the law so that the records are retained by the seller in most cases (Option 2.). It is HMRC's view that changing the law would provide an important contribution to reducing administrative burdens for business that are transferred as a going concern.
- Change the law so that records are retained by seller even where the VAT registration number is transferred in most cases (Option 3.) Under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. However, the risk of tax loss if the records are not required to be transferred to the buyer by law, the limited number of TOGCs involved and the need protect buyers taking on the obligations of the seller, outweigh the minor saving in administrative burden associated with it.

It is therefore recommended that the changes outlined in Option 2. are taken forward.

At the same time, changes will be made to confirm that in UK VAT legislation the transfer of a going concern includes the transfer of part of a business which is capable of separate operation. This reflects HMRC current application of UK law, and ensures that UK law more accurately reflects EC law. Therefore, no additional burdens will occur.

11. CONTACT POINT

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REGULATORY IMPACT ASSESSMENT

VAT: TRANSFER OF GOING CONCERN - RETENTION OF RECORDS

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

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DAWN PRIMAROLO M.P.
PAYMASTER GENERAL

1 March 2007

ANNEX C

HMRC – IMPACT ASSESSMENT

1. Title – **Changes to VAT invoicing**

2. Purpose and intended effect

HMRC is making changes to regulations on VAT invoicing which will affect-

- the way in which invoices are numbered;
- the reference when the invoice involves a supply subject to the second hand margin scheme or a supply to another taxable person under the tour operators scheme;
- the need for cross border invoices to refer to the reason for any VAT exemption or reverse charge.

This impact assessment (IA) considers the costs and benefits of proposals outlined in the related consultation in JVCC Paper 0107.

The Invoicing Directive (2001/115/EC) amended Article 22 of the 6th VAT Directive¹ to reduce national differences in invoicing requirements and simplify cross border trade. The UK was supportive of these objectives and we believed we had properly implemented the Invoicing Directive.

However, the EU Commission began formal infraction proceedings against the UK in 2005 on the grounds that the UK had not fully implemented the Directive. After discussion, the UK has now agreed to make several changes to complete the implementation of the Invoicing Directive and these regulations are the result.

3. Consultation

Within Government

Specialist units in both HMRC and the Treasury have advised on the taxpayer and policy perspectives.

Public Consultation

The UK is committed to bringing UK regulations in line with the Principal VAT Directive. Those changes will be made with the minimum possible impact on business. The changes involve business processes about which the Government has limited information. Accordingly, the consultation included a partial Regulatory Impact Assessment which sought to-

- assess impacts on business generally, including any particular sectoral concerns
- validate assumptions about the limited impact of many of the changes
- check out the regulatory solution proposed and identify any regulatory alternatives for implementation of the changes

¹ All subsequent references are to the Principal VAT Directive, 2006/112/EC.

- Obtain feedback on the need for transitional measures.

Although the consultation did little to assist the quantitative analysis of impacts, it did confirm the judgment that these were minor technical adjustments to business. HMRC outlined the results and confirmed the intention to regulate in a second JVCC paper (02)07 which was drawn to the attention of all those who had responded to the consultation.

4. Options

i) Do Nothing Option

This option maintains the current position which is incompatible with Articles 217-240 of the principal VAT Directive and would lead to the continuation of infraction proceedings against the UK by the Commission.

ii) Make the necessary changes to UK regulations

Making the necessary changes, whilst minimising the burdens on business, is the only viable option.

5. Costs & Benefits

Benefits

No specific benefits accrue to either option but full implementation of the Invoicing Directive should ensure clearer cross-border invoicing.

Costs

Option i)

The do nothing option would incur no immediate administrative costs for government and no costs for business. But the risk of future cost following infraction and an adverse judgment in the ECJ is high and this is not a viable option.

Option ii)

The costs to Government are the administrative costs of the consultation and regulatory change. They are approximately .2 of a staff year.

The key costs are for business and these are considered below for each change:

(a) Numbers on invoices must be sequential. In principle this impinges on every taxable person (1.8 million) issuing VAT invoices to another taxable person. In fact, the existing requirement to issue an invoice with an identifying number means it is difficult to see any change which might be required in business practice. On that assumption, the change appears to impose no new administrative burden and has no compliance cost for business. This judgement was exposed during the consultation and, despite some concerns about the details of implementation, most respondents agreed that the impacts would be small.

(b) Business must have a choice on how invoices indicate treatment under the margin scheme for second hand goods, works of art, antiques and collectors items. The key impact of the change is to remove a mandatory legend on invoices under the scheme and give business the choice of the way in which the treatment is indicated on the invoice. Accordingly, there is no new administrative burden. The schemes are used by approximately 30,000 businesses who will incur some compliance cost in coming to terms with the new regulation and making the change. Margin scheme supplies cross many business sectors. Around 99% of businesses operating the margin scheme are expected to be small businesses.

The costs incurred for businesses amending their invoicing template or in buying a new stamp creates a one off cost. For small businesses it is assumed that they will amend their invoices manually at no extra cost, or by purchasing a customised stamp. The average cost of a customised stamp is around £10. Around 29,000 businesses are affected by the changes almost all of these are small businesses, with an estimate one off compliance cost of just less than £300,000.

The cost to medium and large businesses is assumed to around £100 per business to arrange for a revised template to be printed or around £250 to make appropriate changes to current software. It is estimated that around 1% of scheme users, less than 300, are large or medium sized businesses affected by these changes. Assuming 50% of these businesses use a revised template the one-off compliance costs would be around £15,000. If the other 50% made software changes the one-off compliance costs would be £37,500 giving an average one-off compliance cost of £52,500 for template and software changes.

(c) Businesses invoicing other taxable persons for supplies which have been accounted for under the Tour Operators Margin Scheme (TOMS) must indicate this fact on the invoices issued.

This was not previously a feature of the regulatory framework and so is a new administrative burden for approximately 100 (see details below) businesses that use the TOMS for making supplies to VAT registered businesses. There will be a small compliance cost for those businesses coming to grips with this new requirement, but this will be mitigated by HMRC's commitment to giving business the maximum flexibility to decide how they indicate the TOMS treatment on an invoice.

Around 4000 businesses are required to use the TOMS to account for VAT. As this is a 'margin' scheme, tax invoices are not issued and recipients of the supplies are not able to reclaim input tax. The proposed changes mean that, from 1 October 2007, when a business makes TOMS supplies to another taxable person, an invoice will have to be issued which states that the TOMS has been applied. This confirms to a business customer that no input tax is recoverable. TOMS suppliers will have to:

- Have a system in place to identify business to business supplies, in order to trigger the issue of a tax invoice.
- Annotate those invoices to indicate that a TOMS supply has taken place using one of the three options.

The assumption in this impact assessment is that the majority already operate a computerised billing system under usual business practices so they can identify supplies within the TOMS and those outside the scheme. Compliance costs are more likely to relate to making one off changes

to trigger an invoice and insert text using one of the three options suggested. As such compliance costs are unlikely to be significant.

There is no specific data identifying affected businesses but our best estimate is that the changes will impact around 100 businesses, mainly large scale tour operators that will need to revise invoice templates and make software changes. On average it is estimated that the cost of making changes to invoicing templates is around £100 per business, and around £250 per business making software changes. The average cost per business is estimated at around £350, indicating a one off compliance cost of around £35,000.

(d) Businesses making supplies to taxable persons in other member states must indicate on their invoices the reason for exemption or the requirement of the customer to pay the VAT. HMRC believe that their intention to take a broad view of legends which meet the requirement will in some cases remove the need for change and in other cases mitigate the cost of change.

Intra-EC Supplies of Goods (Dispatches)

About 65,000 businesses are involved in Intra-EC supplies of goods. About 90% of these are small businesses. Although not currently required to indicate the tax treatment (zero-rate) on invoices it is expected that, in many cases, the information already included on such invoices will satisfy the new rules which give business a wide choice. HMRC exposed this view at consultation and it has not triggered any challenge or any evidence of significant cost.

Supplies of Exempt Services of the types specified in VAT Act 1994 Schedule 9

Specific consultation with the financial services sector has led to a clarification in the regulations confirming that cross-border exempt supplies by UK businesses will only require an invoice when the supply is to another business and the recipient member State imposes such an obligation. Other member States do not generally require invoices for such supplies and accordingly, the impact on this sector should be limited.

Supplies of services subject to the Reverse Charge

There was no indication from the consultation that the new rules would have a significant impact on invoicing costs in these circumstances.

Supplies of Gas and Electricity* are subject to the reverse charge – there was no indication from the consultation that the new rules would have a significant impact on invoicing costs in this sector.

Businesses from other member States installing goods in the UK

Non UK businesses involved in these procedures are outside the scope of this assessment. In any case they are already obliged to indicate the tax treatment on their invoices and the new rule simply removes a mandatory reference in place of a reference over which the business has greater choice. HMRC do not anticipate a major impact in this sector and none were brought to their attention during consultation.

*“Triangulation” supplies**

Businesses involved in such supplies are already obliged to indicate the tax treatment on their invoices and the new rule simply removes a mandatory reference in place of a reference over which the business has greater choice. HMRC do not anticipate a major impact in this sector and none were brought to their attention during consultation.

*(HMRC estimate that less than 2000 businesses are involved in these 2 sectors)

(e) Businesses making domestic reverse charge supplies must indicate the treatment on invoices. This is already a requirement for reverse charge supplies under the Gold scheme. For the estimated 70 businesses involved it will impose no new burden and will give maximum flexibility about how the treatment is indicated on an invoice. The invoicing admin burden imposed on businesses making supplies under S55A of the VAT Act 1994 – the “MTIC reverse charge” was included in the IA for that measure.

Summary Table of Costings

	One-off Compliance Costs £	Administrative Burden £
a) Sequential No.	Nil	Nil
b) Margin Scheme		
i) Stamp	300, 000	Nil
ii) Template or Software	52, 500	
c) TOMS	35,000	Nil
d) Zero/exempt	Nil	Nil
e) Gold scheme	Nil	Nil

6. Small Firms Impact Test

There is no indication arising from consultation that the change or its implementation will have any differential impact on small firms.

7. Competition Assessment

The proposed changes are not expected to impact directly on any particular market, or on any business that has more than 10% or 20% of the market share. The consultation described above identified no such impact.

8. Enforcement, sanctions and monitoring

Adherence to the new regulations will be checked as part of the risk based assurance programme by HMRC. There will be no need for any additional sanctions because there is already a penalty for breach of regulatory provisions in s.69 of the Value Added Tax Act 1994. That penalty will apply to the general failure rather than attach to each invoice issued. As is common in such cases, it is unlikely that, in the early stages of implementation, penalties will be assessed except in cases of abusive and repeated or fraudulent non-compliance.

9. Implementation and delivery plan

The UK is committed to making the regulatory changes on 01 October 2007. Nevertheless, a key rationale for the change is greater business choice in indicating the VAT treatment of cross border (and other) supplies and HMRC intends to give business maximum flexibility in meeting these requirements.

10. Post- implementation review

The impacts of the changes will be monitored as part of HMRC's management of administrative burdens on business. A Compliance Cost Review is expected to be carried out once the policy has bedded in (typically between 1 and 3 years after implementation). This will confirm whether the predicted changes in compliance costs were accurate and reasonable.

11. Summary and recommendation.

The EC infraction means that changes to implement the requirements of the principal VAT Directive are now necessary. Option ii) is recommended. The changes in the accompanying regulations do that with the minimum impact on business.

IMPACT ASSESSMENT

CHANGES TO VAT INVOICING

Statement of Ministerial Approval

I have read the impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister

Jane Kennedy

FINANCIAL SECRETARY TO THE TREASURY

18th July 2007