

**EXPLANATORY MEMORANDUM TO THE
VALUE ADDED TAX (AMENDMENT) (NO. 2) REGULATIONS 2007**

2007 No. 768

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.

2. Description

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

- increase the maximum turnover limit for entry to, and withdrawal from, the cash accounting scheme so that more businesses can benefit from the scheme;
- amend the rules relating to the calculation of VAT where a trader makes both taxable and exempt supplies (“the partial exemption method”);
- substitute a revised form for notifying the Commissioners of the supply of a new means of transport (motorised land vehicles, ships and aircraft) for removal to another member state of the European Community.

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

None

4. Legislative Background

Cash Accounting

4.1 Section 25 (1) of, and paragraph 2(7) of Schedule 11 to, the Value Added Tax Act 1994 (VATA 1994) provide that a taxable person can account for and pay VAT by reference to such periods, at such time and in such manner as determined by or under regulations. The cash accounting scheme allows small businesses to account for and pay VAT when consideration for a supply is received. The scheme is set out in Part VIII of the Principal Regulations.

4.2 The effect of this instrument is to amend the Principal Regulations to increase the maximum turnover limit for entry to the cash accounting scheme from £660,000 to £1,350,000. It also makes a corresponding increase to the limit above which a person’s authorisation to use the scheme ceases or is terminated from £825,000 to £1,600,000.

Partial Exemption

4.3 Section 26(1) of VATA 1994 provides that the amount of input tax which a taxable person is entitled to credit for at the end of any period shall be such amount as is allowable by or under regulations as being attributable to supplies within section 26(2).

4.4. Section 26(3) provides that the Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within section 26(2) and that such regulations may provide for provisional attribution and subsequent adjustment including payment and for the prevention of credit where input tax is incurred on self supplies.

4.5. Section 26(4) provides that regulations made under section 26(3) may make different provision for different circumstances and may contain such incidental and supplementary provisions as appear to the Commissioners necessary or expedient.

4.6. These Regulations make provision for two changes to the Principal Regulations.

4.7. The first is to introduce a requirement that a business must make a declaration to the effect that its proposed method will lead to a fair and reasonable recovery of input tax before the Commissioners approve its use under regulation 102. An incorrect declaration will result in the Commissioners being able to serve a Special Method Override Notice to override the method from its effective date.

4.8. The second is to provide for the option that a special method approved or directed under regulation 102 can deal with input tax which is recoverable as attributable to foreign and specified supplies.

4.9. Regulation 8 contains the main amendments. It makes provision as to the ambit, form and content of a partial exemption special method directed or approved under regulation 102 and makes it clear that supplies of a description falling within regulation 101(3) are excluded whether they are made inside or outside the United Kingdom.

4.10 It also provides with effect from 1st April 2007 for the Commissioners' approval of a partial exemption special method to be subject to a declaration made by the taxable person in a prescribed form that the method will fairly and reasonably represent the extent to which goods or services are used by or are to be used by him in making taxable supplies. Where it appears to the Commissioners that such a declaration is incorrect, they may serve a notice to that effect, the consequence of which is in essence that the taxable person must follow the procedure laid down in regulation 102B(1) in relation to periods commencing on or after the date when the approved method took effect although the Commissioners may assess in relation to amounts due for past prescribed accounting periods. This new power is in addition to the Commissioners' power to serve a notice under regulation 102A and any notice served under that regulation shall take priority in relation to the periods which it covers.

4.11. Regulations 6, 9 and 10 make further amendments to clarify the interaction between regulation 102 and regulations 99, 102A and 103 in view of the changes which have been made.

4.12. Regulation 7 amends the list of incidental supplies in regulation 101 and regulation 11 adds a heading to regulation 103A.

New means of Transport

4.13 Under the normal VAT rules, UK VAT is chargeable on supplies of new means of transport. Section 30(8) of VATA 1994 and the Principal Regulations provide an exception to the general rule and provide that where a new means of transport is supplied in the UK, but is to be removed to another member State of the European Community within 2 months, UK VAT is not chargeable. Instead VAT is chargeable in the country of destination. 'New means of transport' is defined in section 95 of VATA 1994.

4.14 In order to take advantage of this treatment, regulation 22(6) of the Principal Regulations provides that the buyer and seller must provide particulars of the supply and make a declaration in respect of it, on a prescribed form. The prescribed form is the form numbered 13 in Schedule 1 to the Principal Regulations. The information thus gathered is then passed on to the destination member State to ensure the proper collection of tax.

4.15 The instrument substitutes a revised form number 13 which gives effect to changes agreed with other member States as to the particulars required in respect of these supplies. The new particulars required are as follows:

- Date of issue of plates.
- Name of Vessel
- Number of km/hours of navigation/flight (if not 0)

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

Cash Accounting

7.1. The purpose of these Regulations is to increase the number of small businesses that are eligible to use the cash accounting scheme and that can take advantage of the benefits that the scheme offers.

7.2. Consultation and research have highlighted the importance of cash flow to small businesses. The measure helps with cashflow, because the scheme enables traders to pay their VAT once they have received payment rather than at the time they issue an invoice (the normal position under the VAT regime). In addition the scheme provides automatic bad debt relief for traders.

7.3. The regulations form part of the Government's wider strategy for administrative simplification, encouraging enterprise and productivity for the UK by removing administrative burdens and barriers to small business growth.

Partial exemption

7.4. Businesses can recover VAT on costs that are used in making taxable supplies (and certain overseas supplies) but cannot normally recover VAT on exempt supplies. Section 26(3) VATA 1994 requires HMRC to make regulations to secure a fair and reasonable recovery of VAT. To this end, a business may apply for a partial exemption special method which HMRC will approve if it judges it to be fair and reasonable. However, as there is currently no requirement on businesses to propose fair methods, HMRC has to thoroughly investigate all proposals which causes delays and adds unnecessary costs to the approvals process. In addition, some businesses faced additional administrative burdens as their special methods were limited to dealing with UK taxable supplies.

7.5. The measure comprises two changes that were the subject of a recent consultation with representatives from all affected businesses.

7.6. The first change (Method Declaration) will require a business to declare ‘to the best of its knowledge and belief’ that its proposed special method is fair and reasonable. HMRC could then set aside a method which the person signing the declaration knew or ought reasonably to have known was not fair and reasonable. The business would then be required to recalculate past returns to ensure that it only recovers a fair and reasonable amount of VAT. This will speed up the approvals process and reduce compliance costs for the vast majority of businesses that apply for a special method each year.

7.7. The second change (Combined Method) is a simplification designed to help businesses that make certain overseas supplies that confer the right of VAT recovery (for example, supplies of finance and insurance to customers outside the EU). The law currently requires this VAT to be calculated separately from a method, which many businesses find cumbersome. The Combined Method gives these businesses the legal right to a special method that caters for VAT recoverable on overseas supplies.

7.8. There was widespread support for the Combined Method and a number of suggested improvements have been made to the Method Declaration following consultation. A more detailed analysis can be found in the attached Regulatory Impact Assessment. The changes are politically important as they help to ensure equity within the VAT system and are legally important in ensuring that UK VAT legislation reflects the aims of the Principal VAT Directive.

New means of transport

7.9. The purpose of the scheme to allow special tax treatment for new means of transport is to ensure that the consumption of these goods is taxed in the member State of destination.

7.10 However, the scheme provides scope for tax avoidance and communications between member States have historically been patchy.

7.11 The standardisation of the form is intended to make the exchange of information easier.

8. Impact

8.1 Regulatory Impact Assessments (RIA) relating to the effects of the amendments to the cash accounting scheme (regulations 3 to 5) and the partial exemption rules (regulations 6 to 11) are attached to this memorandum and can also be found at www.hmrc.gov.uk . An RIA relating to the changes to form 13 has not been prepared as they have no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector of the amendments to the cash accounting scheme will be minimal as businesses are not required to inform HMRC that they are using the scheme. In addition the scheme is monitored via normal assurance visits and imposes little additional burden on compliance checks. However, the scheme does have a cash flow cost to the Treasury in the first year of implementation (see the RIA for more details). This is because the cash accounting scheme delays the time at which money is collected by the exchequer.

8.3 The impact on the public sector of the amendments made to the partial exemption rules and form 13 is nil.

9. Contact

9.1. John Brandwood at HM Revenue and Customs Tel: 0151 703 8661 or e-mail:john.brandwood@hmrc.gsi.gov.uk can answer any queries regarding the changes to the cash accounting scheme.

9.2. Patrick Wilson at HM Revenue and Customs Tel: 0207 147 0595 or e-mail:patrick.wilson@hmrc.gsi.gov.uk can answer any queries regarding the changes to the partial exemption rules.

9.3 Peter Bennet at HM Revenue and Customs Tel: 0207 147 0324 or e-mail peter.bennet@hmrc.gsi.gov.uk can answer any queries regarding the changes to form 13.

FULL REGULATORY IMPACT ASSESSMENT

CHANGES TO THE VAT PARTIAL EXEMPTION SPECIAL METHOD REGIME

1. PURPOSE AND INTENDED EFFECT

i) Objectives

To speed-up and streamline the special method approvals process, reducing costs and improving fairness for partly exempt businesses, and freeing up HMRC resource to offer more effective business support.

ii) Background

A business can recover VAT on costs that it ‘uses’ to make taxable (and certain overseas supplies), but cannot normally recover VAT relating to exempt supplies. This is known as the principle of use. Businesses that make both taxable and exempt supplies are partly exempt and must operate a partial exemption method to determine their recoverable VAT. Most partly exempt businesses operate the default standard method, which is straightforward but broad-brush. But, about 20,000 of the largest and most complex businesses find the standard method unsuitable and seek approval for their own bespoke calculation called a special method. Once approved a special method is binding on both sides.

iii) Rationale for changing the special method regime

HMRC will approve any special method which it judges to be fair and reasonable in satisfying the principle of use. However, this process is inefficient and often results in delays and costs for both businesses and HMRC. Problems can arise because legally a business can seek approval for an unsuitable method which if not detected by HMRC could result in an unfair VAT recovery. Whilst serious problems are rare the VAT involved can be substantial forcing HMRC to critically review and challenge each proposal, even perfectly good ones, causing unnecessary work for both sides. Progress has been made in recent years, including making additional HMRC resource available to deal with special method proposals, and strengthening guidance to help businesses formulate fair and reasonable methods in the first place. But, despite this, delays continue and a typical special method approval still takes six months or longer.

Another problem arises for businesses making certain overseas supplies on which VAT is recoverable. In response to avoidance some years back, legislation requires this VAT to be calculated separately from the partial exemption method, which can prove difficult for some businesses resulting in additional costs and complexity. To help, and where it does not pose a tax risk, HMRC allows a ‘combined method’ by administrative agreement, but this can create legal difficulties when the method needs to be replaced.

2. CONSULTATION

As part of Budget 2006 an informal consultation was announced on two possible changes to the special method regime from 1 April 2007. The aim of the consultation was to help HMRC refine draft guidance and regulations, and to examine how best to implement the changes. HMRC also encouraged a debate on the effectiveness of the special method regime and other options for

improving it. In all, there were over 150 respondents including advisers, business people and business representatives from across the special method community.

Whilst most respondents strongly supported the UK's special method regime, they agreed that gaining approval is a serious problem, which often creates unnecessary delays and costs for businesses. Most respondents accepted that the approvals process would be made more efficient and equitable if businesses shared the same objective with HMRC that special methods had to be fair and reasonable.

3. OPTIONS

Option 1: Method Declaration and Combined Method (recommended option)

This comprises the two changes proposed in the consultation:

- **Method Declaration**

This is a new requirement for businesses to make a declaration to the effect that to the best of their knowledge and belief their proposed partial exemption special method is fair and reasonable. If HMRC subsequently discovers that the method gives an unfair over-recovery of VAT and the signatory of the declaration knew or ought reasonably to have known this at the time the declaration was made, HMRC could require the business to recover a fair and reasonable amount of VAT. This change will speed-up the approvals process for businesses saving them both time and effort. The requirement also reduces the risk of unfair methods, improving equity for those businesses which currently propose fair and reasonable methods. Furthermore, this will release HMRC resource to better tackle unfair methods and help businesses propose fair methods.

- **Combined Method:**

This is a simplification that gives businesses the legal right to apply for, and HMRC to approve or direct, a special method that caters for VAT on overseas supplies that confer the right of VAT recovery (for example, supplies of finance and insurance to customers outside the EU). This change increases certainty and reduces compliance costs. However, this change could not be made safely without the protection of the Method Declaration.

Option 2: Replace special methods with recovery based on 'use'

This option saves the need for special method approvals by simply requiring businesses to determine their recoverable VAT based on the principle of use. However, it would reduce certainty because businesses and HMRC could routinely go back and re-calculate recovered VAT. It also increases administrative burdens because a business would not have an agreed methodology for recovering VAT. This option was deeply unpopular among businesses.

Option 3: Automatic approval of special methods

This option would impose a statutory time limit (e.g. 6 months) after which a method would automatically be approved unless HMRC had rejected it. A rejection could be appealed. This option would not require proposed methods to be fair and reasonable, so HMRC would still have

to closely examine all proposals. There is also a risk that HMRC would be pressured into approving unsuitable methods or rejecting perfectly acceptable methods thereby generating more litigation and slowing down the approvals process. This option does nothing to lessen the risk of HMRC approving an unfair method.

Option 4: Do nothing

Retain the current system, but allocate additional HMRC specialist resource to deal with approvals. Once again, HMRC would have to make detailed enquires to ensure methods were fair and would neither reduce administrative burdens nor improve equity.

4. COSTS AND BENEFITS

i) Sectors and groups affected

Around 20,000 businesses use special methods. The largest 50 of these are predominantly large banks and insurance companies. The remaining special method users cover the full range of partly exempt businesses including finance, insurance, property, retailing, charities and education.

The Combined Method is most likely to benefit finance and insurance businesses and those businesses that routinely make supplies outside the UK. It is thought that half of all special method users will benefit.

ii) Analysis of costs and benefits

Option 1: Method Declaration and Combined Method

Benefits

This option offers benefits to both businesses and HMRC:

Benefits for businesses:

- Speeds-up the approvals process by requiring businesses to propose fair and reasonable methods enabling HMRC to adopt a risk-based approach.
- Reduces the costs for most businesses of applying for a special method.
- Frees-up HMRC resources to help businesses prepare fair methods.
- Improves fairness and equity.
- Clarifies and simplifies the legislation.

Benefits for HMRC:

- Enables a more efficient use of specialist resources.
- Contributes to HMRC’s target of reducing administrative burdens.
- Reduces losses through special methods as shown in the following table:

(£m)	2007-08	2008-09	2009-10
Revenue yield	+20	+20	+25

Costs

Of the 20,000 special method users around 1,000 of the largest operate the most complex methods with the rest operating relatively simple methods.

The 19,000 or so businesses with relatively simple methods fall within the small, medium and large categories. Special methods for these businesses typically last 10 years or more before the business changes such that a new method is needed. These businesses will benefit from the declaration because once they have proposed a fair and reasonable method, HMRC will give faster approval. Submitting the declaration will not require additional correspondence and would normally accompany a proposed method. We estimate the total saving for these businesses to be around £250,000 per year.

The remaining 1,000 businesses are generally large and operate more complex special methods. These businesses evolve quickly and typically need to update their methods on average every 3 years. The top 50 businesses, banks and insurance companies, continually update their methods, often by adding new sectors to a substantial and historically approved base method. These businesses have less to gain from the declaration for, whilst they too will benefit from faster approval, they will incur additional costs in having to review their entire method to ensure it is fair and reasonable. These additional costs are likely to vary significantly among different businesses. For some, the additional costs will be low because they are proposing an entirely new method or they have recently reviewed their method. However, the costs will be higher for those that have not reviewed their method for a long time. With this in mind, it is difficult to arrive at an average increase in costs for the largest 1,000 businesses, but we estimate additional costs will total to less than £250,000 per year. Over time, this should fall because once a business has checked its entire method for the first declaration, the focus for subsequent declarations will be on changing circumstances since the previous declaration.

The Combined Method will reduce administrative burdens for businesses. However this has not been taken into account as a new cost saving because HMRC already allows combined methods in many cases.

Overall this option provides a small net saving in administrative burdens. Rising from over £15,000 in the first year to almost £80,000 in the second and third years. This increases to around £135,000 in subsequent years, by which time the largest 1,000 businesses would typically have updated their methods and so reviewed them to ensure they are fair.

The savings are prepared on the same approach as used by the KPMG Report on Administrative Burdens on Businesses. The Method Declaration and Combined Method contribute to reducing the administrative burden from special methods. In the longer-term, further savings will result because as businesses work with HMRC to ensure fair and reasonable methods, they will become more robust lessening the need for regular updating. These longer-term savings have not been reported here.

Option 2: Replace special methods with recovery based on 'use'

Requiring businesses to determine recoverable VAT in accordance with the principle of use would reduce certainty and increase administrative burdens as businesses would no longer have an agreed methodology for recovering VAT.

Option 3: Automatic approval of special methods

This option would generate more litigation, slow down the approvals process and therefore increase costs for businesses and HMRC.

Option 4: Do nothing

This option would not deliver any benefits, costs would not be reduced and the risk remains that some businesses secure an unfair recovery of VAT.

5. SMALL FIRMS IMPACT TEST

Smaller firms affected by the measure are unlikely to have complex special methods and so are expected to benefit from speedier approval of their method and lower costs.

6. COMPETITION ASSESSMENT

The competition filter test has been applied and the proposed changes passed. The changes will increase consistency in fairness of input tax recovery and are not expected to have a significant impact on any group within particular markets.

7. ENFORCEMENT, SANCTIONS AND MONITORING

HMRC expect that action taken under the Method Declaration will be rare on the basis that the businesses will propose fair methods. If action is needed, the business would be required to repay VAT that it has unfairly over-recovered and in addition may be subject to interest and misdeclaration penalties. Any action will be supervised by Policy Team in accordance with robust procedures which ensure that action can never be taken without thorough review and reconsideration. HMRC will monitor the effectiveness of this.

8. IMPLEMENTATION AND DELIVERY PLAN

The changes will be implemented on 1 April 2007. To help businesses, revised guidance and legislation were circulated following the consultation and will be published on the HMRC website.

9. POST IMPLEMENTATION REVIEW

HMRC has a programme in place to ensure that the compliance cost assessments made for all Regulatory Impact Assessments are reviewed within two years from when a policy is first implemented.

10 SUMMARY AND RECOMMENDATION

Special methods are an important part of the UK's partial exemption system, offering a good balance between certainty and flexibility whilst keeping administrative and audit costs low. However, the current rules do not require businesses to propose fair methods with the result that HMRC is forced to thoroughly challenge proposals before granting approval causing delay and wasted costs. The Method Declaration will discourage unfair proposals and speed up the approvals process reducing administrative costs for most partly exempt businesses. It will

facilitate better use of specialist resources that would help businesses resolve complex partial exemption issues and improve fairness and equity by helping to ensure all businesses recover a fair amount of VAT. It also realises a longer-term benefit of more flexible and robust methods, which will require updating less frequently. The Combined Method simplifies the legislation and is widely supported by businesses. Option 1, the Method Declaration and Combined Method, is therefore recommended.

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REGULATORY IMPACT ASSESSMENT

CHANGES TO THE VAT PARTIAL EXEMPTION SPECIAL METHOD REGIME

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:

Dawn Primarolo

PAYMASTER GENERAL

2nd February 2007

1. Regulatory Impact Assessment: VAT: Changes to the Cash Accounting scheme (CAS)

2. Purpose and intended effect

a) The policy objective

The purpose of this measure is to increase the number of small businesses that are eligible to use the CAS and obtain the benefits that the scheme offers. It forms part of the government's wider strategy for administrative simplification, encouraging enterprise and productivity by removing barriers to small business growth.

The measure will take effect from 1 April 2007.

b) Background

The CAS is a voluntary simplification scheme administered by HM Revenue and Customs (HMRC) and is available to over 750,000 small businesses. There is no application required, so usage is estimated on the basis of a sample survey. That indicates that around 260,000 businesses currently use the scheme.

Under normal VAT rules, businesses are usually required to account for VAT when invoices are issued. This often means that payment of VAT is due to HMRC before the business has received payment of the VAT from their customer. The scheme allows businesses to account for and pay VAT to HMRC only when they receive payment from their customers. A condition of this treatment is that users of the scheme can only recover input tax when they pay their suppliers.

For most businesses the scheme offers a cash flow benefit which is especially useful to businesses whose customers pay late. It also means that there is automatic relief from VAT on bad debts without the need to apply for Bad Debt Relief.

The scheme requires derogation from the Principal VAT Directive 2006/112/EC and is currently open only to businesses with a turnover not exceeding £660,000. The derogation has recently been renewed and extended to December 2009, permitting an upper ceiling for entrance to the scheme of £1.35 million.

3. Consultation

- Within government

Specialist small business units in Treasury and in HMRC have advised on the taxpayer perspective. Those units have regular contact on small business issues with small businesses and with the Department for Trade and Industry.

- Public consultation

This measure is a positive response to small business concerns about tax burdens as expressed in responses to the Budget 2005 consultation *Working Towards a New*

Relationship. Research into the impact of tax on small business cash flow commissioned by HMRC has also indicated that the scheme is acknowledged to be straightforward and helpful to its target audience.

The consultation and research have both emphasised the importance of cash flow to small businesses. Increasing the availability of the scheme is a positive response to these findings.

4. Options

- **Option 1:** Do Nothing. Leave the turnover limit for entry to the scheme unchanged.
- **Option 2:** Increase the turnover limit for entry to the scheme from £660,000 to £1.35 million
- **Option 3:** Make a larger increase to the turnover limit for the scheme.

5. Costs and benefits

- Sectors and groups affected

This measure involves changes to the turnover limit for entry to the scheme and creates no fresh impact on different sectors or groups. There are no gender, regional, DPA or human rights issues arising from the measure.

- Benefits

Option 1: Do nothing. There would be no increase in the number of businesses eligible for the scheme and its associated benefits. This option would provide no response to business concerns about cash flow or compliance costs.

Option 2: Increase the turnover limit for entry to the scheme to £1.35 million. This is the preferred option. It will increase the number of businesses eligible to use the scheme by around 56,500. The increase will bring the total tax deferred because of later payment of VAT under the scheme to £585 million.

On the assumption that this reduces business borrowing or allows cash to remain on deposit, this works out at an average annual interest benefit per user of £150. In addition, businesses using the scheme receive, on average, an ongoing annual administrative benefit of £10.00 due to receiving automatic VAT Bad Debt Relief.

Option 3: Make larger increases to the turnover limit. Larger increases to the turnover limit for the scheme are no longer an option because of the terms of the derogation. Larger increases were rejected at an early stage because:

- They would not proportionately increase the eligible population.

- They would shift the distribution of the benefit to larger businesses and away from the smaller businesses who are disproportionately affected by cash flow difficulties.
 - The move to £1.35 million aligns the scheme with the annual accounting scheme.
 - Restricting the increase helps minimise the cost of any unforeseen avoidance or abuse of the scheme.
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- Costs

Option 1: Do nothing. There would be no increase in the number of businesses eligible for the scheme and this option would not create any extra costs.

Option 2: Increase the turnover limit for entry to the scheme to £1.35 million. This is the preferred option. It will impose no new compliance cost on existing users.

The scheme does impose a transitional administration cost on businesses joining the scheme estimated at £6.30 in the year of change. There is also an ongoing annual administrative burden of £3.40 arising from the need to cross refer cash records to invoicing records. But that would normally be done by most businesses as part of credit control and this cost is further mitigated by the interest and bad debt benefits described above.

Option 2 does carry a cost for Government. The scheme does not affect the total VAT payable but does delay the time of receipt. The increase has an impact of £120 million on Government cash flow for the first year of the change. There is also a staff cost of 0.2 years in making the changes to regulations, IT, guidance etc.

Option 3: Make larger increases to the turnover limit. The impact on businesses would be broadly similar for any increase. But the higher the limit, the greater the cash flow cost to Government. This has not been quantified for any alternative limit because the derogation restricts the change to £1.35 million.

6. Small Firms Impact Test

This measure is an extension of an existing optional scheme that has a limited, but positive, impact on those small firms who use it. The extension of the scheme is consistent with the Budget 2005 consultation *Working Towards a New Relationship*, so further consultation as part of the small firms impact test has not been undertaken. The scheme is available to any business but for those who already receive cash payments, such as retailers, it has no benefit. Businesses who normally receive repayments of VAT will also find it of little use.

7. Competition assessment

HMRC has carried out the competition filter. The scheme is available to businesses across all sectors and the change will not have any detrimental effect on competition.

8. Enforcement, sanctions and monitoring

HMRC will assure correct use of the scheme through its risk and assurance programmes. Non compliance with the rules of the scheme will be managed under the VAT Act 1994. Any evidence of non-compliance will form part of review to be conducted in 2 years time.

9. Implementation and delivery plan

The measure will be introduced by an amendment to the VAT Regulations 1995, coming into effect on 1 April 2007, and subject to completion of the parliamentary processes. Guidance on the changes to the scheme will be published in a new version of Notice 731 *VAT: Cash Accounting Scheme*. Amendments to HMRC's website content, forms and computer changes required for the measure, are targeted for 1 April 2007.

The extent to which the scheme is used depends on awareness of the scheme and its benefits. In the months after Budget 2007, HMRC will raise awareness of the scheme by improvements in their printed publicity and website and by direct mailing to eligible businesses.

In due course HMRC will also undertake a review of the figures in this RIA.

10. Post-implementation review

HMRC will deliver a post implementation review of this measure in two years time. This will include the following -

- We will survey the business population and analyse the results to give us best estimates of changes to the scheme membership.
- Perceptions and attitudes to the changes will be evaluated by surveying the business population. Sampling of the VAT business population is done regularly and will be repeated as part of the post implementation review of this change. Combined with information on usage, this will provide evidence as to the qualitative value of the changes to businesses and the quantitative role they play in helping businesses to manage cash flow and compliance costs.

11. Summary and recommendation

Option 2 is recommended as a well-targeted and proportionate measure for making the scheme more attractive to UK small businesses.

The change will increase the number of businesses that are eligible to join the scheme by around 56,500 and enable more existing members to continue using the scheme. This change makes the cash flow benefits of the scheme available to more small businesses.

John Healey

FINANCIAL SECRETARY TO THE TREASURY

6th February 2007