

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (AMENDMENT) (No. 5) REGULATIONS 2009
2009 No. 3241

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. **Purpose of the instrument**

2.1 This instrument amends Value Added Tax Regulations 1995 (S.I. 1995/2518) ("the Principal Regulations") as follows.

Regulation 3

2.2 Regulation 3 amends Part 3 (VAT invoices and other invoicing requirements). It inserts a new 15A to specify the invoicing requirements in circumstances where a supplementary charge arises under Schedule 3 to the Finance Act 2009 (c. 10).

Regulations 4 to 8

2.3 Regulations 4 to 8 amend Part 4 (EC sales statements) and Schedule 1. Part 4 currently requires UK taxpayers who effect cross-border movements of goods to provide information about those movements periodically on a form called a European Sales List ("ESL"). It also requires UK taxpayers to provide information regarding cross-border supplies of new means of transport in certain circumstances. The regulations, as amended, will impose the same obligation in relation to cross-border supplies of services where the recipient is liable to account for VAT on the supply ('a reverse charge') and introduce new provisions relating to the periods for which ESLs must be rendered. Regulation 8 introduces a revised format for the ESL.

Regulation 9

2.4 Regulation 9 amends Part 7A (flat-rate scheme for small businesses) by substituting a new table with revised percentages to reflect the reversion of the VAT rate to 17.5% on 1 January 2010. The revised rates also incorporate other adjustments required to reflect the net tax payable by businesses in each sector which do not use the scheme.

Regulation 10

2.5 Regulation 10 amends Part 11 (time of supply and time of acquisition) to provide new rules for determining the time at which certain cross-border supplies of services are to be treated as taking place for the purposes of VAT. The regulation applies to cross-border supplies of services that, under the Value Added Tax Act 1994 (c. 23) ("the Act"), are treated as taking place in the United Kingdom ("UK") and are subject to a reverse charge.

Regulations 11 to 18

2.6 Regulations 11 to 18 amend Parts 20 (repayments to Community traders) and 21 (repayments to third country traders). Part 20 prescribes the circumstances and procedure by which a business established in an EU member State other than the UK may apply to HMRC for repayment of certain VAT incurred in the UK and Part 21 does the same in relation a business established in a third country.

2.7 All EU member States are required to make similar VAT refund arrangements. These amendments result from the replacement of the refund scheme required by Council Directive 79/1072/EEC¹ (“the Eighth Directive”) with effect from 1st January 2010 by Council Directive 2008/9/EC² (“the Refund Directive”).

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

3.1 Regulations 4 to 8 are made by the first exercise of the power in paragraph 2(3), as applied by paragraph 2(3ZA) of Schedule 11 to the Act, since paragraph 2(3) was amended, and paragraph 2(3ZA) introduced, by section 78 of the Finance Act 2009.

3.2 Regulations 11 to 18 are made by the first exercise of the power in section 39 of the Act since it was amended by section 77 of the Finance Act 2009.

4. Legislative Context

Regulations 4 to 8 and 10

4.1. Council Directive 2006/112/EC³ (“the Principal VAT Directive”), which provides the framework for a common system of VAT, has been amended, with effect from 1 January 2010, by Council Directives 2008/8/EC⁴ (“the First Amending Directive”) and 2008/117/EC⁵ (“the Second Amending Directive”). The amendments introduce a number of changes affecting the VAT treatment of cross-border supplies of services (“the VAT package”) which will be introduced in stages, the first of which comes into effect on 1 January 2010. Some elements of the VAT package are implemented by section 76 of and Schedule 36 to the Finance Act 2009. These regulations make some other required changes.

Regulations 4 to 8

4.2 Articles 262 to 271 of the Principal VAT Directive impose an obligation on VAT registered persons in all member States (‘EU taxpayers’) to provide specified information, by way of a periodic statement (“recapitulative statement”) about cross-border movements of goods. These articles are given effect in UK legislation by Part 4 of the Principal Regulations (EC sales statements).

4.3 Articles 2(9) and (10) of the First Amending Directive and article 1 of the Second Amending Directive amend articles 262 to 265 of the Principal VAT Directive. The

¹ OJ No L 331, 27.12.79, p 11.

² OJ No L 44, 20.02.08, p 23.

³ OJ No L347, 11.12.06, p 1.

⁴ OJ No L44, 20.02.08, p 11.

⁵ OJ N0 L14, 20.01.09, p 7.

amendments impose an additional obligation on EU taxpayers to submit recapitulative statements in respect of cross-border supplies of services where those services are subject to a reverse charge. They also amend the periods for which recapitulative statements are required for goods.

4.4 The new regulation 22C preserves the existing obligation in regulation 22(6) for taxpayers to provide information about cross-border supplies of new means of transport to unregistered persons in other member States. This obligation is unaffected by the amendments to the Principal VAT Directive.

4.5 Regulations 4 to 8 take account of the change in terminology required by the Lisbon Treaty by using 'EU' rather than 'EC'. The amended form which is substituted by regulation 8 retains the heading 'Value Added Tax EC Sales List'. At the stage when appropriate amendments were made to the draft instrument, the implementation of the revised form, which must be available to taxpayers on 1 January 2010, was too advanced to permit any changes to its format or text.

Regulation 10

4.6 The amendments to regulation 82 of the Principal Regulations implement the amendments to articles 64(2) and 66 of the Principal VAT Directive which are introduced by articles 1(1) and (2) of the Second Amending Directive. Articles 63 to 66 of the Principal VAT Directive provide rules for determining the time of supply of goods and services and the amendments to articles 64(2) and 66 make particular provision for the time of supply of cross-border supplies of services which are subject to a reverse charge.

4.7 Section 8(1) of the Act (as amended by Schedule 36 to the Finance Act 2009) defines the circumstances in which a reverse charge is to be applied to cross-border supplies of services in the UK. Regulation 82 of the Principal Regulations determines the time of supply for such services.

4.8 Please see the transposition note annexed to this memorandum for details of the implementation of the amendments to the Principal VAT Directive.

Regulations 11 to 18

4.9 Member States are required to charge VAT in accordance with the requirements of European law so that, in broad terms, supplies of goods and services are treated similarly for VAT purposes throughout the European Union ("EU"). Most of the detailed requirements of European VAT law are contained in the Principal VAT Directive. In the UK, the requirement for businesses to charge VAT on supplies of goods and services made by them and to be registered for VAT purposes in order to account for the VAT charged is provided for by sections 1, 3, 4 and 5 of the Act.

4.10 When accounting for VAT charged on its supplies of goods and services, a business may deduct from the VAT it pays an amount equal to the VAT it has already paid on goods and services supplied to it if those goods and services are used for the purposes of making its taxable supplies. It may only deduct VAT that it has paid in the member State where it is registered for VAT. In order to facilitate trade between member States, the Eighth Directive required member States, upon receipt of an application from a business established in another member State, to repay VAT incurred by that business

in the member State from which repayment was sought. Part 20 of the Principal Regulations provides for the refunds of UK VAT that must be made to businesses established in other member States. The authority for this is in section 39 of the Act.

4.11. Regulations 11 to 18 implement the changes to the repayment scheme required by the Refund Directive. Section 39 of the Act was amended by section 77 of the Finance Act 2009 for the purpose of making these regulations.

4.12 Regulation 173 is amended to include definitions of ‘claimant’s member State’, ‘repayment period’ and ‘repayment year’, and to modify the definition of ‘established’. It also includes references to the Principal VAT Directive and the Refund Directive. New regulations 173A to 173X are then inserted which:

- describe the VAT that may be repaid under the scheme;
- describe the persons to whom this part applies;
- prescribe the method of making a claim, including the periods that can be covered, and the minimum monetary limits allowed;
- set out the new requirement to submit claims electronically and to submit scanned copies of invoices where certain monetary limits are exceeded;
- set out the contents of a refund application;
- set out the new requirement to describe the nature of goods and services acquired by means of harmonised numerical codes;
- set out the new time limits for the submission of claims;
- set out new time limits for HMRC to notify its decision, including time limits for requesting additional information;
- set out new time limits for HMRC to make payment, including the requirement to pay interest where these are not met.

4.13 Regulations 174 to 179 and 183 of the Principal Regulations are omitted. Consequential amendments are made to regulations 181 and 194. Regulations 182 and 195 are also omitted in consequence of the insertion of section 83(1)(ha) of the Act by section 77 of the Finance Act 2009 which provides a right of appeal in respect of a decision by the Commissioners to refuse to make a repayment under section 39 of the Act.

4.14 Please see the transposition note annexed to this memorandum for details of the implementation of the amendments to the Eighth Directive.

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

7. Policy background

- *What is being done and why*

Regulation 3

7.1 In his 2008 Pre-Budget Report the Chancellor announced a temporary reduction in the standard rate of VAT from 17.5 per cent to 15 per cent between 1 December 2008 and 31 December 2009.

7.2 In two written statements of 25 November 2008 and 31 March 2009 the Financial Secretary to the Treasury set out the scope of anti-forestalling legislation that the Government intended to introduce to prevent artificial avoidance seeking to exploit the change in VAT rate.

7.3 The legislation was enacted as part of the Finance Act 2009. It counters forestalling by introducing a “supplementary charge to VAT” where a VAT invoice is issued or a prepayment received before 1 January 2010 but the provision of goods or services is to take place on or after that date. VAT of 15 per cent is due on the date of issue of the invoice or receipt of payment but, in certain circumstances, a supplementary charge of 2.5% becomes due on the date that the rate reverts to 17.5 per cent. This instrument sets out the invoicing requirements to be followed when the supplementary charge is triggered.

Regulations 4 to 8 and 10

7.4 These regulations amend the Principal Regulations to implement certain elements of the VAT package. The objective of these elements is to introduce a more robust VAT information exchange system for cross-border trade, to improve taxpayer compliance and help combat VAT fraud.

Regulations 4 to 8

7.5 The Principal VAT Directive, as amended, reduces the time limit applicable for the submission of recapitulative statements. It also requires statements to be made in respect of cross-border services which are subject to a reverse charge and, as a general rule, requires statements to be submitted on a monthly basis. It does however allow member States the discretion, subject to certain criteria, to permit taxpayers to submit statements in respect of longer periods.

7.6 The UK has decided to exercise its discretion to permit statements for longer periods in all permitted circumstances.

7.7 The rules for submission of ESLs with effect from 1 January 2010 can be summarised as follows.

An ESL for goods

7.8 This must be made monthly subject to the following exceptions:-

- it may be made quarterly if the value of the goods concerned does not exceed the relevant threshold for that and for each of the four preceding quarters (the relevant threshold is £70,000 until 31 December 2011 and thereafter £35,000);
- it may be made annually so long as the cross-border supplies do not include new means of transport, the taxpayer's annual turnover is below £92,500 and the annual value of the cross-border supplies of goods does not exceed £11,000;
- it may be made for the same period as the taxpayer's VAT return so long as the supplies do not include new means of transport, the return period is longer than a quarter, the taxpayer's annual turnover does not exceed £145,000 and the annual value of the cross-border supplies of goods does not exceed £11,000.

An ESL for services

7.9 This may be made monthly or quarterly and may also be made for same period as the taxpayer's return but the latter option is subject to the same criteria as those set out in the third bullet point above.

Declarations for New Means of Transport

7.10 Regulation 22C preserves the existing obligation on taxpayers to provide information about cross-border supplies of new means of transport to unregistered persons in other member States. It clarifies the fact that this obligation is limited to supplies to unregistered customers. The obligation itself is unaffected by amendments to the Principal VAT Directive.

Regulation 10

7.11 Regulation 10 amends the rules for determining the time of supply of cross-border supplies of services which are subject to a reverse charge. The time of supply determines, amongst other things, when the supply is to be accounted for.

7.12 At present, member States are permitted a wide degree of flexibility when it comes to setting the time of supply rules in these circumstances. However the VAT package introduces, amongst other measures, changes to the place of supply rules for business to business cross-border supplies of services so that, for most types of services, the supply is treated as being made where the customer is established and is subject to a reverse charge which is payable by that customer.

7.13 In order to ensure that the reverse charge is properly accounted for by the recipient, the suppliers of such services throughout the EU will be required, from 1 January 2010, to provide information relating to their supplies and the identity of their business customers. The information will be provided on an ESL which is already required for cross-border supplies of goods.

7.14 The mandatory time of supply rules are a necessary corollary to these changes and will apply from 1 January 2010 to ensure that accounting for and reporting of these supplies is harmonised between member States. The information regarding a cross-border supply which is provided by the supplier (on an ESL) and the customer (on a VAT return) will be subject to the same time of supply.

7.15 The new rules introduced by regulation 10 will apply to all types of cross-border supplies of services which are subject to a reverse charge pursuant to section 8(1) of the Act.

Regulation 9

7.16 This substitutes a new table into regulation 55K containing percentage figures revised to take account of the reversion of the standard rate of VAT to 17.5%.

7.17 The rates are set by reference to the net tax payable by businesses in each sector which do not use the scheme. The changes now introduced to align with the 17.5% standard rate also incorporate changes necessary to ensure that the rates continue to reflect this as accurately as possible.

Regulations 11 to 18

7.18 Businesses registered for VAT can recover VAT incurred on business expenses in their own member State through their VAT return. They cannot, however, use this route to recover VAT incurred in another member State. Typically, this would be VAT incurred when attending conferences, trade fairs etc or – in the case of international road hauliers – on road fuel. A separate mechanism exists for recovering this VAT, currently covered by the Eighth Directive as implemented in each member State's domestic legislation.

7.19 The current procedure requires the applicant to complete a paper claim form and send it - accompanied by all supporting invoices and a certificate confirming their VAT registration status – to the tax authority of the member State where the VAT was incurred. The procedure is cumbersome and time consuming, and the applicant generally has no way of checking on the progress of a claim. Although the Eighth Directive does lay down a 6-month time limit for tax authorities to issue decisions on claims, this is frequently exceeded, with claims to some member States being paid late or not at all.

7.20 In 2008, EU ministers addressed these issues by approving the Refund Directive, due to come into force on 1 January 2010. This introduced the following significant changes to the procedure.

- Claims will now be submitted electronically through a 'portal' hosted by the applicant's own member State (the member State of establishment ("MSE")). The portal will perform various automatic validation checks, eliminating the need for a certificate of status, and most of the data input process will be by way of standard codes and 'drop-down' options, reducing language problems to a minimum. It will no longer be necessary to send all original invoices, only scanned electronic copies of those exceeding certain values. Following successful validation, the claim will be forwarded automatically to the member State in which the VAT was incurred (the

member State of refund (“MSR”)), and the applicant will be notified that this has been done.

- Applicants will now have a longer period in which to submit their claims – 9 months from the end of the year in which the VAT was incurred, rather than 6 months as at present.
- The MSR must notify the applicant by electronic means of the date on which it receives the claim.
- The MSR now has 4 months (instead of 6) from the date of receipt of the claim in which to issue a decision. If it considers that it requires further information in order to do so, it must request this within the 4 month period. The deadline for issue of a decision can then be extended, but only to a maximum of 8 months from the date of receipt of the claim.
- Payment must be made to the applicant within ten business days of the deadlines set out above, otherwise the MSR must pay interest to the applicant at the same rate that would be due to domestic taxpayers.

7.21 The Refund Directive requires member States to set up the electronic portals and messaging systems to handle electronic claims and to make the necessary changes to domestic legislation.

Consolidation

7.22 There are no projects presently on hand to consolidate the Principal Regulations.

8. Consultation outcome

Regulations 3 and 9

8.1 The changes effected by these regulations are administrative in nature and are likely to have no impact on the vast majority of businesses. As such, they have not been subject to consultation.

Regulations 4 to 8 and 10

8.2 HMRC published a Consultation Document covering all of the cross-border VAT changes. Following concerns raised in relation to additional burdens on business, it also engaged with UK businesses on the implementation of these changes at an early date by organising special meetings and seminars, establishing a joint Business/Government Working Group, attending trade sector meetings, inviting comments and dialogue through a special HMRC Website e-mail address and regularly discussing the planned arrangements at standing liaison body meetings such as the HMRC Joint VAT Consultative Committee and the HM Treasury VAT Forum. This has been a constructive process and has enabled HMRC to work with UK businesses to identify possible implementation problems and to try and find solutions which are consistent with legislation but minimise additional burdens on business.

Regulations 11 to 18

8.3 No formal consultation exercise was carried out. Informal consultation with industry representatives took place during 2008. Initial guidance, a final proposal stage impact assessment, and the draft regulations were published on the HMRC website on 1 May 2009, and comments were invited by 26 June. Only two responses were received. One queried a statement in the impact assessment about a possible reduction in agents' charges arising from the new system, and this has been amended in the final impact assessment. The other made various suggestions about the drafting of the regulations and, where appropriate, these have been taken into account in the latest draft.

9. Guidance

Regulation 3

9.1 HMRC has issued guidance on the operation of the anti-forestalling legislation including the issuing of invoices specified in this instrument. It is available at www.hmrc.gov.uk/vat/forms-rates/rates/anti-forestall-guidance.pdf.

Regulations 4 to 8

9.2 In May 2010, in order to assist UK businesses to meet their new obligations, HMRC provided detailed information about these changes on a special section of its Website ("Cross-Border VAT Changes 2010"). It has also set up a special 'VAT Package' e-mail address for enquiries, which is actively monitored to ensure that replies are provided promptly. In addition, HMRC has:

- incorporated advice into the VAT Notes issued to all VAT Registered businesses with their VAT Returns;
- printed 'Alert messages' onto all blank ESLs issued since September;
- sent advisory mail-shots to 20,000 targeted UK businesses who exceeded the new threshold for monthly reporting, in either of the first two quarters of 2009;
- arranged for letters to be sent to individual UK businesses in early December 2009, advising that they exceeded the quarterly threshold during one of the first three quarters of 2009 and confirming that they will be required to submit monthly declarations from 1 January 2010.

Regulation 9

9.3 The updated flat rate percentages can be found at <http://www.hmrc.gov.uk/vat/start/schemes/flat-rate.htm>. Notice 733 VAT *Flat rate scheme* and the online ready reckoner tool at <http://vatreadyreckoner.hmrc.gov.uk> will be updated in due course to reflect the new rates.

Regulation 10

9.4 The time of supply changes are covered as part of the evolving VAT package guidance available on the HMRC website. Permanent guidance will be published in due course.

Regulations 11 to 18

9.5 Interim guidance on the new scheme was published on the HMRC website on 1 May 2009. Extensive amendments are being made to HMRC's internal guidance, the public notice and relevant website content to set out the details of the new scheme.

10. Impact

Regulation 3

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 No Impact Assessment has been prepared for the changes effected by regulation 3.

Regulations 4 to 8 and 10

10.4 An Impact Assessment of the effect that the changes made by regulations 4 to 8 and 10 will have on the costs of business and the voluntary sector is attached to this memorandum and is available alongside this instrument on the OPSI website.

<http://www.opsi.gov.uk/>

Regulation 9

10.5 The impact on charities or voluntary bodies is negligible.

10.6 The impact on the public sector is negligible.

10.7 An Impact Assessment of the effect that the changes made by regulation 9 will have on the costs of business and the voluntary sector is attached to this memorandum and is available alongside this instrument on the OPSI website.

Regulations 11 to 18

10.8 A final proposal stage impact assessment was published on 1 April 2009 and an implementation stage impact assessment is attached to this memorandum and is available alongside this instrument on the OPSI website.

11. Regulating small business

Regulation 3

11.1 The legislation applies to small businesses.

11.2 Technically, the changes do not discriminate between businesses but few, if any, small businesses are likely to be affected.

Regulations 4 to 8

11.3 The legislation applies to small business.

11.4 However, as there is a threshold below which ESLs for goods can continue to be submitted quarterly, these arrangements are unlikely to have a significant impact on them.

Regulation 9

11.5 The scheme is available as a simplification measure to all businesses with annual turnover not exceeding £150,000. These changes support the continuing existence of the scheme.

Regulation 10

11.6 Although the legislation applies to small businesses, it is mainly larger businesses who receive the types of cross-border supplies of services affected by the changes.

Regulations 11 to 18

11.7 The legislation may apply to small business but a Small Firms Impact Test has not been undertaken because the legislation does not alter the existing tax effect.

12. Monitoring & review

Regulation 3

12.1 The changes are administrative with negligible cost and no formal monitoring is planned. HMRC will monitor any feedback by way of technical commentary or casework.

Regulations 4 to 8 and 10

12.2 The application of regulations 21 to 23 and 82 of the Principal Regulations will continue to be kept under review to ensure that they operate as intended.

Regulation 9

12.3 The flat rate percentages are reviewed annually and the effects of these changes will be reviewed in late 2010.

Regulations 11 to 18

12.4 A post implementation review will be carried out.

13. Contact

Regulation 3

13.1 Jack Fletcher at HMRC Tel: 0207 147 0252 or email: jack.fletcher@hmrc.gsi.gov.uk can answer any queries regarding regulation 3.

Regulations 4 to 8

13.2 Jim Gilda at HMRC Tel:0151 703 8351 or email: Jim.gilda@hmrc.gsi.gov.uk can answer any queries regarding regulations 4 to 8.

Regulation 9

13.3 Stephen Davies at HMRC Tel: 0151 703 8653 or email: stephen.c.davies@hmrc.gsi.gov.uk can answer any queries regarding regulation 9.

Regulation 10

13.4 Phil Bryant at HMRC Tel: 020 7147 0067 or email: phil.bryant@hmrc.gsi.gov.uk can answer any queries regarding regulation 10.

Regulations 11 to 18

13.5 Colin Scott-Morton at HMRC Tel: 020 7147 0483 or e-mail: colin.scott-morton@hmrc.gsi.gov.uk can answer any queries regarding the regulations 11 to 18.

TRANSPOSITION NOTE

THE VALUE ADDED TAX AMENDMENT (NO. 5) REGULATIONS 2009 No. 3241

Part 1

The implementation of articles of Council Directive 2006/112/EC as amended

From 1 January 2010 Council Directive 2006/112/EC (“the principal VAT directive”) is amended by Council Directives 2008/8/EC (“the first amending directive”) and 2008/117/EC (“the second amending directive”).

The amendments introduce a package of measures aimed at improving taxpayer compliance, as well as combating evasion of VAT, on intra-Community supplies. These include changes to the time of supply rules as they apply to the supply of cross-border services which are, pursuant to article 196 of the principal VAT directive, subject to a reverse charge to VAT (“reverse charge services”). The amendments also impose more stringent requirements on the existing obligations to report information on cross-border movements of goods and introduce, for the first time, a requirement to report information about reverse charge services.

The new time of supply rules are intended to harmonise the timing of the reporting of cross-border supplies by the supplier, with the inclusion of the supply (by the customer) on the VAT return.

The amendments to the principal VAT directive are implemented by the amendment of the Value Added Tax Regulations (S.I. 1995/2518)(“the principal regulations”), which is the subject of part 1 of this note and by section 76 and schedule 36 of the Finance Act 2009.

The amendments to the principal regulations are effected by an amending S.I made by the Commissioners of Revenue and Customs, the Value Added Tax (Amendment) (No 5) Regulations 2009 (S.I. 2009/3241) made by the Commissioners of Revenue and Customs, which comes into force on 1 January 2010, and does no more than is necessary to implement the Directive.

Time of supply

Articles 63 to 66 provide when goods and services are to be treated as having been supplied for the purposes of a charge to VAT. Article 66 gives a wide discretion to member States to derogate from those basic rules.

The UK relied on this derogation in formulating regulation 82 of the principal regulations. This provides that the supply of cross-border services which are, pursuant to article 196 of the principal VAT directive, subject to a reverse charge to tax (“reverse charge services”) shall be treated as being made when they are paid for or, if consideration is not in money, on the last day of the accounting period in which they are made.

With effect from 1 January 2010 articles 64(2) and 66 are amended by article 1 of the second amending directive. From that date the derogation is not available for supplies of reverse charge services. Reverse charge services are therefore subject to the basic rules regarding time of supply. In addition a specific rule is introduced with regard to continuous supplies of reverse charge services.

The changes to the rules governing the time of supply of reverse charge services are implemented by an amendment to regulation 82 of the principal regulations as follows:-

Articles Dir. 2006/112	Objectives	Implementation by amendment to regulation 82 of SI 1995/2518
Article 63	The charge to tax arises when the services are made	82(1) and (2)
Article 64(1)	Where a supply of services gives rise to successive statements of account, or successive payments, they shall be treated as being made at the end of the periods to which those statements or payments relate.	82(3) and (4)
Article 64(2)	Where reverse charge services are supplied continuously over a period of more than a year and no invoice is issued, or payment made in relation to them, they shall be treated as being made on the expiry of each calendar year until such time as the supply of services comes to an end.	82(3) and (6)
Article 65	Where a payment is made on account before the services are supplied, VAT becomes chargeable on the receipt of payment and the amount received.	82(1), (3) and (5)

Recapitulative statements

Articles 262 to 271 of the principal VAT directive imposes an obligation on VAT registered persons in all member States ('EU taxpayers') to provide specified information, by way of a periodic statement ("recapitulative statement") about cross-border movements of goods. These articles are given effect in UK legislation by Part IV of the principal regulations.

Articles 2(9) and (10) of the first amending directive and article 1 of the second amending directive, amend articles 262 to 265 of the principal VAT directive. The amendments impose an additional obligation on EU taxpayers to submit recapitulative statements in respect of cross-border supplies of services where those services are subject to a reverse charge. They also amend the periods for which recapitulative statements are required for goods.

Articles Dir. 2006/112	Objectives	Implementation by amendment to regulation 82 of SI 1995/2518
Article 262 (c)	Requirement for businesses supplying cross-border services, that are taxable in the Member state and for which the customer is liable to pay tax (“reverse charge services”), to submit a recapitulative statement (EC Sales List).	Regulation 22A (1) and (2)
Article 263 (1) (1a) (1b) (1c) (2)	<p>Requirement for businesses to submit a recapitulative statement for each calendar month, within a period not exceeding one month, subject to the exceptions below.</p> <p>Member states may allow businesses supplying goods to submit recapitulative statements (EC Sales Lists) for a calendar quarter if the value of those supplies does not exceed €50,000 (or its equivalent in national currency) in that and each of the four preceding quarters. This option ceases to be applicable after the end of the month during which the value of supplies (excluding VAT) exceeds that threshold. In that case a recapitulative statement is required from the beginning of the quarter to the end of the month in which the threshold was exceeded.</p> <p>The threshold at 1(a) may be set at €100,000 (or its equivalent in national currency) until 31 December 2011.</p> <p>Member states may allow businesses supplying reverse charge services to submit recapitulative statements for a calendar quarter.</p> <p>Member states shall allow and may require the recapitulative statement to be submitted by electronic file transfer.</p>	<p>Regulation 22(3)(a), 22A(3)(a) and 22B(3)</p> <p>Regulations 21 and 22(4)(a) to (d)</p> <p>Regulations 21 and 22(4)(a)</p> <p>Regulation 22A(3)(a)</p> <p>Regulation 22B(2)</p>

Articles 264(1)(a), (b) and(2) and	The recapitulative statement shall contain, in respect of both goods and services, the VAT identification number of the person to whom supplies of goods and services are made and the	Regulations 22(2) and (3)(a) and 22A(2) and (3)(a)
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265(2)	total value of the supply. The declaration of value must be made by reference to the period during which the tax became chargeable	
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Part 2

Implementation of Council Directive 2008/9/EC (12 February 2008) laying down detailed rules for the refund of value added tax to taxable persons not established in the member State of refund but established in another member State.

Member States are required to charge VAT in accordance with the requirements of European law so that, in broad terms, supplies of goods and services are treated similarly for VAT purposes throughout the European Union (“EU”). Most of the detailed requirements of European VAT law are contained in the principal VAT Directive.

When accounting for VAT charged on its supplies of goods and services, a business may deduct from the VAT it pays to the tax authorities of the country where it belongs an amount equal to the VAT the business has already paid on goods and services supplied to it if those goods and services are used for the purposes of making its taxable supplies. A business may only deduct VAT that it has paid in the member State where it is registered for VAT.

In order to facilitate trade between member States, businesses that incur VAT in member States other than where they belong (which cannot be deducted from the VAT such businesses pay to the tax authorities of the member state in which they belong) may make a direct claim for repayment of such VAT from the member State where the VAT was incurred provided the goods and services concerned are used for the taxable supplies of such businesses and other conditions are fulfilled. Until 1st January 2010, such repayments are governed by the scheme contained in Council Directive 1072/79/EEC (“the Eighth Directive”) which is implemented in the UK by Part 20 of the Value Added Tax Regulations 1995 (S.I.1995/2518) (“the VAT Regulations”).

The refund scheme required by the Eighth Directive will be replaced from 1st January 2010 by a revised scheme in accordance with Council Directive 2008/9/EC (“the Refund Directive”) which revokes the Eighth Directive. The main change effected by the Refund Directive is that claims for repayment will be made by the submission of an electronic application via a portal established for this purpose in the member State where the claimant belongs in place of the paper-based system that applies to claims submitted before 1st January 2010. There are also new rules in respect of other matters such as the time by which successful repayment applications must be paid and the time from which interest must be paid where a repayment is wrongfully delayed. Most of the changes required by virtue of the Refund Directive are made by amendment of Part 20 of the VAT Regulations.

Articles Dir. 2008/9	Objectives	Implementation (Unless stated otherwise, references are to the Value Added Tax Regulations 1995 (S.I. 1995/2518) as amended by the Value Added Tax (Amendment) (No 5) Regulations 2009 (S.I. 2009/3241)
1	States that the Directive lays down detailed rules for the operation of the refund scheme.	No transposition required
2(1) 2(2) 2(3) 2(4) 2(5)	<p>Defines ‘taxable person not established in the member State of refund’.</p> <p>Defines ‘member State of refund’.</p> <p>Defines ‘refund period’.</p> <p>Defines ‘refund application’.</p> <p>Defines ‘applicant’.</p>	<p>Regulations 173(2) and 173E</p> <p>No transposition required</p> <p>Regulations 173(1) and 173G</p> <p>Regulations 173I and 173L, 173M, 173N and 173O</p> <p>Regulation 173(1)</p>
3 3(a) 3(b) 3(b)(i) 3(b)(ii)	<p>Provides that the Directive applies to any taxable person who meets the following conditions during a refund period:</p> <p>he has no fixed establishment or place of residence in the member State of refund;</p> <p>he has made no supplies in the member State of refund, other than:</p> <p>international freight transport or ancillary services;</p> <p>supplies on which the recipient must account for VAT under the reverse charge procedure.</p>	<p>Regulation 173E(a)</p> <p>Regulation 173E(b)</p> <p>Regulation 173E(b)(i)</p> <p>Regulation 173E(b)(ii) and (iii)</p>
4 4(a) 4(b)	<p>Provides that the Directive shall not apply to amounts of VAT which have:</p> <p>been invoiced incorrectly;</p> <p>been invoiced in respect of goods exported outside the member States or removed to another member State.</p>	<p>Regulations 173A(1) and 173B</p> <p>Regulation 173B(2)(b)</p>
5	Provides that refunds shall only be made where the goods or services acquired are used for the purposes of taxable transactions, and that without	Regulation 173B

	prejudice to Article 6 below, the right to deduct shall be determined in accordance with the rules applying in the member State of refund.	
6	Provides that refunds shall only be made where the goods or services acquired are used for the purposes of transactions giving a right to deduct input tax in the member State of Establishment, and that where goods or services are used both to make transactions giving a right to deduct and transactions not giving a right to deduct, only a proportion of the VAT may be reclaimed, calculated in accordance with the rules applying in the member State of Establishment.	Regulation 173C
7	Sets out the requirement that claims shall be submitted via the electronic portal set up in the member State of Establishment.	Regulation 173I
8(1)	Sets out the information required to be contained in a refund application.	Regulation 173L
8(2)	In addition to the information required under Article 8(1), sets out the information required to be contained in a refund application in respect of each invoice or importation document.	Regulation 173M
9(1)	Sets out the primary codes to be used to describe the nature of goods and services in respect of which a refund application is made.	Regulation 173O(1) and (2)
9(2)	Provides that the member State of Refund may require information additional to that required by Article 9(1), in the form of supplementary codes.	Regulation 173O(3) and (4)
10	Provides that the member State of refund may require the applicant to supply electronically scanned copies of invoices or importation documents which exceed certain values.	Regulations 173J and 173K
11	Provides that the member State of refund may require the applicant to describe his business activities using NACE codes.	Regulation 173L(1)(c)
12	Provides that the member State of refund may specify which language(s) shall be used in a refund application.	Regulation 173I(b)
13	Provides that where an applicant's deductible proportion (see Article 6) is calculated using the pro-rata rate as set out in Article 175 of Directive 2006/112/EC, and the rate changes from one year to the next, any VAT claimed in the first year shall be adjusted in the second year, with the	Regulation 173D

	adjustment being submitted via the electronic portal set up in the member State of establishment. The adjustment shall be made either as part of a refund application or, where no application is made, by means of a separate declaration.	
14(1)	Sets out the timing rules for transactions which may be included in a refund application.	Regulations 173A(1)(a) and 173F
14(2)	Provides that a refund application may also include transactions not included in previous applications, providing they took place during the same calendar year.	Regulation 173A(2)
15(1)	Provides that the refund application shall be submitted through the electronic portal set up by the member State of establishment at the latest on 30 September of the calendar year following the refund period. Also provides that the application shall only be considered submitted if it contains the information required in Articles 8, 9 and 11.	Regulations 173P(1) and (2) and 173L, 173M, 173N and 173O
15(2)	Requires the member State of establishment to confirm receipt to the applicant electronically, without delay.	Section 39A of the Value Added Tax Act 1994 (c. 23) which was inserted by section 77 of the Finance Act 2009 (c. 10)
16	Specifies the length of refund periods.	Regulation 173G
17	Specifies the minimum monetary amounts for which refund claims may be submitted, in Euro or equivalent in national currency.	Regulation 173H
18(1)	Sets out the circumstances in which the member State of establishment shall not forward the application to the member State of refund.	Section 39A of the Value Added Tax Act 1994 (c. 23) which was inserted by section 7 of the Finance Act 2009 (c. 10)
18(2)	Requires the member State of establishment to notify the applicant, electronically, of its decision in respect of Article 18(1).	Section 39A of the Value Added Tax Act 1994 (c. 23) which was inserted by section 7 of the Finance Act 2009 (c. 10)
19(1)	Requires the member State of refund to notify the applicant, electronically and without delay, of the date on which it received the application.	Regulation 173P(4)

19(2)	Requires the member State of refund to notify the applicant of its decision to approve or refuse the application, within four months of the date of receipt.	Regulations 173Q(1), 173S, 173T and 173U
20(1)	Provides that, where required, the member State of refund may request additional information by electronic means, from the applicant, the competent authorities of the member State of establishment, or a third party, such request to be made within the time limit set out in Article 19(2).	Regulation 173R
20(2)	Provides that additional information requested under Article 20(1) shall be provided within one month of receipt of the request.	Regulation 173T(4)
21	Sets out extended decision time limits where additional information is requested, up to a maximum of eight months from the date of receipt of the application.	Regulations 173T and 173U
22(1)	Requires the member State of refund to pay approved amounts within 10 working days of the decision deadlines set out in Articles 19(2) or 21.	Regulation 173V
22(2)	Provides that the refund shall be paid in the member State of refund or any other member State at the applicant's request, the applicant being liable for any bank charges in the latter case.	Regulation 180
23(1)	Provides that where an application is refused in whole or in part, the member State of refund must notify the applicant of the grounds for refusal.	Regulation 173Q(2)
23(2)	Provides that appeals against decisions to refuse refund applications must be made under the same procedures available to taxable persons established in the member State of refund. Also provides that where no other administrative or judicial procedures apply in the member State of refund, failure to take a decision within the time limits laid down shall mean the application is deemed to be rejected.	Regulation 173Q(3) and section 83(1)(ha) of the Value Added Tax Act 1994 (c. 23) which was inserted by 77 of the Finance Act 2009 (c. 10)
24(1)	Provides that where a refund is obtained fraudulently or incorrectly, the member State of refund may recover the amounts wrongly paid together with any penalties and interest applicable according to its own procedures.	Section 73(2) of the Value Added Tax Act 1994 (c.23) Schedule 24 of the Finance Act 2007 (c. 11)

24(2)	Permits the member State of refund to recover outstanding penalties and interest by suspending further refunds.	Section 74 and section 39(3)(ba) of the Value Added Tax Act 1994 (c. 23) Section 81(3) of the Value Added Tax Act 1994 (c. 23)
25	Provides that where adjustments are made pursuant to Article 13, the member State of refund shall adjust the refund application in which the adjustment is made, or make a separate payment or recovery where no application is made.	Regulation 173D(3)
26	Requires the member State of refund to pay interest to the applicant where the refund is not paid by the deadline set out in Article 22(1), unless the applicant has failed to provide any additional information requested within the time limits, or has failed to provide scanned copy documents as required under Article 10.	Regulation 173W
27(1) 27(2)	Provides that interest shall be due from the deadline set out in Article 22(1) until the day when the refund is paid. Provides that interest rates shall be equal to those applying to taxable persons established in the member State of refund. If no interest is payable to such taxable persons, the interest shall be equal to any interest or similar charge applied to late payments by taxable persons in the member State of refund.	Regulation 173W(2) Regulation 173W(3)
28(1) 28(2)	Provides that the Directive applies to all refund applications submitted after 31 December 2009. Provides that the previous refund Directive (79/1072/EEC) shall be repealed with effect from 1 January 2010, but that its provisions shall still apply to applications submitted before that date.	Regulations 1 and 17 of the Value Added Tax (Amendment) (No. 5) Regulations 2009 (S.I. 2009/3241) Regulations 1 and 17 of the Value Added Tax (Amendment) (No. 5) Regulations 2009 (S.I. 2009/3241)
29(1)		

29(2)	<p>Requires member States to enact the laws , regulations and administrative provisions to comply with the Directive with effect from 31 January 2010, and to notify the Commission accordingly.</p> <p>Requires member States to provide the Commission with the text of the main provisions of their implementing legislation.</p>	<p>No transposition required</p> <p>No transposition required</p>
30	<p>Provides that the Directive shall enter into force on the day of its publication in the Official Journal of the European Union.</p>	<p>No transposition required</p>
31	<p>States that the Directive is addressed to the member States.</p>	<p>No transposition required</p>

Summary: Intervention & Options

Department /Agency: HMRC	Title: Impact Assessment of implementing EC Legislation regarding the place of supply of services and measures to combat VAT fraud	
Stage: Implementation	Version: 2.0	Date: 16 April 2009
Related Publications: Council Directive 2008/8/EC of 12 February 2008, Council Directive 2008/117/EC of 16 December 2008 and Council Regulation (EC) 37/2009		

Available to view or download at:

<http://www.hmrc.gov.uk/ria/index.htm#full>

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

The EC 'VAT package' of EC legislation seeks to modernise and simplify the VAT place of supply of services rules and introduces a requirement for reporting business to business (B2B) intra-EC supplies of taxable general rule services on EC Sales Lists (ESLs). Other EC anti-fraud legislation has been adopted to require monthly, rather than quarterly ESL declarations for intra-EC supplies of goods, and new time of supply rules for intra-EC supplies of services. The UK has an obligation to implement these measures.

What are the policy objectives and the intended effects?

The new place of supply of services rules aim to achieve taxation in the place of consumption. From 1 January 2010 (B2B) supplies of services will be subject to VAT in the place where the customer is established (the general rule). As now there will be exceptions to the general rule.

To help enforce these place of supply rule changes and to deal with high levels of intra-EC related VAT fraud, from 1 January 2010 there will be a monthly reporting period for most intra-EC B2B supplies of goods, with the information being made available to tax authorities in other Member States within a further month. There will also be a new requirement for the quarterly reporting of supplies of B2B intra-EC supplies of taxable general rule services on ESLs.

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

Doing nothing is not an option, as to prevent widespread double or no taxation (and confusion to businesses) all Member States must implement the EC VAT regime governing the place of supply of services simultaneously. Directive 2008/117 allows Member States some options in implementation which will reduce the burdens to business. Failure to implement the rules risks legal proceedings being taken by the Commission.

Therefore the preferred policy option is to implement the measures making use of such options as will reduce burdens on business and to publish detailed guidance for businesses on the changes.

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 achievements 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) the benefits justify the costs.

Signed by the responsible Minister:



.....Date: 16 April 2009

Summary: Analysis & Evidence

Policy Option:	Description: Implement the EC Legislation into UK law and publish detailed guidance to businesses on the place of supply of services changes and anti-VAT fraud measures
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' An estimated 130,000-140,000 businesses will be affected by the requirement to submit ESLs for services, 65,000-75,000 businesses will be affected by the reverse charge rules and 22,000 will be affected by the changes to ESLs for goods. About 1.3 million businesses will not be affected by the ESL requirements but will need to be aware of the changes.
	One-off (Transition)	Yrs	
	£ 43.2-44.8 million		
	Average Annual Cost (excluding one-off)		
	£ 7.4-7.7 million	5	Total Cost (PV) £ 69-71million
Other key non-monetised costs by 'main affected groups' IT upgrade costs for business have not been quantified. Some but not all HMRC's costs have been quantified.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' UK businesses making or receiving general rule B2B supplies will benefit as they will no longer charge and collect UK VAT from overseas business customers, or pay overseas VAT respectively. The benefit to such businesses of no longer having to submit claims to recover overseas VAT has been quantified at £0.3million.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 0.3million	5	Total Benefit (PV) £ 1 million
Other key non-monetised benefits by 'main affected groups' The introduction of ESLs for services will facilitate HMRC's control of revenue risks that could arise from such services. It is not possible to quantify the revenue benefits of this change, but they may well prove substantial.			

Key Assumptions/Sensitivities/Risks The key assumption is in relation to the number of affected businesses, especially the figures for businesses supplying services who will be required to submit ESLs/apply the reverse charge from 2010 onwards. The net benefit figure has been estimated over a 5 year period to ensure it accounts for the implementation of all the changes.

Price Base Year 2009	Time Period Years 5	Net Benefit Range (NPV) £ -68m to -70m	NET BENEFIT (NPV Best estimate) £ -69m
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What is the geographic coverage of the policy/option?				UK	
On what date will the policy be implemented?				01/01/2010 onwards	
Which organisation(s) will enforce the policy?				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?				Yes	
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	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase – Decrease)
Increase of	£ 6.0-6.3m	Decrease of	£ 0.3m
Net Impact			£ 5.7-6.0m

Key: Annual costs and benefits: (Net) Present

1. The Issue

Place of supply of services changes including the introduction of EC Sales Lists for services

- 1.1 A 'VAT package' of EC legislation was agreed by EU Finance Ministers in December 2007 and adopted and published in February 2008¹. These legislative changes will modernise and simplify the EC VAT rules for businesses involved in cross-border activity. The legislation (Council Directive 2008/8/EC of 12 February 2008 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:04>) changes the rules on the place of supply of services and introduces a requirement to submit EC Sales Lists (the form currently used to declare intra-EC B2B supplies of goods) for intra-EC B2B supplies of taxable general rule services from 1 January 2010. Other EC legislation introduces changes to the system used by EC businesses to recover VAT incurred in Member States, other than their own Member State. UK legislation is required to implement these changes.
- 1.2 There is a phased implementation of the place of supply changes which will take effect on 1 January 2010, 1 January 2011, 1 January 2013 and 1 January 2015. This Impact Assessment covers the changes (including the introduction of EC Sales Lists for B2B general rule services) taking place between 2010 and 2013. It does not cover the changes that will be introduced on 1 January 2015 in relation to B2C supplies of electronically supplied services, telecommunications services and radio and TV broadcasting services. On 1 January 2015 a One Stop Scheme will be introduced aimed at minimising the additional burdens on business of those changes. It therefore makes sense for the relevant place of supply changes and One Stop scheme changes to be covered by a single Impact Assessment. HMRC will be working with the relevant business sectors in implementing those changes. These further changes will be the subject of a separate Impact Assessment in due course.
- 1.3 A consultation Impact Assessment covering the implementation into UK law of the place of supply changes was published on 23 December 2008. It sets out in detail all the place of supply of services rule changes.
- 1.4 A Refund Scheme Impact Assessment is being published.
- 1.5 Both of the above Impact Assessments can be found at: <http://www.hmrc.gov.uk/ria/index.htm#partial>

Anti-fraud measures

- 1.6 The European Council had concerns about levels of VAT fraud within the EC and has asked the European Commission to prepare a Community anti-VAT fraud strategy. In March 2008, the European Commission produced the first set of legislative proposals which contained changes to reporting requirements so that Member States are provided with information about intra-EC transactions received in their country much more quickly. The proposals covered the frequency of EC Sales Lists (ESLs) and the time taken to submit and exchange them. The proposals also included changes to the time of supply rules for reverse charge services.
- 1.7 These proposals have now been agreed by the European Council and EC legislation (Directive 2008/117/EC and Regulation 37/2009) in significantly modified form and have been published at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:014:0007:0009:EN:PDF>

¹ In the Official Journal of the European Union 20.02.08

Implementation of legislation beyond what is mandatory

1.8 HMRC considers that implementation of the place of supply of services changes and time of supply changes by the UK goes beyond minimum EU requirements as it is retaining the current 'use and enjoyment' provisions (which are not mandatory under the EC Place of Supply of Services Directive) and extending the time of supply changes to all services subject to the reverse charge.

Use and enjoyment

1.9 The 'use and enjoyment' provisions provide that services that would be treated as supplied within the EC but are used and enjoyed outside the EC are relieved from VAT, and those services that would be treated as supplied outside the EC but are used and enjoyed within the EC become subject to VAT.

1.10 The purpose of any 'use and enjoyment' provision is to avoid double-taxation, non-taxation or the distortion of competition. Currently, Member States are able to enact 'use and enjoyment' provisions to a narrow range of services under the Principal VAT Directive.

1.11 To date the UK has applied the 'use and enjoyment' provisions to a narrow range of services (hire of transport, hire of goods, telecommunications, broadcasting and electronic services (the latter for B2B supplies only)), but this is more than required under the EC Place of Supply of Services Directive which only specifies that 'use and enjoyment' provisions be implemented in relation to B2C supplies of telecommunications services and radio and broadcasting services where these supplies are made by non-EC suppliers to consumers who are in the EC.

1.12 HMRC has undertaken a public consultation to expose the proposed draft legislation (see section 4 for full details of the consultation). The published consultation document set out HMRC's proposed retention of the UK's existing 'use and enjoyment' provisions. It also confirmed that HMRC would consider wider application, if it was necessary to counter or prevent avoidance or otherwise protect the revenue.

1.13 The legislation to be introduced by Finance Bill 2009 implements the UK's existing 'use and enjoyment' provisions with which UK businesses are already familiar and accordingly UK businesses will not incur any additional one-off compliance cost nor administrative burden. As such it has not been necessary for HMRC to undertake an exercise to determine any cost or burden placed on UK businesses.

Time of supply

1.14 From 1 January 2010, EC law brings in certain time of supply rules [see section 3.6] for cross-border services subject to a reverse charge. Strictly speaking, the UK only needs to apply the new time of supply rules to taxable services covered by the B2B general place of supply of services rule. As drafted, the new rules would apply in the UK to all cross-border reverse charge services, which is permitted by EC legislation. This approach has been adopted to avoid the need for businesses to apply different time of supply rules dependent on the services they receive.

Purpose of this Impact Assessment

1.15 This Impact Assessment combines the impacts on and associated costs to business as a result of the UK legislative changes being introduced. References to 'business/businesses' encompasses unregistered businesses and VAT registered entities (including VAT registered charities, public bodies and similar).

1.16 These changes will have different impacts on businesses that undertake cross-border trading (depending on whether they supply goods and/or services to other businesses) and those that buy in services from overseas suppliers. For the purposes of this Impact Assessment HMRC has attempted to quantify the impacts for each individual change, as this is the only practical way of measuring the potential costs. However it is probable that there will be overlap between the various changes.

2. Policy objectives and intended effects

Place of supply of services changes including the introduction of ESLs for services

2.1 The policy objectives of the place of supply changes are:

- to achieve, as far as possible, taxation in the place of consumption; and
- to monitor and control the application of the mandatory reverse charge for B2B taxable supplies of general rule services through the introduction of ESLs for services.

2.2 In doing so consideration has been given to simplification and the need to ensure the rules are being applied properly. The intended effect is that for UK businesses there will be a reduction in the costs associated with:

- charging UK VAT and collecting payment thereof from an overseas customer when supplying general rule B2B services; and
- paying overseas VAT on services received from an overseas supplier that then must be recovered from an overseas VAT authority.

Anti-fraud measures

2.3 The policy objective is to reduce VAT fraud on intra-EC supplies of goods and control the application of the mandatory reverse charge for B2B taxable supplies of general rule services by reducing the time it takes for the tax authorities to collect and exchange relevant data, and to introduce legislative measures which will help Member States better control the EC VAT system. The intended effect of these changes is that Member States will be able to identify new frauds much more quickly, have more data with which to monitor the mandatory reverse charge for B2B taxable supplies of general rule services, and rapidly develop new countermeasures to protect VAT revenues across the EC.

3. The Options

Place of supply of services changes including the introduction of ESLs for services

3.1 Apart from the application of the 'use and enjoyment' provisions to certain services (see sections 1.6-1.14 above), Member States have little or no flexibility regarding implementation of the place of supply of services changes under the EC Place of Supply of Services Directive into national law.

3.2 The place of supply of services changes covered by this Impact Assessment and effective from 1 January 2010 are:

- the new general rule for B2B supplies of services. Currently the place of supply of such services under the 'basic' (general) rule is where the supplier is established. Under the new rule the place of supply of supplies of B2B services will be determined by where the recipient of the service is established;
- a mandatory reverse charge introduced for cross-border supplies of B2B taxable general rule services (see sections 5.26-5.34). This will also impact upon when a supply subject to the mandatory reverse charge should be included on an ESL for services. As now the UK will continue to apply a wide reverse charge for cross-border supplies of services; and
- there will be a requirement for B2B intra-EC supplies of taxable general rule services to be reported on ESLs on a quarterly basis (see sections 5.19-5.25 and 5.48-5.51).

Anti-fraud measures

Reduced timescales for ESL reporting

3.3 As adopted, Directive 2008/117 and Regulation 37/2009 contain various elements:

- the standard reporting method for ESLs for goods is increased from quarterly to monthly;
- although the basic rule for submission of ESLs has been changed from quarterly to monthly submission, Member States have the option of allowing their businesses to submit ESLs

quarterly for services, with no value threshold, and quarterly for goods, provided intra-EC supplies are below a threshold which is no more than €100,000 (£70,000) per quarter from 1 January 2010 to 31 December 2011, reducing to €50,000 (£35,000) per quarter from 1 January 2012 (see section 5.35-5.40 and 5.57-5.60). The UK has decided to make use of this threshold to keep burdens on business to a minimum;

- Member States have the option of allowing a quarterly rather than a monthly ESL reporting period for taxable supplies of B2B general rule services. Again the UK has decided to make use of this longer reporting period to keep burdens on business to a minimum;
- Member States which opt to allow quarterly ESL reporting periods for taxable supplies of B2B general rule services may require businesses which supply both goods and services to submit ESLs for services at the same frequency as applies to their supplies of goods (e.g. monthly). The UK will allow businesses to decide on the reporting periods within the specified general rules. So if a business would prefer to have different reporting periods for services and goods they may do so. Alternatively, they may choose to adopt the same (monthly) reporting periods for both goods and services; and
- reduced timeframe of one month in total for businesses to submit their ESLs to their tax authority, and for that tax authority to collate and send that data to the tax authorities in the other Member States. The UK has decided to allow businesses 14 days after the end of the reporting period to send HMRC paper ESLs, and 21 days to submit electronic ESLs. The shorter time period allowed to businesses to submit paper ESLs is because HMRC needs additional time to key in, or scan, the ESL data into the VAT Information Exchange System (VIES) so it can be sent to other Member States.

3.4 Apart from these options, Member States have little or no flexibility regarding implementation of the anti-fraud measures under the EC Directive 2008/117 into national law. Regulation 37/2009 has direct effect and is binding on all Member States. Therefore no national law is required to implement its provisions.

3.5 Member States must also offer electronic file transfer of ESL data as a method of submission for businesses. The UK already offers this facility.

Time of supply for cross border services

3.6 From 1 January 2010 new time of supply (tax point) rules will be introduced for supplies of B2B taxable general rule services subject to a mandatory reverse charge. These determine when the reverse charge VAT must be accounted for as follows:

- the tax point to be the completion of the service with an earlier tax point in the event of a payment being made beforehand; and
- for continuous supplies, a tax point at the end of each billing or payment period (or upon payment where this is earlier), with a compulsory tax point on 31 December each year in cases where such periods (or payments) do not arise.

The EC changes to the time of supply rules also determine when a business must include a supply of services on an ESL.

Member States have flexibility as to how to apply the time of supply rules to services other than to supplies of B2B general rule services. HMRC will apply the same time of supply rules as those required under the anti-fraud measures to other services subject to a reverse charge in the UK.

Option selected by HMRC

3.7 Failure by the UK (or any Member State) to implement the EC Directives into national law, would risk legal proceedings by the Commission.

3.8 Therefore, doing nothing is not an option and there is only one option for implementation:

- to enact the EC Directives into UK law and to ensure that HMRC staff and business have clear and detailed guidance on the changes and their impact; and

- where options are available that will simplify the new rules for business or ease the administrative burden associated with the new rules, HMRC will take those options.

4 Consultation

Place of supply of services changes

- 4.1 The views of businesses and advisers were sought informally on the various elements of the VAT Package including discussions with the Joint VAT Consultative Committee (JVCC), the HM Treasury VAT Forum and meetings with specific industry groups including the finance and insurance sector. Concerns were expressed at that stage over practical impacts on business.
- 4.2 HMRC has undertaken a consultation with business and other stakeholders to expose the UK draft legislation for the place of supply of services rule changes. Comments were sought on whether the UK draft legislation fully enacted the EC law, wider issues of interpretation and how businesses might be affected. The consultation documentation consisted of:
- a consultation paper setting out all the place of supply of services changes from 1 January 2010 to 1 January 2013 inclusive (the changes effective from 1 January 2015 to be covered separately at a later date) together with HMRC's interpretation where appropriate, the draft UK legislation for the changes from 2010-2013 inclusive; and
 - a consultation stage Impact Assessment.
- 4.3 HMRC has published a consultation response document regarding the UK's proposed implementation of the changes which can be found at:
<http://www.hmrc.gov.uk/consultations/index.htm>
- 4.4 Where respondents to the consultation have commented on the impact of the changes on business, these have been included in this Impact Assessment along with impacts previously identified in the consultation stage Impact Assessment.

Anti-fraud measures

- 4.5 The views of businesses and advisers were sought on the various elements of the first set of proposals and it was discussed at meetings of the Joint VAT Consultative Committee (JVCC) and with representatives from the finance and insurance sector. A consultation Impact Assessment was also published on the HMRC website and can be found here:
<http://www.hmrc.gov.uk/consultations/index.htm>
- 4.6 Feedback received before the publication of this consultation Impact Assessment included quantification of impacts, but not in monetary terms. In essence businesses recognised the need for tax authorities to respond vigorously to the VAT MTIC fraud threat and the high revenue losses by introducing reduced ESL reporting timeframes for goods. However, they did not consider there to be any credible justification for extending the ESL regime to intra-EC supplies of services. They did not dispute that there might be some fraud associated with intra-EC supplies of services, but considered that this would not be prevented or managed by the ESL reporting regime. Consequently, businesses felt that this initiative simply imposed a significant additional administrative and compliance cost burden on businesses. In addition, some respondents questioned whether the tax authorities would be able to make effective use of all the additional information they would be collecting from businesses under the enhanced reporting requirements. This Impact Assessment includes narrative on the potential impacts identified by businesses and advisers.

5 Costs

- 5.1 The sections below examine the impacts on business of the changes on a costs basis.

Costing assumptions.

- 5.2 HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the administrative burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model', an activity-based costing model

which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

5.3 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>

5.4 Unless otherwise stated, the methodology used to quantify the number of businesses affected by the place of supply of services changes (including the introduction of ESLs for services) can be found in section 5 of the consultation Impact Assessment which can be found here:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

5.5 The estimates of the number of businesses affected by the rule changes for ESLs for goods have been obtained from data held by HMRC.

5.6 In summary, HMRC has estimated the following:

- the current population of UK VAT registered businesses stands at around 2 million, of which 1.3 million will not be required to submit ESLs for services but will require some level of familiarisation with the changes. They may or may not be affected by the other place of supply of services changes, including the mandatory reverse charge, or by the rule changes for ESLs for goods (see below). The majority of the remainder, will not be affected by the various rule changes at all, except for:
 - 130,000 to 140,000 UK businesses estimated to be required to submit ESLs for services;
 - 65,000 to 75,000 UK businesses estimated to be affected by the mandatory reverse charge requirement in relation to supplies of taxable general rule services received from suppliers established outside the UK; and
 - 22,000 UK businesses estimated to be required to submit monthly ESLs for goods.

5.7 'Second round' impacts in relation to the changes are beyond the scope of this Impact Assessment and the 'second round' impacts could include:

- the information collected as a result of the introduction of ESLs for services and more frequent submissions of ESLs for goods enabling better risk assessment by HMRC allowing compliance activity to become more targeted and/or potentially leading to more enquiries by HMRC; and
- legitimate businesses benefiting from a reduction in fraud as they will be able to compete without the distortions introduced by fraud.

5.8 Where businesses need time to understand the changes and how they will be affected this Impact Assessment assumes the task is undertaken by a 'taxation expert' at an hourly rate of £22 using current (2009) prices. HMRC acknowledges that for some businesses this task will be undertaken by a more senior employee earning a higher hourly rate, but adopts the above assumption as a broad average costs across all businesses (small to large).

5.9 HMRC has also made the following assumptions on the time taken by businesses to familiarise themselves with the changes:

- businesses will be affected by varying degrees to the changes covered by this Impact Assessment. Some businesses will not be affected at all, although they will still need to spend some time on clarifying that they are not affected. Other businesses may be affected by all of the changes and consequently their familiarisation costs will be significantly higher; and
- respondents indicated that the estimated average of 30 minutes referred to in the consultation Impact Assessment as the time required for businesses supplying services unaffected by the requirement to submit ESLs for services to familiarise themselves with the new place of supply of services rules was insufficient. HMRC acknowledges this view and

this Impact Assessment therefore assumes that these businesses will spend on average one hour broadly familiarising themselves with the changes.

The assumption of an average of one hour has been made by HMRC because some businesses may only need a few minutes to check whether they are affected by the changes because it will be very clear that supplies of services they make or receive will not be affected at all. For example, if a UK business currently only makes supplies of services where the place of supply is the UK and will continue to do so after 1 January 2010, there will be no requirement to complete and submit ESLs. Other businesses will need significantly more time to consider if and how they are affected. For example, ESLs are not required if a B2B intra-EC supply of a service is exempt from VAT in the customer's Member State. HMRC recognises and respondents have commented that such businesses will incur greater one-off compliance costs and administrative burden costs in this respect.

HMRC intends to publish clear guidance that will enable businesses to decide whether and how they are affected by the ESL requirements.

■ Respondents also indicated that HMRC's assumption in the consultation stage Impact Assessment that:

- UK businesses required to submit ESLs for services; and
- UK businesses required to apply a mandatory reverse charge for supplies of taxable general rule services

would need to spend on average an estimated 1.5 hours on familiarisation on each requirement (i.e. 3 hours in total if affected by both) was insufficient.

HMRC considers that such familiarisation will include reading and understanding the legislation and associated guidance. Many affected businesses will need to evaluate the implication of these changes on their IT capability and HMRC recognises that businesses are differently resourced and the time that will be allocated by businesses to this process will vary. Consequently, HMRC estimates **each** change will require on average 3 hours familiarisation time, as opposed to the 1.5 hours estimated for each change in the consultation Impact Assessment for the implementation of the place of supply of services legislation.

5.10 Respondents made the following general comments on the place of supply of services changes and the anti-fraud measures:

- the estimated administrative burden and compliance costs associated with the changes were generally under-estimated in the two consultation stage Impact Assessments;
- the costs did not take into account the education and training of staff which will be required by businesses in order to implement the changes;
- more frequent submission of ESLs for goods, the introduction of ESLs for services and the introduction of the mandatory reverse charge will increase the administrative burden to businesses because additional staff resource will be spent on meeting these requirements;
- intra-EC trade may reduce because of the burdens placed on business in relation to cross-border trade;
- some respondents consider that without a formal procedure for the resolution of disputes between Member States on the tax treatment of transactions, there could be significant costs to businesses;
- concerns have been raised that difficulties in applying or interpreting the new rules and the potential inconsistency between Member States' implementation will all involve potential additional costs for business;
- the changes impose burdens on business at a time when the economic climate places other pressures on businesses;
- there is insufficient time for businesses to implement the changes required to take effect from 1 January 2010; and

- clear guidance from HMRC will assist business and will help to reduce the burdens placed on business as a result of the changes.

5.11 Where data provided by respondents was representative it has been used to update the costs previously calculated in the consultation stage Impact Assessments and has been included in this Impact Assessment.

5.12 HMRC aims to minimise the additional burdens on business whilst remaining consistent with the legislation.

Costs – one off compliance costs

5.13 Unless otherwise stated, one-off costs are quoted in current (2009) prices. The average costs provided are stand alone costs for the change in question; where a business is affected by more than one change the average cost faced by the business is the sum of the averages of each change.

Familiarisation costs: UK businesses not affected by the requirement to submit ESLs for services

5.14 HMRC estimates that about 1.3 million UK businesses will not be required to submit ESLs for services. They may be affected by none, one or more than one of the other changes referred to in this Impact Assessment.

5.15 Annually about 88,000 UK businesses currently complete ESLs for goods. Of these it is estimated that about 22,000 UK businesses will be required to submit monthly ESLs for goods (15,000 businesses with effect from 1 January 2010 and an additional 7,000 businesses with effect from 1 January 2012), although it is recognised that this figure may not be static.

5.16 If it is assumed that the numbers of UK businesses affected by the ESLs for services and those affected by the ESL requirements for goods are mutually exclusive, an estimated 1.28 million (being 1.3 million minus 22,000) UK businesses will not be affected by the introduction of ESLs for services and related changes.

5.17 For the purposes of this Impact Assessment, HMRC has assumed that 1.28-1.3 million businesses will not be affected by the ESL requirements for services. By spending one hour generally familiarising themselves with these rules at a cost of £22 per hour, HMRC estimates these businesses will face a one-off familiarisation total cost of £28.3-28.6 million (or an average cost of £22 per business).

5.18 While this is viewed as a one-off compliance cost because it will be clear to most businesses how they will be affected, HMRC recognises some businesses might have to re-check over time following particular changes of circumstance.

Familiarisation costs: UK businesses required to submit ESLs for services

5.19 Businesses required to submit ESLs for services will need to list the value of supplies of taxable general rule services made to each VAT registered customer in other Member States. UK VAT registered suppliers will be required to complete and submit ESLs on a calendar quarter basis and may do so either on-line, by electronic file transfer or by using a paper form.

5.20 Reporting such supplies on ESLs will provide an audit trail which will facilitate HMRC's control of revenue risks that could arise from such services for the tax authority in the customer's Member State where the VAT on the supply falls due.

5.21 For the estimated 130,000-140,000 UK businesses expected to be affected by the requirement to submit ESLs for services, an average of 3 hours is expected to be spent by each business on familiarisation with the changes at a cost of £22 per hour. These businesses will face an estimated one-off familiarisation cost totalling £8.6-9.2 million (or an average cost of £66 per business).

- 5.22 Some of these businesses currently supply B2B cross-border services that are already treated as supplied where the customer is established. Therefore, these businesses will already be familiar with the place of supply implications and the cost to these businesses will be reduced.
- 5.23 Those businesses that already complete ESLs for intra-EC supplies of goods that will be required to complete ESLs for services, will already have an understanding of most of the information required. Where this is the case the cost to businesses in relation to their supplies of services would be reduced because the same ESL form will be used for goods and services.
- 5.24 Businesses required to submit ESLs for services will need to familiarise themselves with the new time of supply rules (see section 5.26-5.28) which may result in increased complexity in terms of businesses establishing when a supply should be reported on an ESL.
- 5.25 Businesses affected by this change may also be affected by the mandatory reverse charge requirements if they receive supplies of taxable general rule services from suppliers established outside the UK (see sections 5.26-5.34), and also by the new rules for ESLs for goods (see sections 5.35-5.40).

Familiarisation costs: UK businesses receiving supplies of taxable general rule services from suppliers established outside the UK who will be required to apply the reverse charge² and the time of supply rule changes

- 5.26 Under the reverse charge procedure the customer acts as if they are both the supplier and the recipient of the services by accounting for the VAT due on the supply and recovering the VAT on the supply in accordance with their entitlement to recover under the normal rules. Currently, UK recipients of reverse charge services are, for the most part, only required to account for VAT as and when they pay for the supplies in question.
- 5.27 With effect from 1 January 2010 UK customers receiving supplies of services from suppliers established outside the UK where the place of supply of those services is the UK will need to apply a reverse charge to such services. In addition, the tax point will change to the time at which the service is completed, unless payment is made earlier. For continuous supplies the tax point will arise at the end of each billing or payment period (or on payment where this is earlier), with a compulsory tax point on 31 December each year in cases where such periodic tax points (or payments) do not occur. Under the new arrangements businesses will therefore need to put in place additional accounting procedures to identify and respond to:

- completion of the service;
- the end of billing or payment periods for continuous supplies;
- payments made beforehand; and
- at each year end, continuous supplies that have not been subject to earlier tax points.

5.28 Respondents expressed the following concerns about the time of supply changes:

- service completion is not recorded on accounting systems and therefore a proxy for completion would be needed which could entail changes to existing accounting systems and/or manual processes in accounting for reverse charge VAT and extracting information to include on an ESL. This cost could be significant; and
- the continuous services rules could introduce a new burden of having to value a service for VAT purposes only in order to comply with the new rules.

5.29 HMRC does not hold data on the number of businesses that will be required to apply the reverse charge. For illustrative purposes 65,000-75,000 UK businesses are assumed to have the potential to be affected by the reverse charge rule changes.

² The mandatory reverse charge for B2B cross-border taxable supplies of general rule services is distinct from the reverse charge for supplies of goods of a kind used in MTIC fraud.

5.30 HMRC recognises, however, that among the potentially affected UK businesses there will be businesses already familiar with the reverse charge procedure that applies under the current rules. In addition, UK businesses are not required to account for the reverse charge on supplies of exempt services received from suppliers established outside the UK. HMRC does not hold data on these two categories of businesses and so, for the purposes of this Impact Assessment, has used the total illustrative figure of 65,000-75,000 to estimate the one-off familiarisation costs. While businesses already familiar with the reverse charge procedure and those receiving exempt supplies will not incur an additional administrative burden, HMRC recognises that they will need to spend time on familiarisation, even if it is just to clarify that they understand the requirements and when they apply.

5.31 The Refund Scheme Impact Assessment assumes that about 20,000 UK businesses claim VAT from other Member States using the scheme. The Refund Scheme Impact Assessment is being published at the following link:

<http://www.hmrc.gov.uk/ria/index.htm#partial>

5.32 This Impact Assessment assumes about 5,000 businesses of these 20,000 currently claiming VAT using the Refund Scheme will start applying the reverse charge to supplies of services with effect from 1 January 2010, with 50% of the 5,000 applying the reverse charge and also making claims under the Refund Scheme.

5.33 The estimated 65,000-75,000 UK businesses are estimated to spend about 3 hours each on average familiarising themselves with the changes at a cost of £22 per hour and will incur an estimated one-off familiarisation total cost of £4.3-5.0 million (or an average cost of £66 per business). This is likely to be a one-off cost to most businesses, since it will be clear to most whether the changes apply to them or not. Some businesses might have to re-check over time, following particular changes of circumstances.

5.34 A business affected by this change may also be affected by the requirement to submit ESLs if it makes supplies of taxable general rule services to VAT registered customers established in other Member States. See sections 5.19-5.25 and 5.48-5.51.

Familiarisation costs: UK businesses affected by the increased frequency of submission of ESLs for goods

5.35 UK VAT registered suppliers of goods to VAT registered businesses in other Member States are currently required to submit ESLs for goods on a quarterly basis. Each year some 88,000 UK businesses currently submit quarterly ESLs for goods.

5.36 With effect from 1 January 2010 monthly ESLs will be required to be submitted where intra-EC supplies of goods are over a threshold of £70,000 per quarter in 2010 and 2011, and £35,000 per quarter from 1 January 2012 onwards.

5.37 All 88,000 businesses will need to familiarise themselves with the changes to the frequency of submission for ESLs for goods. However, HMRC estimates that from 1 January 2010 about 15,000 UK businesses will actually be required to submit ESLs on a monthly rather than a quarterly basis and therefore these businesses will need the most time to familiarise themselves with the changes. The estimate has been derived as follows:

- approximately 88,000 UK businesses are known by HMRC to submit ESLs for goods already;
- the 2007-08 VAT data held by HMRC on recorded values of “supplies to the EC” shows that around 17% (being approximately 15,000) of the 88,000 UK businesses are making supplies above an average value of £70,000 per quarter; and
- these 15,000 UK businesses are already familiar with the current ESL submission requirements for goods and therefore will spend an average of about one hour each familiarising themselves with the submission frequency changes at a cost of £22 per hour. The estimated total one-off familiarisation cost faced by these businesses is about £0.3 million (or an average cost of £22 per business).

- 5.38 Using a similar method as above to derive the number of businesses affected by the changes in 2010, an additional estimated 7,000 UK businesses will be required to submit monthly ESLs for goods with effect from 1 January 2012.
- 5.39 The additional 7,000 UK businesses will also be familiar with the current ESL submission requirements for goods and therefore will spend an average of about one hour each on familiarising themselves with the submission frequency changes at a cost of £22 per hour. The estimated total one-off familiarisation cost faced by these businesses is about £0.2 million (or an average cost of £22 per business).
- 5.40 Therefore the 22,000 UK businesses estimated to be affected by ESL for goods changes will face a total estimated £0.5 million in one-off familiarisation costs.

Summary: Familiarisation costs

- 5.41 UK businesses are estimated to incur a total of £41.7-43.3 million one-off familiarisation and compliance costs associated with all the changes (averaging £22-£198 per business).

IT upgrade costs

- 5.42 HMRC recognises that UK businesses will incur significant additional IT upgrading costs on a one-off basis as a result of the changes to the frequency of ESLs for goods and the introduction of ESLs for services.
- 5.43 Respondents have indicated that these changes are expected to impose significant IT costs to businesses in changing accounting systems to comply with the new requirements to identify and react to the various times of supply. In addition, the changes are due to take effect from 1 January 2010 which may be difficult for them, given the need to secure IT resources.
- 5.44 Changes may be required to upgrade the following IT systems in relation to ESLs for goods and services:
- XML schema; and
 - the Electronic Data Interchange messaging facilities.
- HMRC understands that where changes are required, in some instances costs incurred by software suppliers will be passed on to software users, in others software suppliers will bear the cost. HMRC is in the process of identifying what changes may be required and will publish guidance on the ESL requirements to assist business.
- 5.45 HMRC notes that respondents have commented that businesses required to submit ESLs for services who are on non-standard tax periods will incur greater compliance burdens because they will need to build reporting functions for ESL purposes that are out of line with reporting for financial purposes.
- 5.46 HMRC considers that businesses will be affected differently depending on the IT systems an individual business has in place and the level of intra-EC trade. In addition to IT upgrades, HMRC recognises that there may also be some additional annual costs if the required new accounting procedures require more staff resource. Based on the information provided these costs cannot be quantified, but given the numbers of businesses that could be affected and the potentially complex changes to rules, HMRC recognises that these costs could be in the order of tens of millions of pounds.

Other one-off compliance costs

- 5.47 Respondents also commented that the requirement for invoices for reverse charge services to indicate that supplies are subject to a reverse charge will require one-off changes to invoice templates. This is a pre-existing requirement so UK businesses currently supplying reverse charge services should already be complying with it. Therefore, any one-off costs will be confined to UK businesses that currently supply B2B taxable services where the place of supply will change to fall under the new B2B general rule. The actual number of

affected businesses is not known but HMRC considers that the estimated one-off cost to business will be about £110 per business in 2009.

Annual costs

Administrative burden: quarterly submission of ESLs for intra-EC supplies of taxable general rule services

5.48 Based on filing patterns for ESLs for goods, it is estimated that the 130,000-140,000 affected businesses would submit about 400,000 ESLs per year on a quarterly basis (based on patterns observed in administrative data on ESLs for goods) as the overall average number of forms submitted is less than four per year because nil returns are not required.

5.49 The requirement to complete ESLs imposes an estimated additional annual administrative burden on the estimated 130,000-140,000 affected UK businesses of £4.3-4.6 million in 2008 values (£3.9-4.2 million in 2005 values).

5.50 Supplies of services subject to the B2B general rule that are exempt in the customer's Member State should not be reported on an ESL. In order to make this decision UK businesses will need to familiarise themselves with the VAT liability provisions in the Member State of consumption. Extensive comments have been made by consultees on the compliance burden of this requirement unless clear guidance is provided and a pragmatic approach to its operation is adopted.

5.51 A greater take-up of electronic filing of ESLs by the time of implementation would reduce the administrative burden cost to affected businesses. HMRC has not quantified this cost because it is not known at this stage what the take up of electronic filing might be. A wider analysis of the effects of increased use of online filing is in the published impact assessment *HMRC Online Services: Increasing Use of Online Filing and Electronic Payment*, available at <http://www.hmrc.gov.uk/ria/5-online-services-carter.pdf>

Administrative burden: UK businesses receiving supplies of taxable general rule services from suppliers established outside the UK who will be required to apply the mandatory reverse charge³ and the time of supply rule changes

5.52 UK businesses receiving supplies of taxable general rule services from suppliers established outside the UK will be required to apply the mandatory reverse charge and the time of supply rule changes.

5.53 Under the reverse charge procedure the customer acts as if they are both the supplier and the recipient of the services by accounting for the VAT due on the supply and recovering the VAT on the supply in accordance with their entitlement to recover under the normal rules.

5.54 The administrative burden to businesses would be based on the cost of extracting and including the VAT element and the value of reverse charge services they receive to complete boxes 1, 4, 6 and 7 of the VAT return.

5.55 In 2007 HMRC published an Impact Assessment on the introduction of the reverse charge for businesses trading in mobile phones and computer chips. This Impact Assessment estimated the total extra administrative burden to businesses of the introduction of the reverse charge was about £90 per business. The £90 additional administrative burden per business covers administrative burdens for suppliers and customers. HMRC has used this cost per business for the purposes of this Impact Assessment.

5.56 Of the 65,000-75,000 UK businesses referred to in sections 5.29-5.33 above, there will be businesses that already apply the reverse charge and businesses that receive only exempt supplies of general rule services (the latter are not required to apply a reverse charge) which are not expected to face any significant additional administrative burden. HMRC has assumed that an estimated 5,000 UK businesses will switch from claiming overseas VAT using the Refund Scheme to applying the reverse charge and these businesses are

³ The mandatory reverse charge for B2B cross-border taxable supplies of general rule services is distinct from the reverse charge for supplies of goods of a kind used in MTIC fraud.

estimated to face a gross additional administrative burden cost totalling £0.45 million in 2005 values. This gross figure excludes the saving these businesses will be making by no longer submitting claims using the Refund Scheme (see section 6.4).

Administrative burden: Monthly submission of ESLs for intra-EC supplies of goods

5.57 Since the requirement to submit monthly ESLs is based on monetary thresholds, HMRC has assumed that it is only the larger businesses described within the Standard Cost Model that will be affected. However, it is recognised that smaller businesses making a few supplies of goods of high value could also be affected.

5.58 UK suppliers will be required to submit monthly ESLs for goods where they make intra-EC supplies of goods over a threshold of £70,000 in the current and four previous quarters in 2010 and 2011, and £35,000 per quarter from 2012 onwards.

5.59 Some 88,000 businesses currently submit ESLs for goods. HMRC estimates that 15,000 businesses will be required to submit ESLs for goods on a monthly basis with effect from 1 January 2010; with an additional 7,000 UK businesses submitting monthly ESLs for goods when the threshold is reduced from 1 January 2012 onwards.

5.60 Based on comparisons between the annual administrative burdens of monthly VAT returns and quarterly VAT returns across businesses of all sizes, it is expected that moving to monthly ESLs for goods would increase the administrative burdens to businesses in 2010 by about £1.3 million in current prices (about £1.2 million in 2005 prices) and the changes effective from 1 January 2012 would then lead to a total administrative burden of about £1.8 million in current prices (about £1.6 million in 2005 prices).

Administrative burden: Reduced time to submit data

5.61 The time available for both the submission of ESL data by businesses to HMRC and for HMRC to process and exchange the data with other Member States will be reduced from the current three months to one month after the end of relevant ESL reporting period. Following consultation with businesses HMRC will allow businesses up to 14 days after the end of the ESL reporting period to submit their paper ESLs and 21 days to submit electronic ESLs.

5.62 In broad terms, the deadline does not entail a formal administrative burden (since such a change is not related directly to the actual information provided) but HMRC recognises that some businesses would incur additional costs in meeting a shorter deadline. For example, businesses have indicated that they may have to employ more staff in order to meet the deadlines.

5.63 Less time to submit data could also lead to an increase in errors or an increase in penalty processing work if businesses do not submit on time, resulting in increased administrative burdens.

5.64 In respect of penalties, HMRC intends to apply a 'light touch' approach to new declarants of ESLs for supplies of services. As such HMRC will:

- assist businesses to help them meet their obligations (for example by issuing clear guidance); and
- take into account, when considering whether penalties apply for any areas of non-compliance in relation to legal requirements, difficulties faced in adjusting to the changes.

HMRC costs

One-off costs

5.65 There are a number of expected one-off costs to HMRC in relation to the changes. The main one-off costs to HMRC will be:

- publicising the requirements to businesses;
- producing of tailored guidance;
- dealing with queries from businesses on the new requirements;

- the potential increase in enforcement and compliance monitoring work;
- IT upgrades; and
- redesigning the current VAT 101 form.

5.66 Publicity and guidance costs will predominantly be incurred on a one-off basis and quantified costs to date in this respect are estimated to be about £100,000. There will be ongoing costs, particularly for dealing with queries from businesses and potential increases in enforcement and compliance work.

5.67 HMRC will need to upgrade some IT systems to accommodate:

- the requirement to include the information HMRC receives in relation to ESLs for services (in addition to ESLs for goods) on the VAT Information Exchange System (VIES) under EC legislation (Council Regulation (EC) No. 143/2008 of 12 February 2008):

<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0001:0006:EN:PDF>

This is so that the information on ESLs submitted by UK suppliers of services provided to VAT registered customers in other Member States can be accessed by the tax authorities in the customer's Member State. Changes will be needed to the existing VIES database to cope with the additional data that needs to be captured and stored and to cope with increased usage; and

- changes required for the anti-fraud measures connected with intra-EC transactions, for example reduced time to submit, increased number of ESL forms. The IT changes will be required to recognise when the new due date had been reached and trigger potential penalty action. Reduced time to submit and exchange data would concentrate demands for HMRC processing resource.

5.68 The IT changes will be delivered by an in-house development team. To reduce overheads in testing and code changes, this work will have to be amalgamated with work required to deliver monthly ESLs and the reduced timescale for submission. Reduced time to exchange data will be likely to lead to an increase in data correction messages: both those from the UK to other Member States and those received by the UK from other Member States.

5.69 The current quantified costs for HMRC's IT system upgrades is estimated to be £1.4 million. Costs may increase.

5.70 HMRC will need to modify slightly the design of the current ESL form (VAT 101) so that it can be efficiently scanned, and to specify the use of a code for separately identifying intra-EC supplies of taxable services.

Annual costs

5.71 HMRC will need extra resources in relation to the introduction of ESLs for services, the monthly submission of ESLs for goods and the reduced time to process and exchange data with other Member States to:

- deal with queries from businesses on the new requirements;
- deal with a potential increase in enforcement and compliance monitoring work;
- deal with a potential increase in data errors and non-compliance penalties;
- key in ESLs for goods and services; and
- publicise to business on an ongoing basis the requirements in relation to completion and submission of ESLs for services. It is expected that this will be a small residual cost each year for newly VAT registered businesses or existing VAT registered businesses that have started making intra-EC supplies. HMRC intends to target its publicity to businesses that will be affected by these changes. However, it is recognised that a wide number of sectors could be affected and therefore the publicity needs to be extensive.

5.72 Quantified costs are estimated to be about £1.3 million annually.

5.73 HMRC will have a total of one month to submit and exchange data from the end of the relevant period and costs in terms of extra resources required to comply will be incurred. Ongoing operational, IT service and staffing costs are expected to be in the order of £millions.

5.74 In addition to collecting the information sooner from businesses, HMRC will be required to make use of that more timely information more quickly, reducing the time between the occurrence of possible intra-EC VAT fraud and its detection.

6 Benefits

Place of supply of services

6.1 The aim of the place of supply of services changes is to modernise and simplify the rules and to achieve, as far as possible, taxation in the place of consumption. This will be a benefit to businesses that are already registered for VAT, but will also benefit businesses registering for VAT on or after 1 January 2010.

6.2 Most supplies of services to business customers in other Member States will be subject to the general rule for the place of supply of services. Therefore UK businesses will not be required to charge UK VAT on such supplies but will retain entitlement to recover UK VAT they have incurred in order to make their supplies, subject to the normal rules. UK businesses will not, as a consequence, suffer cash-flow problems due to customers paying VAT late (that is to say, after the date the business is required to remit payment to HMRC). HMRC considers this to be a benefit to affected businesses.

6.3 UK businesses receiving taxable supplies of general rule services from suppliers established outside the UK will be required to apply a mandatory reverse charge. The UK businesses receiving such supplies from businesses established in other Member States will no longer need to pay overseas VAT and claim a refund from the supplier's Member State or suffer the associated cash-flow consequence pending repayment. HMRC considers this to be a benefit to affected businesses.

6.4 HMRC has assumed that fifty percent (2500) of the 5,000 businesses estimated to be switching from claiming using the Refund Scheme will save an estimated £0.3 million in administrative burden costs. This is on basis that the estimated 2500 businesses will cease having to submit refund claims for overseas VAT, because the supplies of services they receive will no longer be treated as made in another Member State and subject to VAT in that Member State. Instead the supply will be treated as made in the UK and thus will be subject to UK VAT (and the reverse charge procedure if the supplier is not established in the UK). The remaining 2500 businesses are assumed to be required to apply the reverse charge with effect from 1 January 2010 and to continue incurring overseas VAT on certain supplies of goods or services they receive. Therefore these businesses would need to submit a refund claim if they wished to recover the overseas VAT.

6.5 Respondents identified a benefit to small businesses of the place of supply of services changes. Currently, where a B2B supply of services is made in another Member State, a small business may be required to register in that Member State if the customer cannot account for the tax under a reverse charge. The new general rule for B2B supplies will mean that small businesses making intra-EC supplies of such services will not be required to register in another Member State because the customer will account for any tax due using the mandatory reverse charge.

6.6 Businesses should find it simpler to determine whether UK VAT is chargeable on cross border supplies of services because those that are not supplied where the customer is established are more clearly defined. There are currently borderline issues in terms of whether a service should be treated as supplied in the UK under the current basic rule or is covered by Schedule 5 of the VAT Act 1994 (supplied where the customer belongs). HMRC considers that this may be a significant benefit for some businesses but perhaps less so for other businesses.

6.7 Tax practitioners and HMRC staff new to the place of supply of services rules should need less time than at present to understand the legislation.

6.8 HMRC does not hold data that permits quantification of these benefits and consultees were unable to provide quantitative data in this respect.

Anti-fraud measures

6.9 As stated in section 2 above, the benefit as a whole is that these measures should play some part in reducing intra-EC VAT fraud. However, these benefits are not quantifiable. VAT MTIC fraud represents a serious threat to the revenues of all Member States, although estimates of the level of fraud across the EC vary. The table below shows estimates of attempted fraud and the impact on HMRC’s VAT receipts. In the UK attempted fraud was estimated at between £0.5 billion and £2.0 billion in 2007/08, but has been much higher in earlier years – it was at a peak of £4.0 billion to £6.0 billion in 2005/06.

Estimates of MTIC Fraud (£bn)

	2005-06	2006-07	2007-08
Attempted Fraud			
Upper Bound	6.0	5.0	2.0
Lower Bound	4.0	2.5	0.5
Impact on VAT receipts			
Upper Bound	4.5	3.5	2.0
Lower Bound	2.5	1.5	0.5

6.10 The UK believes that the main changes, for monthly ESLs for significant trade in goods and quicker submission of ESLs will improve its capacity to limit the impact of fraud by providing information earlier and in a form which can be used more easily in conjunction with quarterly VAT returns.

7. Cost summary for businesses

7.1 Summary table of Standard Cost Model anticipated compliance and administrative burdens costs (in 2009 values).

	One-off compliance costs £m / expected magnitude	Annual administrative burdens costs £m / expected magnitude (in current prices)
Quantified costs		
UK businesses not required to submit ESLs for services or goods	28.3-28.6	N/A
UK businesses required to submit ESLs for services	8.6-9.2	4.3-4.6
UK businesses affected by the increased submission of ESLs for goods from 1/1/2010 onwards	0.3	1.3
Additional UK businesses affected from 01/01/2012 onwards	0.2	0.5
UK businesses required to apply the mandatory	4.3-5.0	0.5

reverse charge		
Total	41.7-43.3	6.6-6.9
Unquantified costs		
IT upgrade costs	Tens of millions	-

7.2 HMRC notes that new businesses and businesses starting to make supplies of services that are affected by the changes covered in this Impact Assessment will need to familiarise themselves with the changes depending on how they are affected. It is recognised by HMRC that there will be a cost to businesses in this respect, but because the place of supply of services rules have been simplified, it should take these businesses less time than currently to familiarise themselves.

7.3 There will be overlap in terms of the impact on particular businesses of the various elements of the place of supply of services changes and the measures to combat tax evasion connected with intra-EC transactions. For example:

- the ESL requirements will impact on those businesses supplying taxable general rule services supplied to VAT registered customers in other Member States; and
- the mandatory reverse charge will be of most interest to businesses receiving supplies of taxable general rule services from suppliers established outside the UK.

While available data does not allow HMRC to tell how much overlap there will be for individual businesses, it is expected that the place of supply of services changes and the measures to combat tax evasion connected with intra-EC transactions as a whole will impact most heavily on businesses involved in large volumes of two-way trade with businesses established in other Member States.

8. Implementation plan

Consultation stage

8.1 HMRC has consulted on the VAT Package place of supply of services and the measures to combat VAT fraud connected with intra-EC transactions with business and other stakeholders. Section 4 of this Impact Assessment refers.

Implementation stage

8.2 Following the consultation, this implementation Impact Assessment has been published along with a consultation response document.

8.3 The UK legislative changes for the place of supply of services will be included in Finance Bill 2009.

8.4 The changes to combat VAT fraud connected with intra-EC transactions, other than a minor amendment to primary legislation can be made via secondary legislation. Draft legislation to implement the ESL requirements and the time of supply changes will be published.

8.5 The changes will come into effect in accordance with the timetable laid down by the European Commission.

8.6 Draft guidance on the place of supply of services changes will be released as soon as possible, with finalised guidance issued as soon as possible thereafter. HMRC will provide an overview of how the place of supply of services changes will be implemented in the UK.

8.7 The changes covered by this Impact Assessment will be publicised through regular updates.

9. Impact tests

Small Firms Impact Test

- 9.1 The 'Revised Partial Regulatory Impact Assessment' on the draft 'EU Services Directive' commissioned by BERR in 2006 concluded that small businesses were less likely to engage in B2B cross border supplies of services.
- 9.2 However, HMRC considers that the wide ranging nature of the place of supply of services changes and the measures to tackle VAT fraud connected with intra-EC transactions mean that there is the potential for all businesses including those with 20 or fewer employees to be affected.
- 9.3 HMRC sent alerts to organisations representing small businesses to publicise the consultation with a view to obtaining feedback on implementing the changes with the minimum administrative burden for businesses.
- 9.4 A number of consultees asked whether there could be some form of threshold for taxable services subject to the mandatory reverse charge, under which completion of ESLs for services would not be required by HMRC. This suggestion appears to have most relevance to smaller businesses.
- 9.5 Other than the thresholds for intra-EC supplies of goods, the EC legislation does not allow Member States to provide for an annual ESL reporting period for any business that makes only limited intra-EC supplies of goods and services. The UK will continue to provide for this de-minimis threshold which is currently set at goods or services below a value of £25,500 per annum.
- 9.6 Given the threshold below which ESLs for goods can continue to be submitted quarterly and since HMRC thinks that small businesses are less likely to make cross border supplies of B2B general rule services, although it cannot be assumed that small businesses will not be affected, HMRC does not expect there to be a disproportionate impact on small businesses.
- 9.7 Consultees commented that while small businesses that are not registered for VAT would not be required to submit ESLs for intra-EC B2B taxable general rule supplies, this could increase the difficulty of identifying such supplies.
- 9.8 However, HMRC recognises that if some small businesses are affected by the ESL, reverse charge and time of supply requirements the one-off costs from changing systems and becoming familiar with the changes could be significant in context.

Competition

Place of supply of services changes

- 9.9 The various elements of the place of supply of services changes could affect all UK businesses making supplies of services in some way rather than a particular segment of the UK economy or group of businesses. This means that in one respect, no particular group is put at a disadvantage. Businesses involved in intra-EC trade are affected more than other businesses, but the aims of the changes are to achieve taxation in the place of consumption across the board as far as possible.

Anti-fraud measures

- 9.10 The measures only affect businesses involved in intra-EC trade. Although, therefore, no particular group is put at a disadvantage, the additional burdens placed on businesses engaged in such trade could, at the margin, affect the ability of some businesses undertaking intra-EC trade to compete with those who are not.
- 9.11 In essence, although small businesses are not likely to be affected to any great degree, the compliance costs of the changes as a whole may, at the margin, make it more difficult for some legitimate businesses to take part in intra-EC trade while trying to prevent fraudulent activity in the same arena.

Other Impacts

9.12 The various elements of the place of supply of services changes could apply to all UK businesses making supplies of services. The measures to tackle tax evasion connected with intra-EC transactions apply to all UK businesses involved in intra-EC trade. They will not be expected to significantly increase legal aid impacts. They 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 will they significantly impact on:

- health and well being;
- race equality;
- disability equality; or
- gender equality.

10. Caveats and risks

10.1 As part of its consultation HMRC welcomed representations from interested parties, particularly with a view to submissions of quantitative evidence.

10.2 Where data provided by respondents was representative it has been used to update the costs previously calculated in the consultation stage Impact Assessments and has been included in this Impact Assessment.

10.3 The key caveat is that a number of assumptions have been necessary to quantify many of the administrative burden and compliance cost estimates. The estimates are believed to be broadly indicative of expected impacts.

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	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
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 to disclose information to HMRC or to third parties. The SCM considers which activities a business has to do to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens applying to different sizes of business.

The SCM estimates the costs of using agents; the costs of undertaking work in-house; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation not existed. It considers the costs which apply to a normally efficient business and the costs to businesses which comply. The SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The Impact Assessment template requires SCM figures to be presented in May 2005 prices, as admin burden reduction targets relate to a May 2005 baseline. The Impact Assessment also uplifts those figures to current day prices.

Summary: Intervention & Options

Department /Agency: HMRC	Title: IMPACT ASSESSMENT OF IMPLEMENTATION OF THE NEW VAT REFUND PROCEDURE	
Stage: Final	Version: 1.0	Date: 23 November 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/en/legis/20091001/chap093010.htm>

Contact for enquiries: Irene Frost

Telephone: 020 7147 0685

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 within three years of implementation.

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:



Date: 23 November 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' 1. Most of the one-off costs will be borne by HMRC. HMRC will incur about £5.7m to design and implement an IT system, plus annual maintenance costs of £0.9m annually. 2. An estimated 30,000 UK businesses and agents will face one-off costs of £1.9m for familiarisation and setting up compatible IT.
	One-off (Transition)	Yrs	
	£ 7.6 million	1	
	Average Annual Cost (excluding one-off)		
	£ 0.9 million	15	Total Cost (PV) £ 18.8 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' 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.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit		
	£ 2.2 -2.4 million	15	Total Benefit (PV) £ 27.3-30.0 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) +£8.5 -11.2 million
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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?			N/A		
What is the value of changes in greenhouse gas emissions?			N/A		
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	£ 1.9 to 2.1	Net Impact -£ 1.9 to 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 made the draft legislation available to businesses and advisers on our Website in May 2009 and 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. Feedback received suggested no unforeseen drawbacks and mainly relates to queries as to registration procedures for the on-line system. Full details of these procedures will be made available on the Website in November 2009.

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.
- 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 initially have minimal effect on the time spent and cost on claiming a refund. However, once they become familiar with the new system this Impact Assessment assumes there will be a 50% reduction in costs for businesses not using agents. Similar assumptions regarding agents costs were made in the previously published Consultation Impact Assessment but feedback from agents in response to that consultation suggested agents costs would not change. This Implementation Impact Assessment therefore assumes a range between no change and a 50% reduction in agents costs and also acknowledges 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.

Costs

- 5.8 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. As in the previous Consultation Impact Assessment, the net present value figures have been calculated using an annual discount rate of 3.5% and over a period of 15 years. This long term period has been chosen to give a full picture of the interaction between the one-off costs and the ongoing benefits.
- 5.9 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>
- 5.10 The cost burden is mainly faced by HMRC and the benefits are mainly accruing to businesses.

Costs to UK businesses – one-off compliance costs

- 5.11 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.
- 5.12 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.
- 5.13 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 and HMRC will then carry out electronic verification checks before forwarding the claim electronically to the Member State of Refund.
- 5.14 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 mandate to file VAT returns on-line by 1 April 2010 – some businesses will already have registered on the Gateway.

- 5.15 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.
- 5.16 No additional admin burden costs to businesses over and above the current are expected after the changes.
- 5.17 All UK businesses affected are expected to face about £1.9 million one-off compliance costs associated with the changes.

Costs to HMRC

- 5.18 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.
 - In the Impact Assessment published in April 2009, we stated that we hoped to reduce the initial estimated costs of £18.2 million. By focusing on those aspects which will bring the greatest benefit to the majority of customers, one-off costs have been reduced by £10 million, but there has been a small increase in continuing costs of £0.3 million annually.

Other costs not quantified

- 5.19 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.

- 5.20 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.
- 5.21 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 initially be similar to time spent on current claims but this would reduce by 50% once claimants become familiar with the new system. The costs for agents could be reduced by between 0% to 50% and the reduction could be passed on to businesses. Depending on the outcome of these factors businesses in other Member States could save between £1.9 to 2.1 million in 2005 prices (or £2.2 to 2.4 million in 2009 prices) in admin burden costs.
- 6.6 Similar savings could 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

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	5.5	-
Staff	0.2	-
System maintenance costs	-	0.9
Total	5.7	0.9
Grand Total (costs)	7.6	0.9
Quantified benefits		
Time admin burden saving¹	-	2.2 -2.4 (1.9- 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 only 7 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 about £7.6 million and the ongoing cost of £0.9 million have a present value of about £18.8 million. In contrast, the benefits in terms of the ongoing saving in administrative burden of £2.2–2.4 million p.a. (2009 prices) have a present value of £27.3-30.0 million over the 15 years.
- 7.4 The benefits are permanent and will continue beyond 15 years.

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 was exposed via the HMRC website to business and other stakeholders for further comment.

Implementation stage

- 8.2 Primary legislation was enacted in Finance Bill 2009. The Statutory Instrument will be laid in time for the changes to take effect from 1 January 2010.
- 8.3 The draft secondary legislation was exposed to businesses and advisers in order to informally obtain their views on the potential impact. Feedback received was minimal, and restricted to comments about assumptions on agent's fees in the original Impact Assessment (covered in paragraph 5.6 above), and suggestions on the structure of the draft secondary legislation, which were taken into account where appropriate. A full consultation was not 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 formed part of the informal consultation process.
- 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.

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	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
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.

Summary: Intervention & Options

Department /Agency: HM Revenue & Customs	Title: VAT Flat rate scheme (FRS): Impact Assessment of changes to the flat rate percentages in January 2010.	
Stage: Final	Version: 1	Date: 7 December 2009
Related Publications:		

Available to view or download at:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

Contact for enquiries: Stephen Davies

Telephone: 0151 703 8653

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

Businesses using the FRS apply a flat rate percentage to their turnover to arrive at their VAT liability. The rate used is dependent upon the business sector and is set by reference to net VAT payable by businesses in each sector.

The flat rates were recalculated in 2008 to take account of the reduction in the standard rate of VAT and to provide a more up to date reflection of net VAT liabilities in each sector. They now need to be amended again to reflect the reversion of the standard rate to 17.5%. This impact assessment covers options for revising the flat rates.

What are the policy objectives and the intended effects?

The policy objective is to ensure that the flat rate percentages reflect the standard rate of VAT, as well as current business patterns. This will maintain equality of treatment between businesses that use the FRS and those that do not.

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

- A. A straight mathematical calculation to reflect the change in the standard rate of VAT.
- B. Option A plus technical changes to reflect up to date business patterns. This is consistent with the approach previously adopted in recalculating the rates and better achieves the policy objective of maintaining equality of treatment with non-scheme users. For these reasons it is the preferred approach.

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

The flat rates are reviewed annually and so the effect of the change will be assessed in late 2010.

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 reasonable view of the expected costs and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:



Date: 7 December 2009

Summary: Analysis & Evidence

Policy Option: **B**

Description: **Option A plus technical adjustments to reflect more up to date information on sectoral VAT liabilities.**

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Businesses may expect their flat rates to return to pre-December 2008 levels. The rates will actually be set higher for about 31% of scheme users. This may encourage some of the affected businesses to leave the scheme and revert to normal accounting. If a business does choose to leave the scheme, it will lose the benefit of the admin savings that the scheme provides.
	One-off (Transition)	Yrs	
	£ 100,000 – 500,000	1	
	Average Annual Cost (excluding one-off)		
	£ 200,000 – 900,000		
			Total Cost (PV) £ 2m – 8m
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Some flat rates will be set lower than they were before 1 December 2008, which may encourage businesses within these sectors to join the scheme. Businesses using the scheme save an estimated £45 in admin burdens at today's prices.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£100,000 – 300,000		
			Total Benefit (PV) £1m – 2m
Other key non-monetised benefits by 'main affected groups' The corrections address unfair advantages that otherwise develop in favour of businesses eligible to use the FRS, in those sectors where latest VAT payment data suggest the existing flat rate is too low, and against FRS users who would have difficulty in using normal VAT accounting, in those sectors where latest data suggest the existing rate is too high.			

Key Assumptions/Sensitivities/Risks There is little evidence for how sensitive businesses are to rate changes when deciding whether to join or leave the Flat Rate Scheme. As a consequence, the costs and benefits are given within a wide range.

Price Base Year 2010	Time Period Years 10	Net Benefit Range (NPV) £-1m to -5m	NET BENEFIT (NPV Best estimate) £-3m
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What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		1 January 2010	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£0	
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?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ N/A	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A
Are any of these organisations exempt?	No	No	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£200k – 700k	Decrease of	£100k – 200k
Net Impact			£100,000 – 500,000

Key:

Annual costs and benefits:	(Net) Present
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Evidence Base (for summary sheets)

1 The problem and the need for intervention.

- 1.1 The FRS is an optional scheme that was introduced in 2002 and is available to businesses with a turnover not exceeding £150,000. The aim of the scheme is to simplify the way businesses account for VAT, so that less time is spent keeping VAT records and calculating the VAT due.
- 1.2 Businesses using the flat rate scheme apply a flat rate percentage to their VAT-inclusive turnover. The percentage applied is determined by the trade sector best describing the activities of the business. There are 55 sectors with rates currently varying from 2% to 12%. These percentage flat rates are designed to reflect the net tax payable by businesses in the same sector not using the scheme.
- 1.3 The flat rates were recalculated in 2008 to take account of the reduction in the standard rate of VAT and to provide a more up to date reflection of sectoral VAT liabilities. As the standard rate will revert to 17.5% on 1 January 2010 the rates need to be amended again.
- 1.4 This impact assessment covers the options for revising the flat rates.

2 Policy objectives and intended effects

- 2.1 The policy objective is to ensure that the flat rate percentages reflect the standard rate of VAT, as well as more up to date business patterns. This will maintain equality of treatment between businesses that use the FRS and those that do not.

3 The options

- 3.1 Option A – This is a straight mathematical calculation to reflect the reversion of the standard rate of VAT.

Option B – This is the same calculation as option A - but includes technical adjustments to reflect more up to date business patterns.

This is the preferred option, as it is consistent with the general approach to recalculating the rates and best achieves the policy objective of maintaining equality between those businesses which use the scheme and those which do not.

4 Costs and benefits

- 4.1 There are currently c190,000 businesses using the FRS, each enjoying an administrative saving of approximately £40 against the Standard Cost Model (SCM), which is based on 2005 prices. At today's prices, this is approximately £45.

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the admin burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model', an activity-based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

- 4.2 The costs and benefits under **Option A** are estimated to be zero, because.

- The Flat Rates are being adjusted to reflect the standard-rate of VAT increasing from 15% to 17.5% only and businesses which currently benefit from using the scheme will continue to do so. Overall, these rate changes should not cause businesses to join or leave the flat rate scheme.
- Changing the flat rates was part of the standard rate change measure. Any compliance costs incurred by FRS users in dealing with two separate rates are therefore included in the standard rate change impact assessment.
- This option was rejected because it fails to take the opportunity to reflect the most up to date data which can ensure fairness between people in and outside the scheme.

4.3 The annual costs and benefits under **Option B** are estimated as follows:

- Because the flat rates are averages of the VAT liability per sector, some businesses pay more tax under the scheme than they would otherwise, and some pay less. When these averages are recalculated, individual businesses' position against the average will change and some, who will pay more as a result of the new sector averages, will find that they are paying more tax in the scheme than outside it, so they may choose to leave the scheme. Conversely others will find themselves paying less under the scheme and may choose to join it.
- The £45 saving does not change for those that remain on the scheme, but the overall administrative burden will decrease or increase by £45 times the net number of businesses who join or leave the scheme.
- We would expect usage of the scheme to increase in sectors experiencing a relative rate decrease, and the usage of the scheme to reduce in sectors experiencing a relative rate increase. The magnitude of these changes is difficult to predict, although upper and lower bound estimates can be made..
- We can estimate how much VAT would be paid by some businesses using FRS if they used normal VAT accounting based on historical VAT return data. We take these businesses as being representative of each sector.
- In order to ascertain an upper bound for the number of businesses **leaving** the scheme in sectors experiencing a relative rate rise, it was assumed businesses will leave the scheme if anything we estimate they gain from the scheme is less than the rate rise or if their rate increases above the strict arithmetical equivalent of the change in the standard rate and we estimate they already use the scheme at a VAT loss.
- In order to ascertain a lower bound for the number of businesses **leaving** the scheme, we estimated the number of current "winners" (whose actual rate is lower than their sector average) and the proportion of them who would become "losers" after their sector rate increase, and then applied this fraction to the number of users in the sector.
- The decrease in FRS usage as a result of relative rate increases is estimated to be between 5,000 and 19,000.
- We examined the distribution of net VAT paid relative to turnover for eligible businesses not using the flat rate scheme by sector. Combining this information with the current take up rate of the scheme and the relative change in rates, we estimated an upper bound for the number of businesses **joining** the flat rate scheme in sectors experiencing a relative rate reduction. This was based on the assumption that no businesses would use the flat rate scheme if they would pay more VAT as a consequence, making use of scheme highly sensitive to rate changes.
- Given the admin burden saving of FRS, the sensitivity to rate changes amongst VAT users is likely be less than assumed above. The upper bound figure for potential gainers was therefore halved to arrive at a reasonable lower bound for the increase in businesses joining.

- The increase in FRS usage as a result of relative rate reductions is estimated to be between 3,000 and 6,000
- Once we have upper and lower bound estimates for the changes in FRS usage, we can apply the average annual admin burden saving of £45 to arrive at the average annual benefits and costs of the technical corrections.
- The admin burden baseline figure is calculated in the same way, but using £40 per businesses (2005 prices) and reducing the resulting value to reflect that the population of VAT registered businesses was less in 2005.

4.4 The one-off costs of Option B are estimated as follows:

- Businesses leaving the Flat Rate Scheme will incur one-off compliance costs as a result of familiarisation, extra book keeping checks and potentially IT system changes.
- Businesses which start a new VAT return on 1st January are likely to leave the scheme on this date if they leave as a direct consequence of an increase in their flat rate. The average one-off compliance costs beyond what they would incur as part of the standard rate change are estimated to be £4 for familiarisation and £18 for IT system changes. Businesses leaving the scheme will also have one-off book keeping costs associated with checking sales are correctly ascribed to before or after they left the scheme. For businesses which opt to leave on 1st January, these checks would need to be carried out as part of the standard rate change and are therefore not additional one-off compliance costs for this measure.
- Most businesses which do not start a new VAT return on 1st January and leave the scheme will still have to deal with using two flat rates prior to leaving. These businesses will have one-off book keeping costs associated with dealing with two flat rates and one standard rate; as opposed to just dealing with two flat rates if they remain on the scheme. These businesses are estimated to have average one-off compliance costs of £7 for book keeping or outsourced accounting.
- Around 40% of VAT registered businesses start a new VAT return on 1st January.
- The upper bound one-off compliance cost (based on 19,000 businesses leaving the FRS) is therefore estimated to be
 - One-off cost = $(£4 + £18) \times 19,000 + £7 \times 19,000 \times 60\% = £500,000$.
 - The same calculation based on 5,000 businesses leaving FRS yields a one-off cost lower bound of £100,000.

4.5 Calculation of Net Present Value figures.

- The net present values have been calculated to a ten year horizon, discounting estimated future costs and benefits at a rate of 3.5%. The impacts were capped at a ten year horizon as this is common for measures with indefinite impacts.

4.6 Rounding of figures.

- Annual and one-off costs and benefits have been rounded to the nearest £100,000.
- The 2005 Admin Burdens baseline figures have also been rounded to the nearest £100,000.
- All Net Present Value figures are rounded to the nearest £1,000,000.

5. Implementation

5.1 Implementation of the changes will include legislative amendments and guidance for both businesses and HMRC staff. The changes will be incorporated into the standard rate change publicity and will take effect from 1 January 2010.

6. Impact tests

6.1 The scheme was introduced after consultation and we continue to examine the needs of small businesses, consulting where appropriate. However, the flat rates have been revised on this occasion to reflect the wider change in the standard rate of VAT. Therefore, this is a necessary change.

6.2 The scheme is specifically designed by HMRC to aid small businesses. The changes will therefore impact on small businesses in the UK that currently use or are considering using the scheme. The scheme is available to businesses with annual turnover not exceeding £150,000. A business must leave the scheme if its total income in the previous year exceeds £225,000, although it may continue to use the scheme if it can show that its income will not exceed £187,500 in the coming year.

6.3 These changes will not affect the ongoing administrative burden reductions for businesses using the scheme, which are the main rationale for the scheme.

6.4 The change does not directly or indirectly limit the range of suppliers, or limit the ability of suppliers to compete. It also does not limit suppliers' incentives to compete vigorously.

6.5 Initial screening indicates that this change will not have a significant impact on:

- legal aid
- the Human Rights Act
- emissions of greenhouse gases or other environmental impacts
- health and well being
- race equality
- disability equality
- gender equality
- rural proofing

7. Caveats and risks

7.1 Although the costs are based on estimates of business behaviour, they are believed to be broadly indicative of how scheme users will react to the increase in flat rates.

7.2 Estimates of the reduction in usage of the scheme in sectors receiving a rate increase are based on the assumption that businesses which would pay less VAT using standard VAT accounting than when using the Flat Rate Scheme after a rate increase will leave the scheme. If this is not the case and a significant number of businesses decide to remain on the scheme in order to enjoy the reduced administrative burden of the Flat Rate Scheme, then the additional admin burden resulting from the changes will be less.

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	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
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 to disclose information to HMRC or to third parties. The SCM considers which activities a business has to do to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens applying to different sizes of business.

The SCM estimates the costs of using agents; the costs of undertaking work in-house; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation not existed. It considers the costs which apply to a normally efficient business and the costs to businesses which comply. The SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The Impact Assessment template requires SCM figures to be presented in May 2005 prices, as admin burden reduction targets relate to a May 2005 baseline. The Impact Assessment also uplifts those figures to current day prices.