

Summary: Intervention & Options

Department /Agency: HMRC	Title: EU Legislative Proposals to combat tax evasion connected with intra-Community transactions	
Stage: Consultation	Version: 1.0	Date: 8 July 2008
Related Publications: EC Proposal COM (2008) 147 to amend Council Directive 2006/112/EC and Council Regulation (EC) No 1798/2003		

Available to view or download at:

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

Contact for enquiries: Kris Romanski

Telephone: 020 7147 0756

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

The European Commission has put forward legislative proposals to address what it sees as two main problem areas. Some elements are aimed at tackling missing trader intra-Community (MTIC) fraud, a virulent form of fraud that generally involves the movement of goods across EU borders. Although estimates vary of the level of MTIC fraud across the EU, it represents a serious threat to the revenues of all Member States, and in the UK alone, attempted fraud was estimated at between £2.25 billion and £3.25 billion in 2006/07. Other elements are a response to recently agreed changes to the EU rules for intra-Community supplies of services. Although these could also provide anti-fraud benefits, their main aim is to provide a system of control for services, similar to that which already exists for goods.

What are the policy objectives and the intended effects?

The policy objectives are to improve the working of the existing intra-Community VAT system and to help tackle intra-Community VAT fraud. The intended effects are earlier availability of VAT information on intra-Community transactions, and improved speed of information exchange between Member States (MS). This would allow quicker verification of transactions and help identify and monitor fraud, which will in turn allow MS to develop timely and effective countermeasures. Another objective is to obtain additional and more consistent information on intra-Community transactions which would allow cross-checking of transactions to assure that tax is accounted for properly.

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

The proposal does not have options as such, but eight elements (five of which are tabled in this impact assessment) across three broad categories: EC Sales Lists (ESLs) – increased frequency, reduced time to submit, reduced time for HMRC to exchange data with its EU counterparts and the option of electronic file transfer; VAT returns – mandatory monthly returns for certain businesses, an extra box recording intra-Community purchases of services subject to reverse charge rules, and the option of electronic file transfer; and VAT time of supply – rule changes. The measures relating to electronic file transfer would have no impact on the UK and therefore are not considered in detail.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? If proposals are implemented, a Compliance Cost Review is expected to be carried out once the policy has bedded in (typically between 1 and 3 years afterwards) This will examine whether the predicted changes in compliance costs were accurate and reasonable.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Jane Kennedy.....Date: 12 July 2008

Summary: Analysis & Evidence

Policy Option:	Description: EC Sales Lists – increased frequency
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by ‘main affected groups’ Estimated tentatively to affect around 235,000 businesses in total; increased administrative burden arises from the additional number of ESL forms submitted per year. Business expects significant one-off IT and staffing costs. HMRC system enhancements required to cope with increased ESL volume, cost unknown at this stage.	
	One-off (Transition) Yrs		
	£ Unquantified		
	Average Annual Cost (excluding one-off)		
	£ 10,500,000	Total Cost (PV)	£ 10,500,000
Other key non-monetised costs by ‘main affected groups’ Increased quantity of ESLs for businesses may mean more errors are made, requiring remedial work and/or increasing the risk of penalties.			

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by ‘main affected groups’ No monetised benefits are expected to accrue to business as a result of this proposal.	
	One-off Yrs		
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 0	Total Benefit (PV)	£ 0
Other key non-monetised benefits by ‘main affected groups’ Increased frequency of ESLs would allow tax administrations in the EU, including HMRC, to identify suspect transactions more quickly and easily, enabling them to restrict the potential for VAT fraud losses but it is not possible to quantify the revenue benefits of this proposal.			

Key Assumptions/Sensitivities/Risks

Key assumption is with regard to the number of affected businesses (especially the figure for services suppliers who will be required to submit ESLs for the first time in 2010).

Price Base Year 2008	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Proposal 1/1/2010
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	£ 1.6 million
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£0
What is the value of changes in greenhouse gas emissions?	£ 0
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro 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 £9,600,000	Decrease of £ 0	Net Impact £ + £9,600,000

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

Summary: Analysis & Evidence

Policy Option:	Description: EC Sales Lists – reduced time to submit to HMRC
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by ‘main affected groups’ Businesses submitting ESLs to HMRC could have up to one month from the end of the relevant period rather than the current 42 days (depending on how long HMRC need for intra-Community information exchange). Compliance cost in terms of extra effort required. Continuing staffing costs and one-off IT costs expected, of the order of £ millions.		
	One-off (Transition) Yrs £ millions			
	Average Annual Cost (excluding one-off) £ millions			
	Total Cost (PV)		£ millions	
Other key non-monetised costs by ‘main affected groups’ The shorter time limit may mean that for businesses currently taking longer than a month to prepare ESLs, additional staff may be required to ensure the deadline would be met. Less time may lead to more errors.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by ‘main affected groups’ No monetised benefits are expected to accrue to business as a result of this proposal.		
	One-off Yrs £ 0			
	Average Annual Benefit (excluding one-off) £ 0			
	Total Benefit (PV)		£ 0	
Other key non-monetised benefits by ‘main affected groups’ Reducing the time to submit ESLs would also help to allow suspect transactions to be identified more quickly, enabling tax administrations to take more timely action to restrict the potential for VAT fraud losses.				

Key Assumptions/Sensitivities/Risks

Exact deadlines for businesses to submit ESLs will depend on how long HMRC will need to process and exchange the data, which will have to be done within the same month. Risk from lack of information with which to quantify the number of affected businesses and their potential costs.

Price Base Year 2008	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Proposed 1/1/2010
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?	£ 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 £	Decrease of £	Net Impact	£

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

Summary: Analysis & Evidence

Policy Option:	Description: Monthly VAT returns for businesses purchasing total values of goods and reverse-chargeable services from other EU member states above €200,000 per annum
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Increased number of VAT returns required from a tentative estimate of 80,000 affected businesses per year, increasing their VAT return administrative burden. These returns are likely to be complex. Extra staff may be required to deal with increased workload (cost unknown) and IT adjustments may be needed.		
	One-off (Transition) Yrs			
	£ Unquantified			
	Average Annual Cost (excluding one-off)			
	£ 35,000,000	Total Cost (PV)	£ 35,000,000	
Other key non-monetised costs by 'main affected groups' Businesses moving onto monthly returns may face cash-flow costs from the resulting alterations to patterns of VAT payments. Monthly returns may increase risks from repayment-based frauds.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' No monetised benefits are expected to accrue to business as a result of this proposal.		
	One-off Yrs			
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0	Total Benefit (PV)	£ 0	
Other key non-monetised benefits by 'main affected groups' Increased frequency of VAT returns for certain businesses could help faster identification and tackling of attempted intra-Community VAT fraud.				

Key Assumptions/Sensitivities/Risks
HMRC lacks complete administrative data to establish fully the affected number of businesses so assumption-driven estimates are required.

Price Base Year 2008	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		Proposed 1/1/2010		
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?		£ 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	£ 30,000,000	Net Impact £ +30,000,000
Decrease of	£ 0	

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

Summary: Analysis & Evidence

Policy Option:	Description: VAT return – extra box to record value of purchases of services subject to the reverse charge
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Businesses will need to decide if the new box applies to them. All two million VAT registered businesses will need to fill it in, if only with a zero, leading to increased administrative burdens. Accounting system changes (possibly complex) and associated familiarisation time will also be required but these have not been quantified.			
	One-off (Transition) Yrs				
	£ 15,000,000				
	Average Annual Cost (excluding one-off)				
	£ 1,200,000	Total Cost (PV)	£ 16,200,000		
Other key non-monetised costs by 'main affected groups' No other non-monetised costs are expected.					

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' No monetised benefits are expected to accrue to business as a result of this proposal.			
	One-off Yrs				
	£ 0				
	Average Annual Benefit (excluding one-off)				
	£ 0	Total Benefit (PV)	£ 0		
Other key non-monetised benefits by 'main affected groups' The data in the new box would be checked against data on sales in the ESLs. This could provide an indicator as to whether the recipient of reverse charge services has accounted for them properly; helping to control revenue risks.					

Key Assumptions/Sensitivities/Risks Key assumption is with regard to the one-off costs from time taken by businesses to decide if they are affected by the proposed new VAT return box or not. This one-off cost assumes between five minutes and two hours per business depending on the ease of the decision, across the two million VAT-registered businesses, at an average rate of £20 per hour.

Price Base Year 2008	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	Proposed 1/1/2010			
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?	£ 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	£1,100,000	Decrease of	£0	Net Impact	£+1,100,000

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

Summary: Analysis & Evidence

Policy Option:	Description: Time of supply – rule changes for reverse charge services
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Informal consultees expected to incur significant costs changing procedures for the proposed changes. The number of affected businesses or their costs were not quantified. All VAT-registered businesses dealing in reverse charge services would need to familiarise themselves with new rules, with some system changes. Cost estimates are based on assumptions.	
	One-off (Transition) Yrs		
	£ 6,000,000		
	Average Annual Cost (excluding one-off)		
	£ Unquantified	Total Cost (PV)	£ 6,000,000
Other key non-monetised costs by 'main affected groups' No other non-monetised costs are expected.			

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' No monetised benefits are expected to accrue to business as a result of this proposal.	
	One-off Yrs		
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 0	Total Benefit (PV)	£ 0
Other key non-monetised benefits by 'main affected groups' Revising these rules is designed to ensure that the data on cross-border supplies of services is recorded and reported consistently, which is expected to help control the revenue risks that could arise from such services.			

Key Assumptions/Sensitivities/Risks
Assumptions on time taken to familiarise. No information available with which to quantify likely IT costs, although consultees expect these to be significant.

Price Base Year 2008	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Proposed 1/1/10
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?	£ 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 £0	Decrease of £ 0	Net Impact £ 0

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

Evidence Base (for summary sheets)

1. The issue

1.1 The European Council has concerns about levels of VAT fraud within the EU and asked the European Commission to prepare a Community anti-VAT fraud strategy. An Anti-Tax Fraud Strategy (ATFS) Working Group, made up of representatives of all Member States (MS) and the Commission, has met to discuss options for changes which would address intra-Community VAT fraud. The Commission produced a report for the Council which recommended a number of measures to improve the working of the existing intra-Community VAT system and help tackle fraud. The Council identified priority measures from the Commission's report and asked the Commission to produce legislative proposals for these.

1.2 In March 2008, the Commission produced the first set of proposals which contained changes to reporting requirements for intra-Community trade so that MS are provided with information about intra-Community transactions received in their country much more quickly. In line with discussion at the ATFS, the proposals would affect the frequency of EC Sales Lists (ESLs) and the time taken to submit and exchange them. The proposal also includes changes to the VAT return and time of supply rules for reverse charge services, which had not been discussed by the Commission with MS and were not expected.

1.3 These proposals have not been agreed and are still subject to discussion in the European Council. The Commission has clarified some aspects of the proposal. Where appropriate, this Impact Assessment reflects the clarifications received, and the analysis contained within this document will be taken into account by the UK during further discussions of the proposal. The presence of the individual elements of the proposal in this Impact Assessment does not mean that each will be implemented. The proposal currently shows an expected implementation date of 1 January 2010, should it or parts of it be implemented, but this date may also be subject to revision as discussion of the proposal develops.

1.4 There is no robust estimate of EU-wide VAT fraud, although the level of concern about it has grown in recent years. The UK publishes its own estimates of UK VAT losses from missing trader intra-Community (MTIC) fraud alongside the Pre-Budget Report in *Measuring Indirect Tax losses*. The most recent edition was published in 2007, and contained the following estimates:

Table 1: Estimates of MTIC fraud (£ billions)

	2005-06	2006-07
Attempted fraud:		
Upper bound	4.75	3.25
Lower bound	3.5	2.25
Impact on VAT receipts		
Upper bound	3	2
Lower bound	2	1

2. Policy objectives and intended effect

2.1 The EU Commission's objective is to reduce VAT fraud on intra-Community transactions by increasing the timeliness of relevant data collected, and to legislate for measures which will help MS control the system established in the VAT Package. The intended effect of these changes is that MS will be able to identify new frauds much more quickly, have more data with which to monitor the situation, and rapidly develop new countermeasures to protect VAT revenues across the EU.

2.2 Currently information from quarterly ESLs on supplies to other MS can take up to six months after the supply has been made to become available to the MS in which it should be taxed. A move to monthly ESLs with reduced time for submission and exchange of data between MS, would enable tax authorities to receive information about such supplies much more quickly - in around two months. This would enable earlier comparison of data with VAT returns to identify anomalies for further investigation, for example to identify missing traders or defaulting traders participating in fraud in the UK and those businesses in other MS who supply them. This would enable attempted fraud to be detected more quickly. However, as VAT fraud relating to intra-Community trade is much more prevalent with goods than with services, the benefits, in terms of reduced revenue losses, relate primarily to trade in goods, rather than services.

2.3 The changes detailed in this document are currently proposals and are subject to negotiation by MS in the Council. They are therefore subject to further changes or clarification. However, once a package of measures has been agreed unanimously by all MS, implementation of the agreed measures will become mandatory. Failure by the UK (or any MS) to implement them will risk legal proceedings (known as infraction) by the Commission.

2.4 The UK supports monthly ESLs for goods as it believes this would improve its capacity to limit the impact of fraud by providing information earlier and in a form which could be used more easily in conjunction with quarterly VAT returns. The UK will wish to explore further in discussions the proposal for reduced time limits to submit ESLs and for MS to exchange data as it is likely to be impractical for both these to occur within a month. The UK is less convinced of other elements such as the extra box on the VAT return (to record the value of purchases of intra-Community services subject to the reverse charge), monthly VAT returns for certain businesses and time of supply rule changes, as it believes they would not provide an anti-fraud benefit and they would impose considerable burdens on affected businesses.

3. The options

3.1 The Commission's proposal contains various elements.

ESLs

- Increased frequency of ESLs – from quarterly to monthly.
- Reduced overall time for both businesses to submit ESLs and the MS to exchange data – from three months to one month.
- MS to offer electronic file transfer of ESL data as a method of submission. *(The original proposal appeared to require electronic file transfer to become the norm with MS permitted to authorise submission by other means for certain categories of businesses. However since the initial draft, the Commission has provided a clarification that they intended that*

businesses should be allowed to submit returns by electronic file transfer but should also be allowed to submit by other means such as other electronic methods and on paper.)

VAT returns

- Monthly submission of VAT returns to be compulsory for businesses whose acquisitions of intra-Community goods and purchases of intra-Community services subject to the reverse charge exceeded €200,000 (around £140,000 using sterling-euro exchange rates as of 1 January 1999 as specified in Article 399 of the Principal VAT Directive) in the previous calendar year. MS would remain able to allow other businesses to have longer return periods of up to one year.
- An extra box on the VAT return to record the VAT-exclusive total value of purchases of intra-Community services subject to the reverse charge; and
- MS to offer electronic file transfer of VAT return data as a method of submission. *(The same clarification applies as to electronic submission (file transfer) of ESL data – see above).*

Time of supply rule changes

- Introduction of mandatory rules for reverse charge services:
 - the tax point to be the completion of the service unless an earlier tax point is created by a payment being made or invoice being received; and
 - provision for an annual tax point for continuous supplies of services where there has been no payment or invoice.

3.2 The two proposals relating to electronic file transfer are already in place in the UK via existing facilities; these proposals will therefore not affect the UK, and they are not considered further in this impact assessment.

4. Consultation

4.1 As this is still a proposal, currently subject to further discussion at EU level and to potential changes, no formal consultation has taken place. However the views of businesses and advisers have been sought on the various elements of the proposal and there have been discussions on it at meetings of the Joint VAT Consultative Committee (JVCC). Feedback received to date has included quantification of impacts, but not in monetary terms, and this impact assessment includes narrative on the potential impacts identified by businesses and advisers.

5. Costs and benefits/impacts

5.1 We have already commented at Section 3 that the proposal about use of electronic file transfer to submit ESLs or VAT returns is not intended to be compulsory, it is merely intended that MS should allow electronic file transfer as a submission method (but they can also allow submission by other electronic means or on paper). The UK already offers electronic file transfer for both ESLs and VAT returns, so we do not believe there would be any impact from these proposals in terms of either administrative burdens or compliance costs. Neither do we consider there would be any costs for HMRC as systems are already in place for this.

5.2 The sections below examine costs only. The benefits from all of the measures would accrue to each tax administration, essentially the information to identify fraud quickly and to reinforce control of intra-Community supplies of reverse charge services. Cost figures are informed by data within the Standard Cost Model administrative burden baseline provided to HMRC by KPMG in 2006. 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>.

5.3 In addition to the costs and benefits described below, there may be further 'second round' impacts. For example, the extra information collected could on one hand lead to more enquiries by HMRC, while on the other hand it may enable better risk assessment and allow compliance activity to become more targeted. These additional impacts are not considered further than this overall mention, however. Equally, in general terms, legitimate business will benefit from a reduction in fraud as they will be able to compete without the distortions introduced by fraud.

EC Sales Lists – increased frequency

5.4 The impact of this change has to be considered in light of already agreed changes under the EU VAT Package which will extend coverage of ESLs to include services from 1 January 2010. It is estimated tentatively that this extension to services might lead to another 150,000 businesses submitting ESLs for services per year in addition to the 85,000 or so that are known to submit ESLs for goods already – although there may be some overlap, since if a business supplies both goods and services to other MS then the same form will be used to record data for both. This estimate is tentative because HMRC does not hold data on the number of businesses supplying services to other MS, and will not do so until the VAT package comes into effect.

5.5 The figure of 150,000 businesses relating to ESLs for services is based upon an examination of the VAT register broken down by trade classes, and then in the first instance applying similar patterns as seen amongst traders submitting ESLs for goods. The UK is in general a service-based economy. There is, however, little comprehensive data on exports of services to the EU alone, and even less on the distribution of that trade across businesses. Our expectation is that the initial estimate should be increased, on a subjective basis, to reflect the impact of factors such as:

- inaccurate trade class descriptions (trade classes denote the primary activity of businesses, and may not be entirely accurate. While the initial work only looked at services, it is entirely possible that businesses listed as being involved in goods-related activities also provide services of some description, or are mis-classified); and
- the assumed additional mobility of many services across borders, particularly if they can be provided by electronic means (although language issues and local practices may act as a barrier in some instances).

5.6 While the number of businesses that might have to submit ESLs for services is uncertain, working assumptions use a figure of 150,000 per year based on the above lines of thinking. This gives a total of around 235,000 for both goods and services, although there may be some degree of overlap between the two groups.

5.7 Between them, they might submit around 650,000 ESLs per year on a quarterly basis (based on patterns observed in administrative data on goods ESLs) as the overall average number of forms submitted is less than four per year because nil returns are not required. The

baseline administrative burden cost of ESLs covering both goods and services, if submitted on a quarterly basis, is estimated at approximately £7.5 million in 2008 values. The average estimated cost per form (again in 2008 values) ranges from around £7.30 for smaller businesses submitting electronically, to around £17.75 for larger businesses submitting a hardcopy.

5.8 Moving to monthly ESLs would increase the administrative burden for most businesses (fewer than 1,000 businesses currently submit monthly ESLs); although the same amount of data would need to be reported across the year, it would be spread across more forms than before. For most affected businesses, this will be a threefold increase in the number of ESL forms submitted to HMRC per year - although some may only submit ESLs infrequently even on a quarterly basis due to their trading patterns, and so might not have to submit ESLs on a monthly basis either.

5.9 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 the annual increase in total ESL administrative burdens will be slightly less than a threefold increase. This seems a reasonable conclusion given that the total data content will remain the same, but the number of forms will increase; although there will be more forms to deal with per year, the time spent per form will be less than before. From the VAT return comparison we assume that while the number of forms will increase by a factor of three, the cost will increase by a factor of around 2.4.

5.10 As such, it is expected that moving to monthly ESLs could lead to submission of around 1.3 million more forms, at an additional cost of around £10.5 million in 2008 values. The typical administrative burden increase per year may range from around £45 for smaller businesses submitting ESLs electronically to around £110 for larger businesses submitting a hardcopy. A greater take-up of electronic filing of ESLs by the time of implementation would reduce the cost; for example, a 50% rate of electronic filing would reduce the estimated additional cost to around £9.3 million. The expected reduction in costs from online filing is informed by data within the Standard Cost Model. 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>.

5.11 In addition, businesses would also be likely to incur wider compliance costs. During informal consultation, industry stakeholders have said that the proposed changes to the frequency of ESL submissions would result in significant additional IT costs (a one-off impact), manpower costs (a continuing impact) and an increase in the scale of errors resulting in a higher level of non-compliance and potential additional costs in the form of penalties (a continuing risk, although maybe decreasing over time as the new arrangements would bed in). Consultees have not quantified these costs in monetary terms, but, given the number of businesses involved and the total value of wider compliance costs HMRC considers it reasonable to expect both these one-off and continuing costs to be of the order of millions of pounds. There may also be some costs for software developers, including testing costs, to upgrade ESL software packages, but these have not been quantified at this stage.

5.12 The proposal for changes to the frequency of ESLs would also impact on HMRC in terms of:

- IT changes, as the VIES database (VAT Information Exchange System – the ESL database) would need to be capable of capturing and storing monthly ESLs. Changes are likely to be major and to consume hundreds of man days of IT resource. In addition, the online ESL

channel would be affected and possibly have to be scaled up to ensure it could cope with increased usage;

- resource costs to key an increased number of forms and lines. Estimated costs for increased keying is around £560,000 per year (based on an assumption of three times the amount of paper ESLs or lines to key); and
- potential increase in data errors and non-compliance penalties, including resource costs for handling these. Estimated costs for these are £1.6 million per year (based on an assumption of twice the number of traders making errors of defaulting).

ESLs – reduced time to submit data

5.13 The proposal is to reduce 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 MS from the current three months to one month after the end of relevant VAT accounting periods. The exact time which businesses would have to submit ESLs would depend on how long HMRC would need to process and exchange the data with other MS: this would have to be done within the same month. 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 may have to adapt systems and practices in order to compile accurate information sooner, and/or more staff may be required in order to do so. These concerns have been highlighted during informal consultation, although such potential costs have not been quantified. Still, given the numbers of affected businesses total one-off costs of system changes and continuing staffing costs could be of the order of millions of pounds.

5.14 HMRC IT changes would also 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. Shorter time to submit data could lead to an increase in errors or an increase in penalty processing work if businesses do not submit on time. Estimated increased compliance costs are shown at paragraph 5.12. The estimate includes costs for all ESL elements of the proposal.

ESLs – reduced time for MS to exchange data

5.15 This part of the Commission's proposal would ensure that as well as collecting the information sooner from businesses, HMRC would play its part in making use of that more timely information more quickly, reducing the lag between the occurrence of possible intra-Community VAT fraud and its detection. The amount of time that would be allocated to HMRC to exchange the data would have an impact upon the time afforded to the trader. How this time is apportioned would be a decision for the UK to make and would not be covered by EU legislation.

5.16 However, this would require some HMRC IT development which would be delivered by an in-house development team. To reduce overheads in testing and code changes, this work would have to be amalgamated with work required to deliver monthly ESLs and the reduced timescale for submission. Reduced time to exchange data would be likely to lead to an increase in data correction messages: both those from the UK to other MS and those received by the UK from other MS. This could have an impact on resources required to handle these but this is currently unquantified.

VAT returns – monthly submission for certain businesses (above a set threshold)

5.17 The proposal would require monthly submission of VAT returns, but MS would be able to set longer accounting periods for those businesses whose intra-Community purchases of goods and/or reverse charge services is nil or below a threshold of €200,000 in the previous calendar year.

5.18 Most VAT registered businesses in the UK are on quarterly accounting periods. As this proposal stands it would be likely to impose a considerable administrative burden on larger businesses that are involved in intra-Community purchases of goods and reverse charge services who would have to submit twelve VAT returns per year instead of the four returns currently submitted. However, some businesses already submit monthly VAT returns (generally if they are normally in a net VAT repayment position); these businesses would not face a change.

5.19 As current administrative data required and held by HMRC includes purchases of goods but does not include separately identified values of intra-Community purchases of services subject to reverse charge provisions, the full impact of this proposal is unclear. HMRC data for 2007-08 shows that around 30,000 businesses involved in intra-Community purchases of goods exceed a level of around €200,000. This compares to around 85,000 businesses submitting one or more ESLs per year at present, which relate to sales of goods to other MS. As a (very tentative) working assumption that there is some relationship between suppliers and purchasers of intra-Community goods, we might say therefore that for every three businesses submitting goods ESLs there is one business acquiring goods over the threshold.

5.20 If we then assume that services might follow a similar pattern, it could be concluded very tentatively that with an estimated 150,000 businesses that might have to submit ESLs for services following the introduction of the VAT Package (see above), there might be around 50,000 businesses that would have to go on monthly VAT returns as a consequence of purchasing reverse charge services from other MS above the threshold. Leaving aside further complications from the possibility of overlap between those dealing in both goods and services both of which would contribute towards the monthly VAT return threshold (and the fact that a small number may already be on monthly returns), the basic working assumption is that around 80,000 businesses may have to move on to monthly VAT returns as a result of this part of the Commission's proposal.

5.21 Given the level of the threshold for triggering monthly VAT returns, it is assumed that the very smallest businesses would not be affected.

5.22 There is a very large range in the potential costs per business; a medium business doing its own VAT work might incur an extra burden of around £125 per year, while a larger trader outsourcing its VAT accounts might incur an extra cost of around £5,750 per year. Furthermore, these figures do not assume particularly complex VAT affairs; it is likely that administrative burdens will be increased further if businesses are partly exempt from VAT, for example. Again, these figures are particularly tentative and should be treated with caution.

5.23 Based on existing estimates of administrative burdens for quarterly and monthly VAT returns, it is estimated that the total increased burden for 80,000 businesses moving from quarterly VAT returns to monthly VAT returns is around £35 million per year in 2008 values.

5.24 In addition to the administrative burdens of the VAT returns themselves, informal consultation has identified that wider compliance costs may be incurred; for example, the increased frequency of VAT returns may lead to the need to alter systems and processes. These additional set-up costs have not yet been quantified due to a lack of supporting data, but given the number of businesses involved they are expected to be of the order of tens of millions of pounds. More frequent VAT returns could require additional staffing on a continuing basis – costs for which are expected at present to be of the order of millions of pounds.

5.25 Businesses' cash flow positions will also be affected adversely by paying VAT in smaller amounts more often during the year, although this has not been quantified. We do not know how a proposed threshold would be introduced, for example whether it would be subject to regular review and update to reflect inflation and/or exchange rate fluctuations between sterling and the euro. Assuming that there would be some periodic review and update, this could lead to uncertainty for a business over whether or not the euro threshold has been exceeded at certain times.

5.26 Although HMRC's IT systems already have the facility to enable submission of monthly VAT returns, this proposal would incur costs for HMRC due to necessary IT changes to monitor the threshold to identify businesses required to make monthly returns due to their level of intra-Community purchases of goods and services and amend the return period automatically. This would require a substantial lead-in time and would also need to be prioritised against other key HMRC IT changes. HMRC would also have to assess the capacity of current VAT return systems and processes to cope with an increased volume of VAT returns and costs would be incurred if upgrades were required because of such an increase. No increase in enforcement or compliance costs for HMRC is envisaged, as monitoring would be subsumed in overall VAT enforcement/compliance work and only form a very small part of that.

VAT returns – extra box

5.27 This proposal would require businesses to show the VAT-exclusive total value of their purchases of services subject to the reverse charge separately in an additional box on the VAT return. Businesses will not incur any additional burdens from calculating the value of reverse charge services that they receive, as they are already required to do this in preparation for completing their VAT return.

5.28 When completing the VAT return, the administrative burden for completing an additional box would be based on one of two possibilities: either the cost of extracting and entering the required information for businesses that purchase supplies of reverse charge services from other EU countries, or the cost of entering a zero for all other VAT registered businesses.

5.29 The number of businesses that might have to enter something other than a zero in the new box is not known. For the purposes of this Impact Assessment, the working assumption is that there could be around 150,000 purchasers of reverse charge services in the UK (as well as the same number of suppliers, as detailed in the analysis of the ESL proposals).

5.30 Businesses that currently acquire intra-Community goods complete box 9 on the VAT return; and the cost of completing this box has been used as a proxy measure for estimating the cost of completing the proposed new box for services on the VAT return. It is estimated that the cost of entering something other than zero on the new box is likely to be around 45 pence per business per return, although the burden on businesses with the most complex VAT affairs could be over £5 each.

5.31 Some of these businesses will be on quarterly returns while those with larger values of intra-Community purchases of goods and services may be required to submit monthly returns under the proposal described in the previous section of this document. In line with that previous section, one third of the 150,000 businesses are assumed to be required to submit monthly VAT returns and two thirds are assumed to submit quarterly VAT returns. The resulting total administrative burden cost would be around £450,000 per year in 2008 values.

5.32 For businesses with no intra-Community purchases of reverse charge services (the remaining 1.85 million VAT registered businesses), it is estimated that the time to enter and check a nil return in the proposed additional box may take from 10 seconds to a minute. This cost will range from around £0.05 to £0.30 per business per return, with an average of around £0.10. Assuming quarterly returns for simplicity, the estimated total cost for this part of the VAT population is around £750,000 per year.

5.33 This proposal would also impose a one-off compliance costs on all two million VAT registered businesses because they will have to familiarise themselves with the new box and decide if they are materially affected by the proposed change; some businesses may only have to enter a nil figure in the new box. Appropriately clear guidance would allow businesses with no international trade at all to decide very quickly, while others would need to consider their situation in more detail. Current assumptions are that:

- businesses with no international activities at all account for around 75% of the VAT registered population (around 1.5 million businesses) and would take only five minutes to determine they only need to enter a zero in the new box. No further familiarisation time would be required.
- around 150,000 businesses would definitely have to record something other than zero in the new box. These businesses will need the most time to understand the change and decide what to do; two hours are assumed to be required.
- the remainder - around 350,000 VAT registered businesses - would need to consider the change in more detail, but would conclude they still only need to enter a zero in the new box. One hour per business is assumed in this case.

5.34 Taking average earnings cost for a business around £20 per hour (derived from information within the Standard Cost Model on the hourly time values for office managers), the estimated one-off cost to businesses (using the assumptions above) could be in the region of around £15 million. This is likely to be a one-off cost for most businesses, since it will be clear to most whether the new box applies to them or not. Only a few businesses might have to re-check over time, following particular changes of circumstance.

5.35 In summary for this section, the proposed extra VAT return box could lead to one-off compliance costs of around £15 million and continuing administrative burdens of around £1.2 million in total, in 2008 values.

5.36 Through informal consultation, businesses have said that this proposed change would make them incur significant costs in terms of changes to IT systems and processes although they have not quantified this. In addition, any businesses using software packages during VAT return preparation would incur costs of upgrading it or renewing it to reflect the change in the number of boxes on the VAT return. Similarly, software developers would be affected by this proposed change due to developing new, or upgrading existing, software packages to include

an additional box on the VAT return. Although these costs have not been quantified by consultees, since a new VAT return box would affect all VAT accounting packages and systems this additional set-up cost is expected tentatively to be of the order of tens of millions of pounds.

5.37 In addition to business costs, this proposal would lead to significant costs for HMRC in terms of changes to IT systems. At present likely HMRC costs cannot be quantified in monetary terms. Adding an additional box to the VAT return would affect return processing and any proposed form changes would have to be tested with current scanning equipment and adjustments made to the form and/or equipment as necessary to ensure robust processing. Changes would also be required to the VAT accounting system and tentative estimates indicate that it could take up to 10 staff years over a two year period to develop the VAT accounting system to accept and process an additional box of data. It is also likely that if this development was to go ahead, the VAT accounting system would need to be recalculated to reallocate electronic storage space to individual trader information, which could take up to five days. There could potentially be a knock-on effect to VAT return capture and subsequent processing the impact of which would need to be thoroughly assessed. In addition, there would be costs in developing the online system and such work could severely impact on HMRC's ability to deliver a robust on-line service within the published timescales set for mandating electronic submission of VAT returns under the Carter programme¹. Developments would also be required for the XML VAT declarations service. This would impact not only on HMRC but also on software developers as upgrades to software packages would be required. No increase in enforcement or compliance costs for HMRC is envisaged, as monitoring would be subsumed in overall VAT enforcement/compliance work and only form a very small part of that.

Time of supply rule changes for intra-Community reverse charge services

5.38 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. The proposal would instead make the tax point the time at which the service was completed, unless payments were made or invoices issued earlier, and would create an annual tax point where services are supplied continuously without payment or invoice. Under the new arrangements businesses would need to put in place additional accounting procedures to identify and respond to:

- completion of the service;
- any payment made, or invoice received beforehand; and
- for continuous supplies, quantify the value of services within that year, compare against invoices/payments already made, and account for VAT on any difference.

5.39 As a result of informal consultation, a leading accountancy firm has raised concerns over the time of supply changes.

- Receipt of invoice – how would this be defined in terms of forming a tax point? Would it be a postal delivery date, invoice approval date or date posted into an accounting system?
- Annual tax point – impact on inter-company charges where no invoice raised and no settlement is made, how would these charges be valued or accounted for?
- Would the annual tax point apply to continuous supplies of services only - currently there is no completion tax point on reverse charge services generally?

(These points would have to be addressed once the final EU requirement is established and policy options are being developed for its implementation.)

¹ The programme to implement recommendations made by Lord Carter of Coles in his Review of HMRC Online Services, published in March 2006. Businesses with a turnover above £100,000 and all newly registering traders will be required to file VAT returns online and pay electronically from April 2010.

5.40 The time of supply proposal is not expected to cause any administrative burdens in the sense of requiring more information to be sent to HMRC. However, the wider compliance costs such as familiarisation with the new rules and staff training may well be significant, particularly if solving the issues identified above lead to further complexities in the time of supply rules.

5.41 By way of illustration, if 150,000 businesses are assumed to be involved in reverse charge services and then had to spend two hours each working out how the new rules applied to them in detail, at an average cost per hour of around £20 (derived from information within the Standard Cost Model on the hourly values for office managers), the total cost of familiarisation time might be over £6 million. Changing the time of supply rules would also require some system changes – for example, ensuring the new rules are reflected in accounting software packages and in other business systems.

5.42 This proposed change would be 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; and businesses would need sufficient lead time to build a case to obtain the IT resources necessary to make the changes. These costs cannot be quantified on the information available, but given the numbers of businesses that could be affected and the potentially complex changes to rules, these costs could be of the order of tens of millions of pounds. Any software packages used to calculate figures for the VAT return would be likely to need upgrading to reflect the proposed changes.

5.43 These set-up impacts are expected to form the bulk of the costs from the time of supply rule changes. However, there may also be some additional continuing costs if the final proposals involve more work for businesses as a result of the required new accounting procedures. These are most likely to be in the form of extra staffing costs. These costs cannot be quantified on the information available, but again could be relatively significant depending on the final design of the new rules and systems. At this early stage a prudent estimate of these continuing costs could be of the order of millions of pounds, given the number of businesses potentially affected.

5.44 There is no expected impact on HMRC. Enforcement and compliance monitoring would be subsumed in overall VAT enforcement/compliance work of which the proposed change would only form a very small part.

6. Cost summary

6.1 Summary table of anticipated compliance costs and administrative burdens (2008 values)

	One-off implementation costs £m / expected magnitude	Annual continuing costs £m / expected magnitude
<i>Quantified costs</i>		
Monthly ESLs	Unquantified	10.5
Reduced time to submit ESL	Unquantified	Unquantified
Monthly VAT returns	Unquantified	35
Extra box on VAT returns	15	1.2
Time of supply rules	6	Unquantified
Total quantifiable costs:	21	46.7
<i>Unquantified costs</i>		
Monthly ESLs	IT (millions)	Staffing (millions)
Reduced time to submit ESL	IT (millions)	Staffing (millions)
Monthly VAT returns	IT & systems (tens of millions)	Staffing (millions)
Extra box on VAT returns	IT & software (ten of millions)	-
Time of supply rules	IT & systems (tens of millions)	Staffing (millions)
Total	21 quantified plus expected additional tens of millions	46.7 quantified plus expected additional millions

6.2 Where costs are currently listed as unquantified, HMRC invites further contact from interested parties to try to construct estimates or refine the current expected order of magnitude of each impact.

6.3 There will be overlap in terms of the impact of the various elements of the EU proposals on particular businesses. For example, the ESL elements will impact on those businesses supplying services to other MS; the monthly VAT return element will affect businesses receiving high values of goods or reverse charge services from other MS, and the extra box on the VAT return would be of most interest to businesses receiving reverse charge services from other MS. While available data do not allow HMRC to tell how much overlap there will be for individual businesses, in general it is expected that the proposal as a whole would impact most heavily on businesses involved in large values of two-way trade in reverse charge services with other MS.

6.4 As stated above, the benefit of the proposal as a whole is that these measures should play some part in reducing EU-wide intra-Community VAT fraud. However, these benefits are not quantifiable. MTIC fraud represents a serious threat to the revenues of all MS, although estimates of the level of fraud across the EU vary. In the UK attempted fraud was estimated at between £2.25 billion and £3.25 billion in 2006/07.

6.5 The UK believes that the proposal for monthly ESLs for goods would improve its capacity to limit the impact of fraud by providing information earlier and in a form which could be used more easily in conjunction with quarterly VAT returns. Given the potential scale of fraud, the likely cost of this proposal to business seems reasonable. The UK is less keen on other elements of the proposal as they appear to have little fraud benefit and would impose considerable burdens on affected businesses.

7. Implementation plan

7.1 There is no implementation plan for these proposals at present. Discussion on these proposals is currently still taking place in the council of Ministers so they are still subject to change.

8. Impact tests

8.1 The wide ranging nature of the Commission proposal mean that there is the potential for businesses of any size to be affected - but smaller businesses are unlikely to be affected to any disproportionate degree. For example, a small business supplying goods or relevant services abroad is relatively unlikely to be doing so to large numbers of customers, in which case filling in an EC sales list each month should not involve significant quantities of data and time. The presence of a threshold in the proposal for monthly VAT returns should prevent the majority of small businesses from being affected. However, HMRC recognises that if some small businesses are caught up in some parts of the proposal as they stand, the one-off costs from changing systems and becoming familiar with the changes could be significant in context.

8.2 The same theme applies when examining the potential impacts on competition. The wide scope of the proposal only targets businesses involved in intra-Community trade rather than a particular segment of the UK economy or group of businesses means that in one respect, no particular group is put at a disadvantage. However, in creating something of a dividing line between those businesses involved in intra-Community trade and those not, it is possible that the extra burdens imposed could at the margin affect the ability of some businesses in the former group to compete with those in the latter.

8.3 In essence, although small businesses are not likely to be affected to any great degree, the potentially high compliance costs of the proposal as a whole may make it more difficult for some legitimate businesses to take part in intra-Community trade while trying to prevent fraudulent activity in the same arena.

8.4 The various elements of this proposal, if agreed and implemented, would apply to all UK businesses involved in intra-Community trade. They would not be expected to significantly increase legal aid impacts. They would be in accordance with the principles of sustainable development and would have no significant impact on emissions of greenhouse gases or other environmental impacts. The elements of this proposal are compatible with the Human Rights Act. They would 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.

9. Caveats and risks

9.1 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.

9.2 HMRC would welcome further representations from interested parties, particularly with a view to submissions of quantitative evidence.

9.3 On behalf of HMRC's chief analyst, KAI have confirmed that the assessment of expected impacts (including on compliance burdens, other costs and benefits) is reasonable in the circumstances, being based on appropriate methodologies and making best use of the evidence available.

10. Monitoring and evaluation

10.1 Because this is only a proposal at present which is still under discussion and therefore subject to changes, the timing and form of implementation is not yet known so formal evaluation of any resulting changes is also uncertain. However, 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

A brief outline of the Standard Cost Model

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.