

COMPLIANCE COST REVIEW

REGULATORY IMPACT ASSESSMENT FOR CHANGES TO THE VAT RULES ON THE PLACE OF SUPPLY OF GAS AND ELECTRICITY

1. Introduction

1.1 Background

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in a final Regulatory Impact Assessment (RIA) when the associated legislation is laid before Parliament.

This document summarises the outcome of a post-implementation review of the final RIA that was published in March 2004 for the above-mentioned measure by H M Customs & Excise (C&E). The measure was implemented with effect from 1 January 2005. A copy of the published final RIA is attached.

The review re-assesses the compliance cost analysis published in the original RIA and addresses two main questions:

- whether the estimates of compliance costs used in the RIA were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the RIA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

2. The published RIA

2.1 Description of the policy change

The changes reflected a EU wide agreement to simplify and modernise the VAT rules in response to the liberalisation of the piped gas and electricity markets through deregulation, and an increase in trade between Member States.

The changes were introduced with effect from 1 January 2005 and amended the place of supply of natural gas within the natural gas distribution system and of electricity. Wholesale supplies for resale take place where the

customer's business is established, while supplies made for consumption take place where the gas or electricity is actually consumed. The changes also included:

- relief from VAT on imports from outside the EU of gas through the natural gas distribution system and of electricity;
- changes in the place of supply of services related to providing access to, and use of, gas and electricity distribution systems, and
- a compulsory "reverse-charge" which requires VAT-registered customers to account for VAT where the supplier is located outside the UK.

2.2 Anticipated compliance costs or savings

Section 6 of the RIA anticipated that UK businesses would achieve savings in the region of £1.5 to £3m through no longer being required to register for VAT in other EU Member States. It was also anticipated that non-UK businesses would similarly achieve cost savings in the order of £0.5m by no longer being required to register for VAT in the UK.

3. Conduct of the review

Each compliance cost review is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on making sure that the review itself - and any burden of consultation - are sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by the policy team which implemented the necessary changes to UK VAT legislation. This team worked closely at that time with the UK industry through its Energy Participants Indirect Tax Forum (EPITF). It was the EPITF that provided much of the detail used in the RIA.

This review has therefore focussed on the EPITF as the representative of UK businesses most affected by the changes. We are grateful for the invaluable assistance the group has again provided in canvassing the views of its members. The review also draws on input from HMRC colleagues responsible for the VAT registration of overseas businesses and for import procedures and those directly engaged in applying the VAT rules within the gas and electricity sector

As agreed with the EPITF, consultation took the form of a letter covering the following points:

- the overall effect of the changes on compliance costs for UK businesses and what they have amounted to;
- realisation of the predicted reduction in the need for UK businesses to register for VAT in other Member States;
- identifying the period during which cost savings have occurred or are yet to occur;

- identifying any unexpected additional costs or savings for UK businesses and their reasons;
- establishing whether the compliance cost element of the RIA represented a reasonable prediction based on the information available at the time or whether HM C&E's approach in calculating it could have been improved, and
- establishing the extent to which the VAT changes have succeeded in simplifying and modernising the cross-border VAT treatment of gas and electricity.

The EPITF in turn canvassed its members and provided a response summarising member's contributions.

4. Were the original estimates of compliance costs accurate?

This section addresses the two main aspects - the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
Were the specific types of cost and benefit identified in the RIA incurred?	<p>As anticipated the new rules have succeeded in simplifying and facilitating the cross border trading of gas and electricity for UK businesses. In particular:</p> <ul style="list-style-type: none"> • compliance costs in maintaining registrations in other EU Member States have largely diminished and now only arise in cases where continued registration is required because of other trading activities; <p>A number of other savings were also anticipated, but not quantified. These include:</p> <ul style="list-style-type: none"> • without the need to establish where gas or electricity is physically located, it is now easier to establish the place of supply and so time spent on VAT place of supply matters by UK businesses has been greatly reduced, and • with the physical location of the gas no longer being an issue,

	<p>and with it the need to comply with local VAT requirements, the closure of trades in gas and electricity is now far easier.</p> <p>Furthermore staff training and systems changes did not produce significant costs.</p> <p>Also, as anticipated, the number of UK registrations for overseas suppliers of gas and electricity has reduced and with it the corresponding compliance costs for those overseas businesses.</p>
<p>Were costs/savings incurred at the expected time?</p>	<p>A substantial element of the predicted savings materialised at the outset as expected. Others took a little longer due to factors that were not identified in the RIA.</p> <p>Compliance costs in respect of overseas VAT registrations have largely diminished. The benefit was initially delayed to an extent by businesses experiencing delays in obtaining refunds of VAT in Member States where their registrations were compulsorily cancelled on 1.1. 2005, the date of implementation of the changes. The cancellation of the registrations has resulted in costs of submitting Eighth and Thirteenth Directive claims for refunds of VAT.</p> <p>Some marginal, but nevertheless significant issues, have led to a delay in UK businesses maximising anticipated savings. These arise from continuing inconsistencies in treatment amongst Member States in the application of:</p> <ul style="list-style-type: none"> • the relief from VAT at importation, and • interpretation of what is to be

	<p>treated as “directly linked” for the purposes applying the new rules as they relate to services of access to, and use of, gas and electricity distribution systems.</p> <p>These are issues that HMRC is pursuing at EU level and we are hopeful that a successful outcome will open the way for these further savings.</p>
<p>Were costs/savings incurred by the expected people?</p>	<p>Yes, as anticipated both UK and non-UK businesses have benefited from the changes.</p>
<p>Were any other costs/savings, not identified in the RIA, incurred?</p>	<p>There have been some unexpected side-issues (some transitional, others ongoing) which have had an impact on costs. These arise from:</p> <ul style="list-style-type: none"> • foreign exchange differences where trading is in Euros but, under the new rules, VAT is required to be accounted for in the UK in sterling (this can be managed through effective hedging but still imposes a cost); • inability of IT systems to handle higher monetary values leading to technical difficulties in submitting electronic VAT returns; • premature cancellation of VAT registrations in some Member States that led to transitional difficulties for some businesses; • existence of “force of attraction” rules in some Member States (not UK) which restricts the scope for cancellation of registrations in the Member States concerned and therefore lowers the aggregate savings for those affected;

	<ul style="list-style-type: none"> delays in obtaining refunds of VAT incurred in other Member States through no longer being VAT registered and therefore having to rely on the more protracted (in some Member States) 8th and 13th Directive refund mechanism, and additional time spent dealing with the inconsistency issues subject to ongoing discussion at EU level.
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>These additional costs only became apparent to both UK industry and HMRC after the changes were implemented.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>With one exception the industry view is that they are the result of market forces beyond the control of HMRC. However, the differences in interpretation of the import relief could perhaps have been minimised had the industry been more fully consulted about the relevant technical references during negotiation of the Directive.</p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p>There has been a significant compliance saving as a result of the changes, particularly for those only involved in trading gas and electricity. However, the savings, although still significant, have been reduced by:</p> <ul style="list-style-type: none"> unexpected costs, and remaining inconsistencies in treatment which mean that some savings have yet to be fully realised. <p>But this is to some extent off-set by confirmed gains from the general simplification and facilitation of day-to-day trading activities.</p> <p>HMRC are unable to quantify the</p>

	impact of these savings.
If different from the original RIA, what has caused the discrepancies?	This is a combination of unexpected costs, which were not anticipated at the time of the preparation of the RIA, and the ongoing interpretation issues that have affected the anticipated savings.
With hindsight were the compliance cost estimates correct?	The estimate of compliance cost savings was a fair estimate at the time.

In summary, HMRC believe that the original RIA was accurate in terms of predicting the overall outcome as one of savings (both to the extent that they have been attained so far and taking into account the further savings that can reasonably be expected to accrue once remaining issues have been resolved at EU level). However, the RIA failed to take into account the unanticipated costs that, post implementation, have been found to offset those savings.

5. Was the process used to estimate compliance costs reasonable?

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comment
Who worked on the original RIA?	Place & Time of Supply Team (C&E) and the department's analysts were involved in the RIA.
Was an adequate audit trail maintained?	Yes for the purpose of the original RIA but HMRC accept there is room for improvement in terms of orderly record keeping to support historically the calculations in the RIA.
Was Cabinet Office and/or internal guidance on RIAs followed correctly?	Generally but with room for some improvements, such as: <ul style="list-style-type: none"> • Inclusion of a "do nothing" option, even though the policy was an implementation of an EC directive and hence "do nothing" would have lead to infraction proceedings. • Starting the RIA earlier in the process and thus maximising the RIA's potential as a "living document" within the policy process.
How much effort was devoted to compliance cost estimation, and was	From the outset the driver for these changes was modernisation and

<p>that effort proportionate in the context of the policy measure?</p>	<p>simplification of the VAT rules so as to ease the administrative burden for those engaged in cross-border trading in gas and electricity. Against this backdrop the compliance cost calculation was naturally focused on estimating the extent of the potential savings. This was proportionate in the circumstances given that this reflected the outcome anticipated by both HM C&E and UK industry.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Yes. The team worked closely with the UK industry through its Energy Participants Indirect Tax Forum (EPITF) and it was the EPITF that provided much of the detail used in the RIA</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>There is no evidence of any problem here.</p>
<p>Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?</p>	<p>No.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>The RIA included only one option. The do nothing option was not considered.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>No. This was not necessary as the changes only impact on a very small, clearly defined, category of businesses.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Yes. The HM C&E Analysis Team was involved throughout the process.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Yes – insofar as was considered appropriate given the “win-win” nature of the changes.</p>
<p>Were any assumptions reasonable given the circumstances at the time?</p>	<p>Given the nature of the changes it was a reasonable assumption that the immediate impact for UK businesses would be a dramatic reduction in their costs when those registrations were no longer required in other EU Member States.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Savings were presented as “in the region of”. A range was used on the per business savings to give some indication of the uncertainty.</p>

Were any risks correctly identified addressed and explained?	No specific risks were identified.
Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?	Not appropriate in this case.
Would HMRC do anything differently, if the exercise were repeated, and hence could the RIA process have been improved?	If the process were to be repeated the main changes would be to start the RIA earlier in the process. This would enable the RIA to better fulfil its role as a tool to help design policy.

On this basis we consider that the process of estimating compliance costs was reasonable in this case.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- There is a benefit to establishing a good working relationship with those businesses affected and their representative body.
- Involving those representatives in the negotiating and implementing process as fully as practically possible, particularly in the drafting of legislation which directly impacts on technical aspects of the industry (e.g. in defining the means of importation of gas), can help to ensure that detailed issues which may prevent savings from being realised can be resolved early on in the process.
- Actively working (at EU level) to eradicate remaining inconsistencies in treatment between Member States in this case can maximise benefits for UK businesses.

6.2 Learning points for the RIA and compliance cost process

- Work on the RIA to start as early on as possible to maximise its influence in the policy process.
- Attention should be given to creating and maintaining an adequate paper audit trail to facilitate future reviews.
- HMRC to consider guidance on how to assess compliance costs of UK businesses operating overseas.
- Ensure that all impact assessments include a “do nothing” option, where necessary stating clearly why this might not be a practical option.

7. The way forward

Comments are invited on any aspect of this report or the wider compliance cost review programme

The learning points are being fed into the policy development process directly if particular to one RIA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to create an action plan for HMRC to take forward to improve the RIA process and development.

8. Contact points for further information

For issues relating to the place of supply of gas and electricity specifically:

Bob Gilligan HMRC 100 Parliament Street London SW1A 2 BQ

Telephone: 0207 147 0276

E-mail: bob.gilligan@hmrc.gsi.gov.uk

For issues relating to the compliance cost review programme generally:

Richard Bowyer HMRC 100 Parliament Street London SW1A 2BQ

Telephone: 020-7147-0062

Email: richard.bowyer@hmrc.gsi.gov.uk

If you have a query about your own affairs in this tax area, please contact the HMRC helpline number on 08457 143 143.

THE PUBLISHED REGULATORY IMPACT ASSESSMENT

[Changes to the VAT rules on the place of supply of gas and electricity](#)