

## **HMRC – IMPACT ASSESSMENT**

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

### 2. Purpose and intended effect

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

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

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

The Invoicing Directive (2001/115/EC) amended Article 22 of the 6th VAT Directive<sup>1</sup> to reduce national differences in invoicing requirements and simplify cross border trade. The UK was supportive of these objectives and we believed we had properly implemented the Invoicing Directive.

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

### 3. Consultation

#### Within Government

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

#### Public Consultation

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

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

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

- Obtain feedback on the need for transitional measures.

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

#### 4. Options

##### i) Do Nothing Option

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

##### ii) Make the necessary changes to UK regulations

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

#### 5. Costs & Benefits

##### Benefits

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

##### Costs

###### Option i)

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

###### Option ii)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### *Intra-EC Supplies of Goods (Dispatches)*

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

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

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

#### *Supplies of services subject to the Reverse Charge*

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

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

#### *Businesses from other member States installing goods in the UK*

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

#### *“Triangulation” supplies\**

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

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

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

#### Summary Table of Costings

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

#### 6. Small Firms Impact Test

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

#### 7. Competition Assessment

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

#### 8. Enforcement, sanctions and monitoring

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

#### 9. Implementation and delivery plan

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

#### 10. Post- implementation review

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

#### 11. Summary and recommendation.

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

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## IMPACT ASSESSMENT

### CHANGES TO VAT INVOICING

#### Statement of Ministerial Approval

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

Signed by the responsible Minister

*Jane Kennedy*

FINANCIAL SECRETARY TO THE TREASURY

18th July 2007