

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

2. Purpose and intended effect

a) The policy objective

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

The measure will take effect from 1 April 2007.

b) Background

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

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

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

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

3. Consultation

- Within government

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

- Public consultation

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

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

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

4. Options

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

5. Costs and benefits

- Sectors and groups affected

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

- Benefits

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

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

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

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

- They would not proportionately increase the eligible population.

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

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

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

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

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

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

6. Small Firms Impact Test

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

7. Competition assessment

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

8. Enforcement, sanctions and monitoring

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

9. Implementation and delivery plan

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

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

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

10. Post-implementation review

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

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

11. Summary and recommendation

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

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

Contact point for enquiries and comments:

John Brandwood

HM Revenue and Customs

CT & VAT

Queen Dock

Liverpool

Merseyside

L74 4AA

Phone number: 0151 703 8661

REGULATORY IMPACT ASSESSMENT

VAT: Changes to the Cash Accounting scheme (CAS)

Statement of Ministerial Approval

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister

John Healey

FINANCIAL SECRETARY TO THE TREASURY

6th February 2007