

**EXPLANATORY MEMORANDUM TO THE
VALUE ADDED TAX (AMENDMENT) (No. 2) REGULATIONS 2005
2005 No. 2231**

1. This explanatory memorandum has been prepared by HM Revenue & Customs and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 To reflect the changes to section 80 and section 80A of the Value Added Tax Act 1994 (c. 23) introduced by sections 3 and 4 of the Finance (No. 2) Act 2005 (c. 22), this instrument amends the regulations set out in the Value Added Tax Regulations 1995 (S.I.1995/2518) that prescribe the procedures for claiming a credit of output tax over-accounted for or overpaid and for reimbursing the VAT to consumers who in practice bore the burden of the tax.

2.2 The principal changes to the reimbursement arrangements are that a claimant must notify the Commissioners of any credit he has not reimbursed to consumers in accordance with the undertaking he has given and must repay to the Commissioners any amount they have paid (or repaid) to him with or without any interest that he has not reimbursed to consumers.

2.3 The instrument also provides that for VAT purposes and in the following circumstances, supplies of goods subject to customs warehousing are not automatically treated as taking place outside the United Kingdom and are governed by the ordinary VAT place of supply rules:

(a) if a taxable supplier's business includes supplying goods to non-taxable persons for retail sale, and

(b) that business retails the goods (even though customs warehousing authorisations must not be granted if the premises or storage facilities are used for retail sales) or actually makes such a supply to the non-taxable retailer.

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

None.

4. Legislative Background

Credit for, or repayment of, overstated or overpaid VAT

4.1 Section 80 of the Value Added Tax Act 1994 ("the Act"), before the amendments introduced by the Finance (No. 2) Act 2005, provided taxpayers with a right to claim a repayment of amounts paid as VAT that was not VAT due, subject to a three-year time limit for making claims and on condition that the repayment would not unjustly enrich the claimant. Unjust enrichment normally arises where customers have been charged and paid VAT and the taxpayer has not suffered any loss of profit by including the tax in the price of goods or services that he has supplied.

4.2 Unjust enrichment is, however, disregarded if the claimant enters into and complies with the arrangements for reimbursing customers which are prescribed by the Commissioners in regulations made under section 80A of the Act.

4.3 The amendments to section 80 essentially bring within its scope all taxpayers who have accounted for (but not necessarily paid) an amount by way of VAT that was not due. This has been achieved by changing the right to claim a repayment of an amount paid as VAT which was not due into a right to claim a credit of an amount accounted for to the Commissioners as output tax which was not output tax due. The amendments ensure that all claimants are subject to the defence of unjust enrichment and the reimbursement arrangements. Consequential amendments have thus been made to section 80A of the Act and, by this instrument, to the procedures set out in Parts V and VA of the Value Added Tax Regulations 1995.

Goods subject to warehousing regime: place of supply

4.4 This is the first use of the power to make regulations under section 18(1A) of the Value Added Tax Act 1994 (c. 23) (inserted by section 1 of the Finance (No. 2) Act 2005 (c. 22)).

4.5 Section 18(1) of the Act has long provided for supplies of goods subject to customs warehousing to be treated as taking place outside the United Kingdom (and therefore outside the scope of VAT).

4.6 This has led to avoidance of VAT in the circumstances described in paragraph 2.3.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

Credit for, or repayment of, overstated or overpaid VAT

7.1 Section 80(3) of the Value Added Tax Act 1994, before the latest amendments, only provided for the use of the unjust enrichment defence in circumstances where an amount had been paid as VAT that was not VAT due. This could lead to claims being made arising from identical errors being treated differently, depending on whether or not tax had been physically paid. This led to complaints of unequal treatment. In order to ensure equal treatment of all claims, the wording of section 80 has been amended to extend the defence to all circumstances where VAT has been accounted for to Revenue and Customs, or assessed by them in error, and applies to all of the VAT accounted for or assessed in error.

7.2 The level of public interest is minimal. The changes to primary and secondary legislation are technical changes and are likely only to be of interest to affected businesses and tax advisers.

7.3 The changes are not politically important. They are legally important to correct perceived unequal treatment between claimants.

Goods subject to warehousing regime: place of supply

7.4 Sales of goods within customs warehouses are treated as taking place outside the UK for VAT purposes. The EC VAT law that provides for this trade facilitation measure stipulates that relief from VAT can only be allowed where the amount of VAT payable on removal of the goods from the warehouse corresponds to the amount of VAT that would have been due had the sales in warehouse not been VAT free. This condition has not been specifically reproduced in UK law, and a small number of businesses are exploiting this through an avoidance scheme.

7.5 Import VAT is charged when the goods are removed from warehouse. Where goods are sold before removal, the buyer is normally responsible for accounting for import VAT, and the value of the supply is used as the basis for calculating the tax. The avoidance scheme relies on the fact that import VAT may legally be calculated using a value which is less than the value of any supply within warehouse. The seller supplies goods to non-VAT registered UK customers and removes the goods on the buyer's behalf. The value declared for import VAT purposes is the cost price to the seller, rather than the price paid by the buyer. Those businesses currently engaged in the scheme typically mark up goods by around 500%, and losses to the Exchequer are significant.

7.6 The instrument ensures that the prescribed sales within warehouse will be subject to the normal rules governing supplies of goods within the UK.

8. Impact

Credit for, or repayment of, overstated or overpaid VAT

8.1 A Regulatory Impact Assessment has not been prepared for this part of the instrument, as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is very minimal. Claims for credit of VAT from public sector bodies are not treated any differently from those of private businesses. Therefore, the unjust enrichment defence is being extended to those claims from public sector bodies in identical circumstances to those from the private sector.

Goods subject to warehousing regime: place of supply

8.3 A Regulatory Impact Assessment has not been prepared for this part of the instrument. This is the established policy for anti-avoidance measures, such as this, where the impact on business, charities and voluntary bodies which do not engage in tax avoidance is minimal.

8.4 The Commissioners have agreed with the Better Regulation Executive of the

Cabinet Office that this measure does not call for a Regulatory Impact Assessment for this reason.

8.5 The Commissioners have prepared a Tax Avoidance Impact Assessment which replaces a Regulatory Impact Assessment in respect of these regulations. It can be found on the internet at www.hmrc.gov.uk and a copy is annexed to this memorandum.

8.6 The impact on the public sector is negligible.

9. Contact

Ron Scott at HM Revenue & Customs Tel: 0151 703 8557 or e-mail: ron.scott@hmrc.gsi.gov.uk can answer any queries regarding the recovery of overpayments, etc. parts of the instrument.

John Brandwood at HM Revenue & Customs Tel: 0151 703 8661 or e-mail: john.brandwood@hmrc.gsi.gov.uk can answer any queries regarding the warehousing parts of the instrument.