EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (SECTION 55A) (SPECIFIED GOODS AND SERVICES AND EXCEPTED SUPPLIES) ORDER 2010

2010 No. 2239

THE VALUE ADDED TAX (AMENDMENT) (NO. 2) REGULATIONS 2010

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

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

These instruments, with effect from 1 November 2010, apply a reverse charge for VAT to the supply of emissions allowances and similar units (often colloquially referred to as '"carbon credits") and make consequential amendments to the Value Added Tax Regulations 1995[1] ("the VAT Regulations") to make provision for the fact that a reverse charge now applies to services of a kind used in missing trader intra-community fraud ("MTIC fraud") whereas it had previously only applied to certain goods.

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

None.

4. Legislative Context

4.1 Council Directive 2006/112/EC[2] ("the Principal VAT Directive") (EUR-Lex link[3] establishes a common system for VAT in the European Union. This is implemented in the United Kingdom primarily by VATA and secondary legislation made pursuant to powers in VATA.

4.2 As general rule the Principal VAT Directive requires a supplier of taxable goods or services to account for and pay the VAT due on them. In certain circumstances the VAT must instead be accounted for and paid by the recipient of a supply. A charge to tax in these circumstances is called a reverse charge. A reverse

[1] S.I. 1995/2518
[2] OJ L No 347, 11.12.2006, p.1
[3] Original text http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:347:0001:0118:EN:PDF
Consolidated text http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0112:20100409:EN:PDF

charge may be applied to supplies of goods and services used in MTIC fraud in order to frustrate the operation of the fraud (see paragraphs 7.1 to 7.5).

4.3 From 16 April 2007 the United Kingdom has been permitted, by Council Decision 2007/250/EC[4] (EUR-Lex link[5]), to apply a reverse charge to supplies of mobile telephones and integrated circuit devices. These are goods which are used to perpetrate MTIC fraud.

4.4 Section 55A, as originally inserted into the Value Added Tax Act 1994 ("VATA") by section 19(1) of the Finance Act 2006 (c. 25), enabled a reverse charge to be applied to supplies of goods of a kind used in MTIC fraud. The goods were to be specified by Treasury order pursuant to powers in that section. The Value Added Tax (Section 55A) (Specified Goods and Excepted Supplies) Order 2007[6] ("the 2007 Order"), with effect from 1 June 2007, applied the reverse charge to supplies of mobile telephones and integrated circuit devices.

4.5 In 2009 evidence emerged of MTIC trading involving supplies of emissions allowances and other units which are recognised for the purposes of the European Union greenhouse gas emission allowance trading scheme ("the EU ETS scheme")(see paragraph 7.6). With effect from 9th April 2010 Council Directive 2010/23/EU[7] (EUR-Lex link[8]) inserted a new article, Article 199a, into the Principal VAT Directive. Article 199a permits all member States, until 30th June 2015, to apply a reverse charge to the transfer of allowances and other units that are recognised for the purposes of the EU ETS scheme.

4.6 Supplies of allowances are treated as supplies of services for the purposes of VAT. Section 50 of the Finance Act 2010 (c.13) therefore amended section 55A with effect from 8 April 2010 so that it may now be applied to services as well as goods.

The Value Added Tax (Section 55A) (Specified Goods and Services and Excepted Supplies) Order 2010 (S.I. 2010/2239)

4.7 This Order revokes and replaces the 2007 Order. It specifies the goods and services which are to be subject to a reverse charge pursuant to section 55A of VATA. It reproduces the effect of the 2007 Order in its application to supplies of mobile telephones and integrated circuit devices. In addition it applies section 55A to supplies of allowances and other units recognised for the purposes of the EU ETS scheme. This is the first exercise of that power to apply section 55A to services.

The Value Added Tax (Amendment) (No.2) Regulations 2010 (S.I. 2010/2240)

4.8 This instrument makes an amendment to the title to regulation 38A and also amends regulations 55C(6) and 58(2)(g) of the VAT Regulations. These regulations

[4] OJ L 109, 26.4.2007, p. 42.
[5] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:109:0042:0043:EN:PDF , as amended by Council Decision 2009/439/EC (OJ L 148,11.6.09, p. 14) (EUR-Lex link http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:148:0014:0015:EN:PDF)
[6] S.I. 2007/1417
[7] OJ L 72, 20.3.2010, p. 21.
[8] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:072:0001:0002:EN:PDF

make provision for accounting for VAT in particular circumstances and, before the amendment now described, were drafted on the basis that section 55A of VATA applies only to goods. The regulations are amended to reflect the fact that section 55A may now apply to supplies of services as well as goods.

4.9 A transposition note dealing with the implementation of Article 199a of the Principal VAT Directive is annexed to this memorandum.

5. Territorial Extent and Application

These instruments apply to all of the United Kingdom.

6. European Convention on Human Rights

As these instruments are subject to the negative resolution procedure and do not amend primary legislation no statement is required in respect of them.

7. Policy background

- *What is being done and why*

7.1 These instruments, with effect from 1 November 2010, apply a reverse charge to the supply of emissions allowances and other units recognised for the purposes of the EU ETS scheme and make consequential amendments to the Value Added Tax Regulations to make provision for the fact that a reverse charge now applies to services used for MTIC fraud as well as goods.

7.2 MTIC fraud is a highly sophisticated and well organised criminal attack on the VAT system. The fraud is perpetrated through contrived transaction chains involving supplies of high-value goods or services with the tax loss occurring when the VAT charged by the supplier is not paid to HMRC but can be reclaimed by the recipient.

7.3 MTIC fraud has been used by criminals to steal billions of pounds in VAT from Governments throughout the European Community. In recent years this was most significant in trade in mobile telephones and computer chips known colloquially as “carousel fraud”, with an estimated impact on UK VAT receipts of up to £4.5bn in 2005-2006.

7.4 HMRC has tackled and continues to tackle this fraud operationally, reducing its impact on VAT receipts and successfully catching and prosecuting the perpetrators. However in order to stem the tide of criminal activity on such a scale, it has been necessary to bring in legislative changes.

7.5 From 1 June 2007 a reverse charge has been applied to supplies of mobile telephones and integrated circuit devices. Reverse charge accounting makes it impossible to perpetrate MTIC fraud using the goods or services to which it applies because the customer rather than the supplier accounts for the VAT due on the supply directly to the tax authorities.

7.6 In summer 2009 evidence emerged that MTIC fraud was being carried out using trades in emissions allowances issued by Governments under a European scheme, the EU ETS scheme, designed to reduce carbon emissions by businesses. These allowances are used by certain taxpayers to comply with their obligations under the scheme. They are intangible in nature and therefore treated as services for the purposes of VAT. They are traded in high volumes and at high values.

7.7 In order to combat this fraud on a Europe-wide basis the Principal VAT Directive was amended with effect from 9th April 2010 by the insertion of Article 199a which permits Member States, until 30th June 2015, to apply a reverse charge to supplies of emissions allowances and other units that can be used by businesses to comply with the EU ETS scheme.

7.8 Domestic powers for the application of a reverse charge to the supply of services used in MTIC fraud were introduced by the Finance Act 2010.

7.9 As an interim measure to tackle MTIC fraud involving allowance trading in the United Kingdom, pending the amendment to the Principal VAT Directive, supplies of emissions allowances were subject to a zero rate (which frustrates the fraud in a similar way to a reverse charge). That rate was imposed with effect from 31st July 2009 and will be repealed, with effect from 1 November 2010, by an affirmative instrument to be laid later this year. The scope of that zero rate also included options on emissions allowances as "belt and braces" but the reverse charge cannot be applied to options trading in allowances under the amended EU law. However there is no evidence of fraud in options nor does the options trade lend itself to fraud. Along with futures trades, options are largely transacted in the UK on the markets to which a different zero-rate applies under the Value Added Tax (Terminal Markets) Order 1973[9]

- *Consolidation*

None.

8. Consultation outcome

An informal consultation was conducted with the emissions trade sector which was supportive of the introduction of a reverse charge to combat MTIC fraud.

9. Guidance

Guidance is being published to cover the changes brought about by these instruments.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

[9] S.I. 1973/173

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 Technically, the changes do not discriminate between businesses but few, if any, small businesses are affected.

12. Monitoring & review

It is a requirement of exercising the option to apply the reverse charge under the Directive 2010/23/EU that an evaluation is provided to the Commission by 30th June 2014. HMRC will continue to monitor whether MTIC fraud may spread to other goods or services and what further measures may be appropriate.

13. Contact

Nick Chambers at HM Revenue & Customs Tel: [020 7147 2639] or email: nick.chambers@hmrc.gsi.gov.uk can answer any queries regarding these instruments.

ANNEX

Transposition Note setting out how the Value Added Tax (Section 55A) (Specified Goods And Services and Excepted Supplies) Order 2010 (S.I. 2010/2239) implements the provisions of Council Directive 2010/23/EU which amends Council Directive 2006/112/EC.

Council Directive 2006/112/EC of 28 November 2006[10] ("the Principal VAT Directive") on the common system of Value Added Tax provides the framework governing the harmonization of the laws of the member States relating to VAT. The Directive is implemented in the UK by the Value Added Tax Act 1994 (c.23)("VATA") and various statutory instruments.

Council Directive 2010/23/EU[11] amended the Principal VAT Directive by inserting Article 199a. This article provides a discretion for member States to require a recipient of certain supplies to account for VAT on those supplies (a "reverse charge"). If a member State exercises the discretion it must do so for a minimum of 2 years and must not extend beyond the 30th June 2015. The supplies to which Article 199a applies are supplies of emissions allowances and other units which are used by businesses for compliance with Directive 2003/87/EC[12] (EUR-Lex link[13]) of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community ("the EU ETS Directive").

[10] OJ No L347 11.12.2006, p. 1.
[11] OJ No L72 20.3.2010, p. 1.
[12] OJ No L275 25.10.2003, p. 32.
[13] Original text http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:275:0032:0046:EN:PDF , consolidated text http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625:EN:PDF .

Supplies of emissions allowances and analogous units are treated as supplies of services for the purposes of VAT.

This transposition note concerns the secondary legislation made under section 55A of VATA necessary to specify the transfer of emissions allowances and analogous units as supplies of services subject to a reverse charge.

Article	**Objectives**	**Implementation**	**Responsibility**
Article 1	Inserts Article 199a of the Principal Directive in relation to supplies of services susceptible to fraud. This permits Member States to provide that supplies of emissions allowances and other units used for compliance with the EU ETS Directive's scheme are subject to a reverse charge.	Section 55A of VATA provides that a reverse charge shall be applied to supplies of goods or services which are of a description specified by Treasury Order. Article 4 of the Value Added Tax (Section 55A) (Specified Goods And Services and Excepted Supplies) Order 2010 ("the Order") provides that section 55A of VATA applies to specified services. Specified services are described by article 3 and 6 of the Order as being (i) a transfer of an allowance as described in Article 3 of the EU ETS Directive; (ii) a transfer of an emission reduction unit which can be used by an operator for compliance with the scheme established by the EU ETS Directive as described in Article 3 of that Directive and (iii) a transfer of an emission reduction which can be used by an operator for compliance with the scheme established by the EU ETS Directive as described in Article	Commissioners for Revenue and Customs

		3 of that Directive.	