**EXPLANATORY MEMORANDUM TO**

**THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2019**

**2019 No. 1048**

## 1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

## 2. Purpose of the instrument

2.1 The purpose of this instrument is to make the accounting procedures for value added tax (VAT) clearer in cases where the amount which a customer pays for a supply changes at a later date and to prevent attempts to misuse the existing tax adjustment provisions.

2.2 In particular, the amendments will make it clear that adjustments for decreases in what the customer pays, resulting in a reduction in the amount of VAT payable to HMRC, can only be made in cases where there is a real change to the amount that customer has paid, resulting in a refund to that customer.

## 3. Matters of special interest to Parliament

***Matters of special interest to the Select Committee on Statutory Instruments***

3.1 None.

***Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)***

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business.

## 4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the whole of the United Kingdom.

4.2 The territorial application of this instrument is the whole of the United Kingdom.

## 5. European Convention on Human Rights

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

## 6. Legislative Context

6.1 Regulation 38 of the Value Added Tax Regulations 1995 SI 1995/2518 (the VAT Regulations) requires a business to adjust its VAT account where:

- there has been a change in the consideration (price) for a supply of goods or services that includes an amount of VAT; and

- the increase or decrease occurs after the end of the VAT accounting period in which the original transaction took place.

6.2 This instrument amends regulation 38 and also makes amendments to other accounting provisions in the VAT Regulations. New requirements in relation to the provision of debit notes and credit notes will come into force on 1 September 2019 along with other new rules which will establish clear procedures for accounting for changes in consideration. These changes are made to Part 3 (VAT invoices and other invoicing requirements) and Part 5 (accounting, payment and records) of the VAT Regulations.

## 7. Policy background

***What is being done and why?***

7.1 The amount a customer pays for a supply is, in VAT law, referred to as 'the consideration'. The amount of VAT charged on a supply is based upon the amount of consideration a business receives for that supply.

7.2 The consideration a customer pays for a supply can change at a later date, for example, when a business fails to deliver goods or perform services and the price is reduced or cancelled. The business would then normally send a credit note to their customer and give them a refund. This triggers the entitlement to a VAT adjustment for the supplier. As the amount received from the customer is reduced, so the corresponding VAT must also be reduced.

7.3 Some businesses have attempted to manipulate the existing provisions in order to gain a tax advantage, for example, issuing credit notes internally and then reclaiming VAT without actually refunding customers. The tax tribunals and courts have found in favour of HMRC in relation to such tax manipulation, but some litigation is ongoing. The purpose of these new provisions is to put clear procedures in place to ensure that changes in consideration are properly accounted for.

7.4 This instrument will establish new rules which set out precisely when adjustments for changes in consideration must be accounted for. It will make it clear that adjustments for decreases in consideration cannot be made unless there has been a 'real world' refund to the customer. Consequently, decreases in consideration will only qualify for a VAT adjustment when there has been an actual refund in money by the supplier. Provision is also made to include cases where a set-off against an existing corresponding liability is made, for example, where the customer has not yet paid in full for the supply.

7.5 Additionally, rules regarding the content of the relevant accounting documents (credit and debit notes), and a requirement that they actually be provided to the customers, are being introduced.

7.6 Currently, the VAT Regulations do not state when a credit or debit note should be issued. This instrument introduces a time limit for issuing the relevant accounting documentation. This will ensure that customers receive the documentation they need to make any consequential adjustments promptly, and that VAT adjustments are accounted for in the VAT accounting period in which the price change occurs.

7.7 Specific provision is made to identify when such changes are to be treated as occurring and to make it clear that a failure to make the required accounting entries in the correct accounting period is an error.

7.8 The making of errors and incorrect returns may result in penalties under existing provisions, guidance on which can be found in 'Misdeclaration and repeat misdeclaration penalties (VAT Notice 700/42)'. Such errors must be corrected in accordance with existing provision within the time limits prescribed, see guidance which can be found in 'VAT Notice 700/45: how to correct VAT errors and make adjustments or claims'. Where errors involve a failure to account for decreases in consideration, corrections must be made in accordance with section 80 of the Value Added Tax Act 1994, and within the time limits provided by that section.

7.9 Failure to issue the appropriate credit note or debit note within the relevant time limit will result in a breach of the VAT Regulatory Provisions and a penalty may arise under Section 69(1)(d) of the VAT Act 1994. HMRC's internal guidance on these penalties can be found in 'VCP11132 - Definition of Regulatory Penalties: Conditions and rates for general Regulatory Penalties' .

7.10 Regulation 38 of the VAT Regulations also provides for additional VAT to be paid to HMRC when there are price increases. This instrument introduces rules to ensure that the tax on price increases is accounted for at the correct time and that the appropriate document in the form of a debit note is provided to the customer.

## 8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

## 9. Consolidation

9.1 This instrument amends the VAT Regulations and there are no plans for consolidation.

## 10. Consultation outcome

10.1 In order to prevent putting further tax at risk, a short four-week technical consultation was carried out between 19 March 2019 and the 15 April 2019 by HMRC. The draft legislation was published on the Gov.uk website alongside a Tax Information and Impact Note and responses were invited. Responses were received from the Chartered Institute of Taxation, the Finance and Leasing Association and four businesses.

10.2 The majority of the responses acknowledged that this area of the law needed amending to prevent abuse. The main area of concern was in relation to the new provisions for issuing credit notes and debit notes and how that would operate in the context of existing accounting systems. The instrument has been revised to address such concerns by making the format of the required documents more flexible.

## 11. Guidance

11.1 A Revenue & Customs Brief will provide guidance on the changes introduced by this instrument. The Brief will be published shortly at: https://www.gov.uk/government/collections/revenue-and-customs-briefs#revenue-and-customs-briefs-2019

## 12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A Tax Information and Impact Note was published on 19 March 2019 alongside the draft legislation and is available on the website at: https://www.gov.uk/government/consultations/amendment-to-vat-regulation-38-statutory-instrument-technical-consultation. It remains an accurate summary of the impacts that apply to this instrument.

12.4 There is no significant impact on businesses and other organisations which makes taxable supplies because, although there is a new obligation to issue a credit note within 14 days, most businesses and organisations already do this as part of their general accounting systems and so the impact on them is expected to be negligible.

## 13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses (employing up to 50 people).

13.3 The basis for the decision not to take specific action in this regard is the fact that the changes made by this instrument will not significantly impact the administrative burdens placed upon those businesses.

## 14. Monitoring & review

14.1 The approach to monitoring of this legislation will be through the review of information collected from tax returns and receipts, and information collected by HMRC checking VAT returns and how they have been compiled.

14.2 The regulation does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 under section 28(3)(a) a review clause is not required as the statutory instrument makes or amends provisions relating to a tax.

## 15. Contact

15.1 Richard Lay at HM Revenue and Customs, Telephone: 03000 593190 or email: richard.lay@hmrc.gov.uk, can be contacted with any queries regarding the instrument.

15.2 Eileen Patching, Deputy Director for Indirect Tax Policy at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 Jesse Norman MP, Financial Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.