EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (INPUT TAX) (AMENDMENT) ORDER 2011

No. 1071

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

2. Purpose of the instrument

This instrument amends the Value Added Tax (Input Tax) Order 1992 (SI 1992/3222). The amendment removes the restriction on the right to recover VAT in respect of business entertainment where the entertainment is provided to overseas customers and is of a kind and on a scale that is reasonable, having regard to all the circumstances.

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

None.

4. Legislative Context

4.1 Article 5 of the Value Added Tax (Input Tax) Order 1992 (SI 1992/3222) ('the 1992 Order') imposes a restriction on the right to recover VAT in respect of all business entertainment. The extension to the restriction on the right to recover VAT in respect of all business entertainment now contained in the 1992 Order was made by the Value Added Tax (Special Provisions) Order 1988 ('the 1988 Order'). Prior to the 1988 Order the right to recover VAT in respect of business entertainment was restricted except where it was provided to overseas customers. The extension in 1988 of the restriction on the right to recover VAT to all business entertainment brought VAT rules into line with rules for direct tax purposes.

4.2 The European Court of Justice in Case C-371/07 Danfoss A/S v. Skatteministeriet [2008] has recently confirmed that Member States are not permitted to extend restrictions in this way. As a consequence, as provided for in Article 176 of Council Directive 2006/112/EC, the exclusions provided for under national law at 1 January 1979 are to be reinstated and recovery of VAT will be permitted on business entertainment expenses where is it provided to overseas customers and is of a kind and on a scale that is reasonable, having regard to all the circumstances.

5. Territorial Extent and Application

This instrument applies to the whole of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

7.1 This Order removes the block on the right to recover VAT in relation to the provision of business entertainment to overseas customers to ensure compatibility with EU law.

7.2 Normally, businesses can recover VAT incurred on expenses which are used for business purposes. However, EU law permits Member States to maintain restrictions on the recovery of VAT on certain business expenses that existed in their national legislation at 1 January 1979; these are known as blocks.

7.3 From the inception of VAT in 1973, the UK blocked the recovery of VAT incurred on business entertainment except where it was provided to an overseas customer. In 1988, the UK introduced legislation that removed the exception for overseas customers and, from that date, an extended block on all business entertainment was applied.

7.4 The 1988 extension was considered at the time to be consistent with EU law, but following the decision of the European Court of Justice in Danfoss A/S v. Skatteministeriet [2008] it became clear that the national position was incompatible with EU law. In March 2009 HMRC published a statement inviting repayment claims pending a review of policy in this area.

7.5 On 2 November 2010 HMRC announced the change of policy in a Revenue and Customs Brief and this instrument now amends UK law to remove the incompatibility.

Consolidation

7.6 Not applicable.

8. Consultation outcome

8.1 The draft SI was published for comment in accordance with the Tax Policy Making: Draft Tax Consultation Framework published on 9th December 2010. This sets out a minimum 4 week consultation period for secondary legislation. This consultation came to an end on 28 March 2011. There were no responses.

9. Guidance

New HMRC guidance on the recovery of VAT in respect of business entertainment is available at: http://www.hmrc.gov.uk/briefs/vat/brief4410.htm .

10. Impact

10.1 This measure does not create any additional administrative burdens on business because the removal of this exception allows them to choose to apply

existing VAT recovery legislation. Whilst business will be able to recover VAT that was previously restricted the impact on individual businesses will not be significant.

10.2 Similarly, the impact on the public sector is negligible.

10.3 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

The changes do not discriminate between businesses but few small businesses are likely to be affected.

12. Monitoring & review

No formal monitoring is planned.

13. Contact

David Webb at HMRC Tel: 020 7147 0641 or email: david.webb@hmrc.gsi.gov.uk can answer any queries.