

EXPLANATORY NOTE

**CLAUSE 1: GOODS SUBJECT TO WAREHOUSING REGIME:
PLACE OF ACQUISITION OR SUPPLY**

SUMMARY

1. Clause 1 confers on HM Revenue and Customs power to make regulations prescribing circumstances in which the relief from VAT applying to supplies of goods within customs warehouses, contained in section 18(1) of the VAT Act 1994, shall not apply.

DETAILS OF THE CLAUSE

2. Supplies of goods within UK customs warehouses are treated as taking place outside the UK for VAT purposes. The clause provides HM Revenue and Customs with the power to make regulations detailing circumstances in which such supplies will instead be viewed as subject to normal VAT rules. The change will affect only a tiny minority of those making supplies of goods that are within UK customs warehouses: the overwhelming majority of businesses will be completely unaffected.

3. The Government is introducing the clause in order to address an avoidance scheme. The relief from VAT on sales of goods in warehouse is a trade facilitation measure, so that businesses do not have to account for both supply VAT and, on removal of the goods from warehouse, import VAT. A small number of businesses are however exploiting the relief by declaring values for import VAT that, while complying with UK and Community import valuation rules, result in less VAT being accounted for than would be the case if the supplies in warehouse were taxed. Details of the relief and the avoidance scheme the clause addresses are set out in the background section of these notes.

4. The regulations HM Revenue and Customs make will specify the circumstances in which section 18(1) will be disapplied. Sales of goods by taxable persons that are unable to be treated as taking place outside the UK must be taxed at the normal VAT rate applicable to domestic supplies, and must be accounted for on VAT returns. Import VAT will also be due when the goods are removed from the warehouse. Initially regulations will target a specific avoidance scheme, but will be capable of amendment to address other schemes seeking to exploit the relief.

BACKGROUND NOTES

5. Sales of goods within customs warehouses are relieved from VAT as a trade facilitation measure. The relief is optional under EU law, but a key condition is that the amount of VAT payable on removal of goods from the warehouse corresponds to the amount of VAT that would have been due had the sales in warehouse not been VAT free.

6. The avoidance scheme works as follows. Company A purchases goods from (for example) the USA for £10,000 and lodges them in a UK customs warehouse. It then sells the goods to a number of non-VAT registered UK customers for a total of £30,000. Company A then removes the goods from warehouse on behalf of the new owners but, because it is aware of the price it originally paid for the goods, it can legally declare a value for import VAT of £10,000.

7. Strictly speaking, under EU law company A should account for an amount of tax that fairly reflects both the import VAT and supply VAT. However, the UK allows the supply to be ignored because the declared value of the goods upon which import VAT is charged on removal is usually based on the value of the final supply in warehouse.

8. Thus, in the example quoted import VAT would normally be charged on a basic value of £30,000. However, because company A is able to declare and pay VAT on the earlier value of £10,000, the practice of entirely ignoring the supply for VAT purposes results in a loss to the Exchequer that was never intended by EU or UK legislation.

9. HM Revenue and Customs are challenging these schemes under existing law wherever possible. However, specific legislation is needed to prevent the use of the facilitation measure in particular circumstances where it may give rise to VAT avoidance.

EXPLANATORY NOTE

CLAUSE 2: REFORM OF FUEL SCALE CHARGES

SUMMARY

1. Clause 2 provides for the basis of the fuel scale charge system to be amended to include a fuel scale charge system based on CO² emissions of a vehicle. The clause includes a power to insert Rules and Notes to supplement Table A in section 57 of the Value Added Tax Act 1994. The changes will take effect on a day to be appointed.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that section 57 of the Value Added Tax Act 1994 is amended as follows.

3. Subsection (2) amends section 57(4) of the Value Added Tax Act 1994 by inserting new subsection 57(4A) so that Table A may be substituted for a different Table based on CO₂ emissions.

4. The new subsection 57(4B) provides for flexibility in applying the percentages and monetary amounts in Table A.

5. Subsection 57(4C) provides that Table A may be implemented or supplemented by Rules or Notes.

6. The new subsection 57(4D)(a) - (e) sets out the provisions that may be made in the Notes.

7. The new subsection 57(4G) provides that the Treasury may by Order insert, vary, remove or substitute any or all of the Rules or Notes.

8. The new subsection 57(10) provides that the Treasury may by order amend, repeal or replace subsections (1A) to (3) of section 57.

BACKGROUND NOTES

9. The fuel scale charges are a simplified means of taxing the private use of business fuel. It provides a system of accounting for output tax on road fuel, which is bought by a business and subsequently put to private use. The taxpayer can then claim back all the VAT

charged on road fuel without having to split mileage between business and private use.

10. The existing VAT fuel scale charges system, which is based on engine size and fuel type, was introduced to sit alongside a similar system for direct tax. However, with effect from April 2003, the rules for direct tax changed and a system based on CO₂ emissions was introduced. Subject to obtaining EC Commission approval, HM Revenue and Customs is proposing, therefore, to change the existing VAT fuel scale charge system to one based on CO₂ emissions.

11. The proposed change would align the VAT fuel scale charges system with the direct taxation of the private use of fuel. In line with the Government's wider environmental objectives, it would provide consistent tax incentives for less polluting cars. This is not a revenue raising measure and any change would be revenue neutral overall.

EXPLANATORY NOTES

CLAUSE 3: CREDIT FOR, OR REPAYMENT OF, OVERSTATED OR OVERPAID VAT

SUMMARY

1. Clause 3 provides for the extension of the defence of unjust enrichment by HM Revenue and Customs to all claims, made on or after 26 May 2005 by businesses, for a credit of VAT where the business has over charged and over accounted for tax in error. It provides for HM Revenue and Customs to refuse to give credit for over accounted output tax where, to give credit would unjustly enrich the claimant.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that section 80 of the VAT Act 1994 is amended as follows.

3. Subsection (2) amends section 80(1) as set out below, so that the section, with its unjust enrichment defence and three-year limitation period, will apply to claims for credit of over accounted for VAT on supplies as well as to erroneous payments by way of VAT.

- The new section 80(1) provides that where a person has accounted to HM Revenue and Customs for too much VAT on sales, HM Revenue and Customs will be liable to credit that person with the over accounted for amount.
- The new section 80(1A) provides that where HM Revenue and Customs have assessed a person for VAT and that assessment included an amount that wasn't VAT due, HM Revenue and Customs will be liable to credit that person with the wrongly included amount.
- The new section 80(1B) provides that where a person has paid to HM Revenue and Customs an amount of VAT that was not due, for example by paying a tax liability twice, HM Revenue and Customs will be liable to repay the amount overpaid.

4. Subsection (3) amends section 80(2) so that the claim that must be made under this section will be for the credit of as well as the repayment of any amount.

5. Subsection (4) inserts a new section 80(2A). This provides that where HM Revenue and Customs accept that credit is due, they will only be liable to pay (or repay) the credit net of any VAT liabilities.

6. Subsection (5) amends section 80(3) to provide that HM Revenue and Customs will be able to invoke the defence of unjust enrichment in relation to any claim for credit made under this section rather than, as previously, any net repayment due.

7. Subsection (6) substitutes a revised section 80(3A). It provides that the whole or part of the amount of credit claimed, which has for practical purposes been borne by someone other than the person making the claim, will be subject to the unjust enrichment defence.

8. Subsection (7) amends section 80(3B) so that where the taxpayer has or may have suffered loss or damage due to his mistaken assumptions made about the operation of VAT, that loss or damage should be disregarded in deciding whether, or to what extent, the crediting of an amount, rather than the repayment of an amount as previously provided for, would unjustly enrich him.

9. Subsection (8) substitutes revised time limit rules for lodging a claim under this section.

- The new section 80(4) provides that HM Revenue and Customs will not be liable to credit or to repay an amount to a person making a claim under this section if it is made more than three years after the relevant date.
- The new subsection 80(4ZA) sets out the relevant date for each situation whereby a taxpayer can make a timely claim for a credit of or for a repayment of overpaid VAT.
 - Where the wrongly accounted for VAT was on a return, the claim must be made within three years of the end of the prescribed accounting period for which the return was rendered.
 - Where the wrongly accounted for VAT was on a voluntary disclosure made by the claimant which turned out to be an erroneous disclosure, a claim must be made within three years of the end of the prescribed accounting period in which the disclosure was made.
 - Where the wrongly accounted for VAT was assessed by HM Revenue and Customs, the claim must be made within three years of the end of the prescribed accounting period in which the assessment was made.

- In other cases where there has been an overpayment, the claim must be made within three years of the date of the overpayment.

It also provides that, when a claimant is no longer VAT registered, the prescribed accounting periods set out above will be the period that would have applied if he had continued to be registered for VAT.

- New subsection (4ZB) defines for the purposes of this section what is meant by an erroneous voluntary disclosure made by a taxpayer. It is a disclosure that an amount thought to be due was not accounted for, was made some time afterwards and, in the event, the tax was not due.

10. Subsection (9) substitutes new subsection 80(4A) and deletes the existing subsection (4B). The old section 80(4B)(a) is no longer required and the remainder of the subsection has been combined with subsection (4A) to simplify the legislation. The new subsection provides that the power to make a recovery assessment, when a person has been credited with too much following a claim under this section, is in respect of any amount over credited rather than any amount overpaid.

11. Subsection (10) substitutes a revised section 80(7). It provides that it is only by a claim made under section 80 that HM Revenue and Customs is liable to credit or repay any VAT over accounted for or overpaid. This ensures that the unjust enrichment rules and the three-year limitation period in section 80 cannot be bypassed.

12. Subsection (11) amends the existing heading to section 80 to reflect the change of emphasis in the section, to claims being for credit of overstated output tax as well as for repayment of overpayments.

13. Subsection (12) is consequential and supplementary.

BACKGROUND NOTES

14. The existing wording of section 80 of the VAT Act 1994 which carries the defence of unjust enrichment in section 80(3) only provides for the use of this defence in circumstances where an amount has been paid as VAT that was not VAT due. This could lead to claims arising from identical errors by different taxpayers being treated differently depending upon whether or not tax had been physically paid to HM Revenue and Customs. For example, a repayment trader, i.e. a trader who submits a return where the VAT incurred on his purchases exceeds

the VAT due on his sales such that he is due a payment from HM Revenue and Customs, may charge and account for VAT in error but he is currently excluded from the unjust enrichment defence because his claims are not within the scope of section 80. In order to afford equal treatment of claims, this measure extends the defence of unjust enrichment to all circumstances where VAT has been accounted for to HM Revenue and Customs or assessed by them in error and applies to all of the VAT accounted for or assessed in error.

EXPLANATORY NOTES

CLAUSE 4: SECTION 3: CONSEQUENTIAL AND
SUPPLEMENTARY PROVISION

SUMMARY

1. Clause 4 provides for consequential amendments to other sections of the VAT Act 1994 arising from the amendments made to section 80.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for consequential amendments to be made to the following sections of the VAT Act 1994.

3. Subsection (2) makes a consequential amendment to section 78(1)(a) (Interest in certain cases of official error) so that HM Revenue and Customs are only liable to pay interest on the net amount that HM Revenue and Customs pay or repay on any claim made under the amended provision in section 80.

4. Subsection (3) makes consequential amendments to section 80A (Arrangements for reimbursing customers) to reflect the shift in section 80 to provide for claims for credit of over accounted for output tax. Typically 'repayment' is changed to 'credit.' Provision is also made for regulations to provide for notifications to be made to HM Revenue and Customs.

5. Subsection (4) inserts new subsections in section 80B (Assessment of amounts due under section 80 arrangements) It provides for a new power of assessment to reflect the change of emphasis in section 80 to claims being for credit of overstated output tax. HM Revenue and Customs will be able to assess to recover any credit that was not reimbursed to customers.

- The new subsection 80B(1A) sets out the conditions where the new assessment power will be available, ie where a credit has been given that has not been fully reimbursed to customers.
- The new subsection 80B(1B) provides the new power to assess a claimant, to best of judgement, to recover credit not fully reimbursed to customers. The subsection further provides, to

avoid double jeopardy, that there shall be no liability arising under both the subsection (1) and subsection (1B) assessment provisions.

- The new subsection 80B(1C) provides that, where an amount has been reimbursed to customers, that amount should first of all be deemed to have been funded from any payment made to the claimant before any credit given. This is necessary to determine which assessment provision, subsection (1) or (1B) will apply in the event that all of the credit is not reimbursed to customers.
- The new subsection 80B(1D) provides that nil is an amount for the purposes of this section so that the assessment provision in subsection (1B) bites even where no amount is reimbursed.
- The new subsection 80B(1E) provides that other provisions of the Act apply to the new subsection (1B) assessment as they apply to the existing subsection (1) assessment. This means the same time limits etc will apply without the need for them to be separately specified.

6. Subsection (5) amends subsections 83(t) and (ta) of section 83 (Appeals) so that the right of appeal is extended to decisions given by HM Revenue and Customs on claims for credit and / or repayment of amounts under section 80 and to assessments made for credits not reimbursed to customers.

7. Subsection (6) provides that the amendments made to section 80 and the consequential amendments to sections 78, 80A, 80B and 83 are effective in relation to any claim made under section 80 after 26 May 2005, the day following the passing of the Budget resolution, whenever the claimant accounted to HM Revenue and Customs, HM Revenue and Customs issued an assessment or the overpayment by way of VAT was made.

EXPLANATORY NOTE

**CLAUSE 5: REVERSE CHARGE: GAS AND ELECTRICITY
VALUATION**

SUMMARY

1. Clause 5 extends special valuation provisions to supplies of natural gas or electricity. These rules apply in cases where a UK VAT registered customer is required to account for the VAT on such supplies where they are received from an overseas supplier.

DETAILS OF THE CLAUSE

2. Subsection (1) amends paragraph 8 of Schedule 6 to the Value Added Tax Act 1994 to extend its scope to include supplies of goods treated by section 9A of the Act as being made by the recipient. Section 9A applies to goods in the form of natural gas and electricity. Because the consideration payable to the supplier in these circumstances will not include the VAT due on the supply, paragraph 8 of Schedule 6 provides for the value to be based on the full consideration.

3. Subsection (2) provides that the amendment to paragraph 8 applies to supplies of natural gas or electricity made on or after 17 March 2005.

BACKGROUND NOTES

4. New place of supply rules for natural gas and electricity were introduced from 1 January 2005. As a result, supplies of natural gas or electricity to wholesale customers (i.e. those purchasing for resale) take place where the customer's business is established. For supplies to business and private consumers it is the place of consumption.

5. Where, under these rules, an overseas supplier makes supplies of natural gas or electricity in the UK to a customer who is registered for UK VAT, the supplier does not charge tax. Instead the customer is required to account for the VAT as a "reverse charge". This clause puts natural gas and electricity (which are goods) in the same position, in relation to valuation, as reverse charge services and ensures that VAT is accounted for on the full amount charged by the overseas supplier.

EXPLANATORY NOTES**CLAUSE 6 AND SCHEDULE 1: DISCLOSURE OF VALUE
ADDED TAX AVOIDANCE SCHEMES****SUMMARY**

1. Clause 6 and Schedule 1 amend the requirement for businesses using VAT avoidance schemes to disclose their use. The definition of ‘tax advantage’ is extended to include cases where the amount of a person’s non-deductible VAT is reduced as a result of using an avoidance scheme. The duty to notify avoidance schemes is amended accordingly. In addition, where the Treasury designates a new scheme, a person will not be required to notify the Commissioners about the use of that scheme if he has previously notified it as a scheme including, or associated with, a prescribed provision. The changes will take effect from a day to be appointed by the Treasury.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that Schedule 1, which relates to the disclosure of VAT avoidance schemes, shall have effect.
3. Subsection (2) provides that the changes will come into effect from a day to be appointed by the Treasury.
4. Subsection (3) provides that the Treasury may bring different provisions into effect on different days and make such transitional or saving provisions as they think fit.

DETAILS OF THE SCHEDULE

5. Paragraph 1 provides that this Schedule amends Schedule 11A (disclosure of avoidance schemes) to the Value Added Tax Act 1994.
6. Paragraph 2 amends paragraph 1 (interpretation) of Schedule 11A by providing that, for the purposes of the Schedule, “non-deductible tax” has the meaning given by the new paragraph 2A.
7. Paragraph 3 amends paragraph 2 (obtaining a tax advantage) of Schedule 11A by substituting a new paragraph.

- Sub-paragraph (1) provides that a tax advantage is obtained by a taxable person (a person who is, or is liable to be, registered for VAT) when:
 - (a) the amount accounted for on a VAT return is lower than it would otherwise be;
 - (b) he obtains a VAT credit when he would not otherwise do so;
 - (c) he recovers input tax before the supplier accounts for output tax at a time that is earlier than would otherwise be the case; or
 - (d) the amount of his non-deductible tax is less than it would otherwise be.
 - Sub-paragraph (2) provides that a tax advantage is obtained by a person who is not a taxable person when the amount of his non-refundable tax is less than it would otherwise be.
 - Sub-paragraph (3) defines “non-refundable tax” for the purposes of sub-paragraph (2) as the VAT on:
 - (a) goods and services supplied to him;
 - (b) goods acquired by him from other Member States; and
 - (c) goods imported by him from outside the Member States;but excludes any VAT that he is entitled to be refunded under a provision in the VAT Act 1994.
8. Paragraph 4 inserts a new paragraph 2A (meaning of “non-deductible tax”) into Schedule 11A.
- Sub-paragraph (1) of the new paragraph 2A defines, for the purposes of the Schedule, “non-deductible tax”, in relation to a taxable person, as:
 - (a) input tax for which they are not entitled to credit; and
 - (b) the VAT incurred on goods or services which is not input tax and for which they are not entitled to a refund.
 - Sub-paragraph (2) defines, for the purposes of sub-paragraph (1)(b), that “incurred” means the VAT on:
 - (a) goods and services supplied to a taxable person;
 - (b) goods acquired by him from other Member States; and
 - (c) goods imported by him from outside the Member States.
9. Paragraph 5 amends paragraph 6 (duty to notify Commissioners) of Schedule 11A.

- Sub-paragraph (2) inserts a new sub-paragraph (1)(c). This imposes a duty on a taxable person to notify HM Revenue and Customs where the amount of his non-deductible tax in any VAT return period is less than it would be but for the scheme.
 - Sub-paragraph (3) inserts a new sub-paragraph (2A), which provides that a taxable person does not have a duty to notify use of a designated scheme if he has previously notified his use of that scheme as a designated scheme, or, before it became a designated scheme, he has provided the Commissioners with prescribed information.
 - Sub-paragraph (4) substitutes a new sub-paragraph (5). This provides that a taxable person does not have a duty to notify use of a scheme that is not a designated scheme if he has previously provided the Commissioners with prescribed information.
10. Paragraph 6 makes consequential amendments to paragraph 7(9) (exemptions from duty to notify) of Schedule 11A.
11. Paragraph 7 amends paragraph 11 (amount of penalty) of Schedule 11A. Paragraph 11(2) provides that any penalty is to be calculated by reference to the VAT saving achieved by an avoidance scheme.
- Sub-paragraph (2) inserts a new sub-paragraph (3)(c), which provides that, to the extent that the case falls within the new paragraph 6(1)(c) of Schedule 11A, the ‘VAT saving’ is the amount by which the amount of notional non-deductible tax exceeds his non-deductible tax but excludes any excess that is represented by a corresponding amount that is a VAT saving by virtue of sub-paragraph 3(a) or (b).
 - Sub-paragraph (3) makes consequential amendments to paragraph 11(4) of Schedule 11A.
 - Sub-paragraph (4) inserts a new sub-paragraph (5), which defines, for the purpose of the new sub-paragraph (3)(c), that “notional non-deductible tax” means the amount that would, but for the scheme, have been the amount of the taxable person’s non-deductible tax.

12. Paragraph 8 amends paragraph 12 (penalty assessments) of Schedule 11A by substituting sub-paragraph (3) and inserting a new sub-paragraph (3A).

- The new sub-paragraph (3) applies where it is not possible to readily attribute notional tax to one or more VAT periods for the purposes of calculating a penalty under paragraph 11(3) of Schedule 11A. In those circumstances the Commissioners may determine the attribution of that notional tax to the best of their judgment and notify the person liable for the penalty accordingly.
- The new sub-paragraph (3A) defines “notional tax” as the VAT that would, but for the scheme, have been shown in returns as payable by or to the taxable person, or any amount that would, but for the scheme, have been the amount of the non-deductible tax of the taxable person.

BACKGROUND NOTES

13. Schedule 11A is designed to provide greater information about the take-up of avoidance schemes HM Revenue and Customs already know about and early notice of some new, potentially damaging, schemes. It works by requiring businesses with a turnover over £600,000 to notify HM Revenue and Customs when they use a scheme prescribed in a list of VAT avoidance schemes. Businesses with an annual turnover exceeding £10 million must also notify schemes that include, or are associated with, a ‘hallmark’ of avoidance. These changes will improve the effectiveness of the rules, drawing on the experience of disclosures to date.

14. Under those rules, a scheme is notifiable when, amongst other things, it has as a main purpose the obtaining of a tax advantage by any person. Tax advantage is defined as including reductions in the amount of VAT shown on a VAT return. However, the purpose of many schemes is to reduce the amount of irrecoverable VAT incurred and, unless the reduction is represented by a corresponding increase in credit for input tax on a VAT return, would not be notifiable schemes.

15. Similarly, a taxable person has a duty to notify use of a scheme when it makes a difference to the amount of tax shown on his return. However, for some schemes, this can mean that nobody notifies – the beneficiary’s return may not be affected and the other parties to the scheme may not be registered for VAT, or liable for registration, in the United Kingdom.

16. This provision closes these anomalies by extending the definition of a tax advantage to include a reduction in a taxable person's non-recoverable VAT. That is, VAT that would not be shown on his return. It also extends the definition of a tax advantage to include a reduction in the amount of VAT incurred by persons who are not taxable persons. Consequential amendments are made to the notification and penalty requirements imposed by Schedule 11A.

17. This provision also makes amendments to prevent a taxpayer having to notify a scheme to the Commissioners if he has previously provided prescribed information in relation to that scheme.