EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (SECTION 55A) (SPECIFIED GOODS AND EXCEPTED SUPPLIES) ORDER 2014

2014 No. 1458

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

2. Purpose of the instrument

2.1 This instrument imposes a reverse charge for VAT purposes on certain wholesale supplies of gas and electricity.

2.2 Article 3 of the Order provides that the goods referred to in article 4 of the Order are goods to which section 55A of the Value Added Tax Act 1994 ("the Act") applies and that the supplies described in article 5 of the Order are excepted supplies for the purpose of section 55A.

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

None.

4. Legislative Context

4.1 Council Directive 2006/112/EC ("the Principal VAT Directive") establishes a common system of value added tax applicable throughout the European Union. As a general rule, the Principal VAT Directive requires the person who makes supplies of goods or services to account for and pay the VAT on those supplies. However, in certain circumstances, the VAT may be required to be accounted for and paid by the recipient of those supplies. This charge is referred to as a "reverse charge".

4.2 The Principal VAT Directive was amended by Council Directive 2010/23/EU which inserted Article 199a. Article 199a permits Member States to apply a reverse charge in certain circumstances. Article 199a was itself amended by Council Directive 2013/43/EU which extends the circumstances in which Member States may apply a reverse charge to combat missing trader intra-Community fraud. In particular, it permits Member States to apply a reverse charge until 31 December 2018 and for a minimum period of two years to supplies of gas and electricity to a taxable dealer as defined in Article 38(2) of the Principal VAT Directive.

4.3 Section 55A(6) of the VAT Act 1994 ("the Act") provides that if a taxable person makes a supply of goods or services to which section 55A applies and which is not an excepted supply, and the recipient of that supply is a taxable person and supplied in connection with the carrying on by him of any business, then it is for the recipient on the supplier's behalf to account for and pay tax on the supply.

4.4 Section 55A(9) and (10) confer power on HM Treasury to make an Order specifying the goods or services to which section 55A applies and the description of supplies which are to be "excepted supplies" for the purposes of section 55A.

4.5 Article 3 of the Order specifies that gas and electricity as described in article 4 are specified goods for the purpose of section 55A and that the supplies described in article 5 are excepted supplies for the purpose of section 55A.

4.6 HMRC has also made an instrument which is being laid at the same time as this one which amends the Value Added Tax Regulations 1994 so as to ensure that the obligation to make reverse charge sales statements does not apply to those to whom the Order applies.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to 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 instrument, with effect from 1 July 2014, applies a reverse charge to certain wholesale supplies of gas and electricity to remove the opportunity for missing trader intra-community (MTIC) fraud in the energy sector.

7.2 MTIC fraud is a highly sophisticated and well organised criminal attack on the VAT system. The fraud is perpetrated through 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 is 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 Union. In the UK the Government has previously had to act to combat MTIC fraud in the trading of mobile telephones and computer chips and in trading of emission allowances. A reverse charge for mobile telephones and computer chips was introduced with effect from 1 June 2007 and one for emissions allowances was introduced with effect from 1 November 2010.

7.4 Reverse charge accounting makes it impossible for fraudsters 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 HMRC.

7.5 HMRC has tackled and continues to tackle this fraud operationally with success, reducing its impact on VAT receipts and successfully catching and prosecuting the perpetrators.

7.6 Given the size of the gas and electricity sectors, and in the knowledge that fraudsters are in the market the Government has decided to introduce this instrument now to address the residual risk and prevent any escalation in attacks.

8. Consultation outcome

HMRC has consulted informally with representatives in the gas and electricity trading sector about the introduction of the reverse charge. They are supportive of the introduction of a reverse charge to remove the opportunity of MTIC fraud from their sector.

9. Guidance

HMRC will publish guidance to coincide with the introduction of the reverse charge so that businesses affected have the information they need to be able to make the changes to their systems.

10. Impact

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

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note this instrument was published with Budget 2014 and is available at https://www.gov.uk/government/publications/vat-reverse-charge-for-gas-and-electricity . It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The changes do not discriminate between businesses but few, if any, small businesses are affected. The impact on small and micro businesses is negligible.

12. Monitoring & review

It is a requirement of exercising the option to apply the reverse charge under the Directive 2013/43/EU that an evaluation is provided to the Commission by 30th June 2017. 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 email: nick.chambers@hmrc.gsi.gov.uk can answer any queries regarding these instruments.