

## EXPLANATORY MEMORANDUM TO

### THE VALUE ADDED TAX (SECTION 55A) (SPECIFIED GOODS AND SERVICES AND EXCEPTED SUPPLIES) (AMENDMENT) ORDER 2021

2021 No. 369

#### 1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

#### 2. Purpose of the instrument

- 2.1 This instrument amends Value Added Tax (VAT) reverse charge legislation introduced in 2010 to prevent missing trader fraud by requiring the recipient rather than the supplier of certain emissions allowances and other units to account for VAT. The scope of the reverse charge is currently defined by reference to European Union (EU) Directive 2003/87/EC ("the Directive") that created an EU emission allowance trading scheme (EU ETS). As a consequence of the United Kingdom's exit from the EU, the Department for Business, Energy and Industrial Strategy (BEIS) introduced a new emissions trading scheme (UK ETS) on 1 January 2021. This instrument extends the existing reverse charge to include allowances under UK ETS preventing the exploitation of a loophole and thereby continuing to protect the revenue.

#### 3. Matters of special interest to Parliament

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

- 3.1 Although the new BEIS scheme was introduced on 1 January 2021, the earliest trading in emissions allowances under UK ETS can take place will be 19 May 2021 so there is no current or imminent risk to the revenue. Trading in emissions allowances created under the Directive under EU ETS will also continue to be possible in the United Kingdom (UK). The existing reverse charge applying to the transfer of an allowance under the Directive remains in place and continues to be effective.
- 3.2 Whilst the UK as a whole is no longer part of EU ETS, Northern Ireland electricity generators remain in EU ETS by virtue of Article 9 and Annex 4 of the Northern Ireland Protocol. There are five such businesses affected, and this instrument does not change the way in which they currently account for VAT on EU ETS allowances.

##### *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)*

- 3.3 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 at this stage.

#### **4. Extent and Territorial Application**

- 4.1 The territorial extent of this instrument is the United Kingdom.
- 4.2 The territorial application of this instrument is 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 The Value Added Tax Act 1994, as a general rule, requires a supplier of goods and services to account for VAT on those supplies. Section 55A of the Act (“section 55A”) requires VAT to be paid by the recipient of supplies (“a reverse charge”) if the supplies are of a type specified for that purpose in a Treasury order. A reverse charge prevents supplies of goods and services from being exploited by those engaged in missing trader VAT fraud.
- 6.2 The goods and services to which section 55A applies and the goods and services which are to be excepted from its application are to be specified by Treasury order pursuant to powers contained in section 55A(9) and (10).
- 6.3 This instrument amends the Value Added Tax (Section 55A) (Specified Goods and Services and Excepted Supplies) Order 2010 (S.I. 2010/2239) (“the 2010 Order”). It is being made to prevent a loophole in current anti-fraud legislation following the introduction of UK ETS by BEIS under the Greenhouse Gas Emissions Trading Order 2020 (S.I. 2020/1265). This instrument extends the scope of the reverse charge to allowances under UK ETS. These amendments ensure the continued effectiveness of the legislation by stopping the VAT being passed by the customer to the supplier and subsequently being stolen.
- 6.4 Article 3 of this instrument expands the definition of “allowance” in the 2010 Order to include an allowance created under UK ETS, thereby applying a reverse charge to allowances created under UK ETS as well as allowances created under the Directive.
- 6.5 Article 6 of the 2010 Order is amended to remove the transfer of an “emission reduction unit” and the transfer of a “certified emission reduction” (“international units”) from the scope of the reverse charge because EU ETS no longer allows for these international units to be exchanged for EU ETS allowances and UK ETS also does not allow for these international units to be exchanged for UK ETS allowances. In consequence there are additional amendments to article 3 of the 2010 Order to remove definitions which are no longer needed.
- 6.6 No new supplies are excepted from the reverse charge by this instrument.

#### **7. Policy background**

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

- 7.1 As a consequence of the introduction of UK ETS by BEIS, this instrument extends the scope of the current VAT reverse charge for emissions allowances to cover allowances created under the UK ETS. This prevents a loophole and an opportunity for fraud.

- 7.2 Emissions allowances or “carbon credits” are issued by governments under various schemes designed to cut carbon emissions by businesses. The UK used to participate in EU ETS, under which member states issue operators in EU ETS with allowances. Further allowances would be auctioned by some governments (including the UK). The allowances could be traded and there is also a secondary market in which anybody can trade, for example to speculate on the price of the credits. Operators (or “polluters”) must ensure they have sufficient credits to cover their actual emissions at the end of April each year when these credits are “retired”. UK ETS developed by BEIS broadly follows EU ETS.
- 7.3 Missing trader 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 to and recovered from the customer by the supplier is not passed on to HMRC but is retained by the supplier.
- 7.4 Missing trader fraud has been used by criminals to steal billions of pounds in VAT from governments throughout the world. In the UK, the government has previously had to act to combat missing trader fraud by introducing a VAT reverse charge: in the trading of mobile telephones and computer chips (from 1 June 2007), for gas and electricity (from 1 July 2014), for telecommunications services (from 1 February 2016), renewable energy certificates (from 14 June 2019) and construction services (from 1 March 2021). The current reverse charge for emissions allowances was introduced on 1 November 2010.
- 7.5 Reverse charge accounting makes it impossible for fraudsters to perpetrate missing trader 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.
- 7.6 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.

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

- 8.1 This instrument is not being made under the European Union (Withdrawal) Act but relates to the withdrawal of the United Kingdom from the European Union because an EU emissions trading scheme has been replaced with a new UK emissions trading scheme by BEIS which is effective from 1 January 2021.

## **9. Consolidation**

- 9.1 There is no current plan to consolidate the various Treasury orders that specify the goods and services to which section 55A applies.

## **10. Consultation outcome**

- 10.1 There has been no formal consultation with the trade sectors affected by this instrument. The number of business affected is small and they are already familiar with the reverse charge procedure and will not have to amend any of their accounting processes as a result of this instrument. When this legislation was first implemented in 2010, it was well received as it prevented fraud and helped maintain confidence in the market and protected businesses that made the market work.

## **11. Guidance**

- 11.1 HMRC will update its existing guidance in [VAT Notice 735](#) to coincide with the effective date of this instrument.

## **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 covering this instrument will be published on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

## **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 final decision on what action to take to assist small businesses was that, although the change does not discriminate between the small number of businesses affected, few, if any, small businesses will be affected in any case. The impact on small and micro businesses is negligible. Those businesses already operating this reverse charge will be familiar with the required accounting processes and this process will not change what they have to do.

## **14. Monitoring & review**

- 14.1 HMRC will monitor the effectiveness of the amended reverse charge to ensure that it covers the trading of emissions allowances under UK ETS. HMRC will also remain in contact with BEIS to ensure early notification of any future proposed changes to the scope of UK ETS.
- 14.2 The regulation does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

## **15. Contact**

- 15.1 Paul Grimwood at HMRC email: [paul.grimwood@hmrc.gov.uk](mailto:paul.grimwood@hmrc.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 James Smallbone, Deputy Director for VAT Fraud and Transition Readiness, at HMRC can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.