



HM Revenue
& Customs

Alternative method of VAT collection

Call for evidence

Publication date: 20 March 2017

Closing date for comments: 30 June 2017

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1. Introduction

The issue

1.1 There has been a large increase in online shopping in the UK in recent years, with many goods sold to UK consumers by overseas sellers using online marketplaces. To satisfy consumer demand for rapid delivery, overseas sellers now routinely store their goods in the UK.

1.2 Under existing VAT legislation, businesses who are VAT registered (or are required to be registered) must charge VAT on relevant sales to their customers. VAT registered businesses are expected to collect VAT and remit it to HMRC at regular intervals, usually quarterly. The business is also required to submit a VAT return detailing the net VAT owed to HMRC.

1.3 When goods are in the UK at the point of sale, the overseas sellers are required to register for VAT in the UK regardless of the level of sales. In these circumstances the seller must charge and collect VAT. Many overseas sellers are not VAT registered – or if they are VAT registered, they are not always collecting the appropriate amount of VAT. The government wants to ensure a level playing field, removing any unfair advantage to overseas sellers.

1.4 Through this call for evidence, we want to explore solutions to address the three key factors within the current system that create this opportunity for non-compliance:

- Businesses based in overseas jurisdictions, but with VAT obligations (to register and pay VAT) in the UK;
- The time lag between the consumer paying for the goods and the business later remitting the VAT element to HMRC;
- Where the VAT is paid by a UK customer to an overseas business which then may or may not pay it over to HMRC in due course.

1.5 The growth in shopping via online marketplaces has resulted in significant losses of VAT. HMRC estimates that the losses from overseas businesses selling goods to UK consumers via online marketplaces was £1-1.5 billion of VAT in 2015 - 2016.

What the government has done already

1.6 The government announced new measures at Budget 2016 to strengthen HMRC's powers to tackle this issue. As of September 2016, HMRC can direct overseas businesses to appoint a tax representative in the UK and can make online marketplaces jointly and severally liable for the VAT of overseas businesses who do not comply with UK VAT rules. HMRC has already started to use the new measures

with immediate success on first cases where notices have been issued. As a result of joint and several liability notices issued, non-compliant overseas business are being removed from online marketplaces. This acts as a strong deterrent to overseas businesses evading VAT.

1.7 As these goods are often stored in UK fulfilment houses for distribution to UK consumers, HMRC consulted on and will introduce a Fulfilment House Due Diligence Scheme from 2018. Fulfilment houses will be required to join the scheme, carry out due diligence checks on their overseas clients or face penalties.

1.8 These measures deliver a step-change in HMRC's ability to tackle this problem. In parallel with the timeline for implementation of the new measures, HMRC has already seen, over the last year, more than a tenfold increase in online overseas businesses applying to register for VAT – from 700 in 2015 to 8,700 in 2016. Using existing powers, HMRC is already taking action against fulfilment houses, assessing for unpaid taxes and seizing goods where appropriate, working with Trading Standards and Border Force. HMRC is grateful for information that assists in tackling this type of evasion. Whilst the new measures are proving effective they do not solve the problem altogether. The government recognises the need for longer-term solutions to keep pace with changing business models to ensure the efficient collection of tax.

1.9 The government wants to ensure that VAT collection mechanisms reflect the evolving retail environment. VAT collection has not changed significantly since it was introduced in 1973. There have been significant technological advances in the payment industry, which may facilitate different approaches to VAT collection and help reduce fraud. HMRC is therefore exploring alternative solutions for collecting VAT in real time through payment technology.

1.10 The UK is not alone in its experiences. Jurisdictions across the world are confronting similar challenges. There are broader conversations taking place internationally, within both the European Union and the Organisation for Economic Co-operation and Development (OECD), about the future of VAT collection. This includes reviewing the role that technology can play in facilitating the introduction of more efficient and effective collection mechanisms. The European Commission has recently launched a detailed study into the scope for split payment, which for the first time will consider business to consumer sales.

1.11 Alternative collection mechanisms are also being explored at the OECD as many jurisdictions are keen to explore efficient and effective collection of VAT to help drive down fraud. The OECD provides an international forum to help explore possibilities, share experiences and facilitate discussions.

1.12 In this call for evidence we are seeking views on an alternative method of collecting VAT for online business to consumer sales. We are looking for evidence on the technical feasibility of extracting VAT in real time using payment technology and depositing it with HMRC. This is often referred to as split payment.

2. Who should respond to this call for evidence?

2.1 The government is particularly interested in responses from:

- merchant acquirers
- payment service providers
- relevant businesses
- card scheme operators
- banks
- payment industry representative bodies
- 'fintech' companies
- tax engine companies
- representative professional bodies
- accountancy firms

The government also welcomes views from anybody interested in this topic.

Question 1: Please indicate what type of organisation/individual you are.

2.2 We welcome written responses from the organisations listed in paragraph 2.1. If you are also willing to engage in face-to-face working groups arranged by HMRC please contact Dympna Kelly using email indirecttax.projectteam@hmrc.gsi.gov.uk

3. Alternative VAT collection mechanism

Split payment concept

3.1 Extracting VAT in real time and depositing it directly with the tax authority is often referred to as split payment. For simplicity this is the descriptor we will use in this call for evidence.

3.2 Our focus in this call for evidence is where the VAT is extracted using payment technology.

International examples

3.3 Split payment mechanisms, sometimes referred to internationally as 'tax withholding' mechanisms, have been implemented in a number of countries. The basis of each approach is often different from a payment technology approach, but they do provide some insight into how a split payment model might work in practice. There are examples¹ of split payment models being implemented in Mexico, Ecuador², Peru and the Dominican Republic. In some of these countries, for example Ecuador, when the buyer uses a credit or debit card to pay a retailer the payment is split into the VAT element and the net amount, and the VAT is deposited with the tax authority. Sometimes only a small percentage is extracted and deposited with the tax authority in recognition of differing VAT liabilities and businesses' cash-flow. In these circumstances businesses are required to remit the remaining balance due in the usual manner. Businesses selling primarily or exclusively exempt goods may be exempt from the split payment mechanism.

3.4 The means by which split payment operates differs from country to country, but of particular interest to the UK are those countries that effect the split using one of the participants in the payment cycle and deposit the tax directly with the tax authority.

¹ VAT Fraud as a Policy Stimulus - Is the US Watching? Richard T Ainsworth

² <https://www.pwc.com/gx/en/tax/indirect-taxes/assets/pwc-indirect-tax-guide-americas-2015.pdf> page 91

Case Study – Dominican Republic

Transactions involving card payments have increased in the Dominican Republic and, in January 2005, to reduce VAT evasion the Dominican Republic implemented a VAT withholding mechanism on transactions using credit and debit cards. To facilitate the VAT withholding mechanism, designated 'acquisition companies' act as intermediaries between the credit and debit card issuing banks and the seller who accepts the cards as payment. 30% of the VAT is withheld by the 'acquisition companies' and reported weekly to the tax authority.

Some supplies, such as medicines, books, newspapers and education services, are exempt from VAT withholding and businesses involved in the sale of these goods can request a VAT withholding exemption from the tax authority.

Case Study – Argentina

In Argentina there are 'withholding agents' responsible for implementing VAT withholding and submitting the VAT collected to the tax authority. There are different withholding rates depending on the nature of the transaction. For example, different rates apply to goods and services compared to utilities and telecommunication. Payments through credit cards are also subject to withholding rates. Small businesses are not subject to the requirement to withhold VAT.

Case Study – Ecuador

Ecuador adopted a VAT withholding scheme in 1997 where all credit and debit card companies were designated ‘withholding agents’. This means that the credit and debit companies are required to split all or some of the VAT from the payment and immediately deposit it with the tax authority. This applies to both business to business and business to consumer sales. Additionally, some companies qualified by the tax authority as “special taxpayers” are also designated as VAT withholding agents.

Withholding agents are required to withhold VAT from other entities and individuals as follows:

- 30% of VAT on purchases of goods taxed at the 12% rate
- 70% of VAT on the acquisition of services taxed at the 12% rate, except in the case of services supplied by professionals where 100% of the VAT charged must be withheld

For transactions between two “special taxpayers”, VAT is withheld as follows:

- 10% of the VAT for purchases of goods
- 20% of the VAT for purchases of services

Withholding agents must record the withheld VAT in their accounting records, and must file a return and pay the withheld VAT on a monthly basis.

We would like to build on our understanding of VAT withholding or split payment and are interested in any experiences respondents may have had in other jurisdictions of tax amounts being extracted from payments in real time. We want to learn any lessons from existing practices.

Question 2: We are interested in any experiences you may have had in countries that operate a split payment mechanism where tax is extracted in real time. We would be like to understand when it works well and when it doesn’t work well.

Question 3: We understand that fees and other payments are extracted in the payment cycle. Please provide evidence of how this is done and your thoughts on whether you think the same technology to extract fees could be adapted to extract VAT.

4. Split payment feasibility

Design principles

4.1 In considering a split payment model for VAT we think it is important that we take the work forward under the umbrella of some agreed design principles. As part of this call for evidence we are including some suggested design principles for discussion:

- VAT split payment should increase tax efficiency for both businesses and HMRC
- The split should be initiated at a point in the payment cycle by one of the participants and be driven by payment technology
- VAT split payment should be simple for the seller
- VAT split payment should be invisible to the UK consumer, who will continue to pay by whichever method the consumer chooses, for example credit or debit card or by using a payment service provider
- UK consumers' rights will not be affected
- There should be significantly less opportunity for fraud as the VAT will be extracted in real time in the payment cycle and later deposited with HMRC
- VAT split payment will be in UK legislation (set out in statute)
- VAT split payment should be proportionate and fair and every effort will be made to ensure a level playing field for all sellers to UK consumers
- Every effort would be made to ensure VAT split payment is cost efficient to build, implement and maintain

Question 4: Do you think these are the right design principles for a split payment model? Is anything missing or is there anything that should be excluded? If you think the design principles should be different please provide evidence on alternatives.

Payment technology

4.2 Our initial work, including with the payment industry, has helped us to understand the payment cycle and to determine how VAT might be extracted and deposited with HMRC.

4.3 From our conversations with the payment sector we understand that the payment cycle involves many different participants each playing a different role in moving money from consumer to seller. The main participants in a payment cycle as we understand it are cardholders (consumers), merchants (sellers), merchant acquirers, card issuers and card schemes.

4.4 We understand the card schemes manage and control the operation and clearing of card payment transactions according to card scheme rules. The schemes are responsible for passing card transaction details from the acquirer to the issuer and for passing payments back to the acquirer which in turn pays the merchant. At

Annexes A-C we have included flow diagrams that represent our understanding of how the payment cycle works in the context of overseas businesses selling to UK consumers via online marketplaces. Annex A illustrates an overseas seller selling to a UK consumer where the goods are outside the UK at point of sale. Annex B illustrates an overseas seller selling to a UK consumer where the goods are in the UK at point of sale. Annex C is an illustration of the payment cycle as we understand it.

4.5 We understand that there can be other parties involved in a payment cycle such as payment service providers (PSP), but for simplicity we have not included them in the illustrations.

Question 5: If you are an organisation that plays a part in the payment cycle but you are not captured in our illustrations in Annex C it would be helpful if in your response you outlined how you interact with the payment cycle.

4.6 In high level discussions with the payment sector industry we have explored how a split payment might work in practice, where the split might occur and some of the likely challenges with split payment both in terms of implementation and operations. We discussed what information would be required to effect the split. The consensus from these discussions is that the party effecting a split would need to know as a minimum:

- If VAT is applicable, for example, do the goods attract VAT?
- The location of the seller
- The location of the buyer

4.7 Those we spoke to thought the payment cycle participant most likely to be able to effect a split would be the merchant acquirer as they are in possession of most of the information available such as:

- The customer's card number
- The country where the card is issued
- The merchant's name and address
- The value of the transaction
- How the money is collected, such as face to face or online

4.8 The overall consensus from those we spoke with is that a split payment mechanism is possible but clearly there would be a need for evolutionary changes to enable implementation.

Question 6: Please can you comment on our understanding of how the payment cycle works and whether it is correct. Please provide evidence about any gaps or misunderstandings.

Question 7: Please can you comment on our assumptions about how a split payment model could work. We welcome evidence about the best way of exploiting payment technology to extract VAT from payments in real time to deliver a sustainable model for the future. Please provide as much technical detail as possible.

Question 8: Based on your own understanding and experience of the payment cycle, at which point do you think the VAT split should take place?

Challenges and enablers to the development of a split payment model

4.9 Conversations with the payment industry have helped us understand some of the likely challenges we would face in developing, designing and implementing a split payment mechanism. Conversations centred on the time to develop, the likely costs and difficulties in being able to identify the transactions requiring split payment mechanism activation. We also discussed potential problems around the geographical location of the different payment sector participants and whether that might pose jurisdictional challenges.

4.10 We discussed possible solutions to the difficulties identified. We explored the idea of simplifying the VAT rules which could allow for a flat amount to be split rather than the full VAT amount. Together we looked at how the payment sector might be compensated for costs incurred in the build and implementation of a split payment mechanism.

Question 9: What are the key challenges, from your perspective, to the development of a split payment model for VAT? Please provide evidence about the challenges you have identified and any solutions you think might help in overcoming those challenges.

Question 10: Are there any enablers or new developments in the sector that would facilitate the development of a new collection mechanism for VAT? Please provide evidence about any new developments or technological advances in the payment sector that are relevant to this issue.

Question 11: Do you see a role for the card schemes in ensuring payment sector participants adhere to any future UK split payment legislation?

Question 12: Is there any other evidence you would like to submit as part of this call for evidence?

5. Summary of questions

Question 1: Please indicate what type of organisation/individual you are.

Question 2: We are interested in any experiences you may have had in countries that operate a split payment mechanism where tax are extracted in real time. We would be like to understand when it works well and when it doesn't work well.

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Question 10: Are there any enablers or new developments in the sector that would facilitate the development of a new collection mechanism for VAT? Please provide evidence about any new developments or technological advances in the payment sector that are relevant to this issue.

Question 11: Do you see a role for the card schemes in ensuring payment sector participants adhere to any future UK split payment legislation?

Question 12: Is there any other evidence you would like to submit as part of this call for evidence?

6. Next steps

6.1 The government is very grateful to those who take the time to respond to this call for evidence. We will consider all responses carefully and will publish a response document later in the year.

7. Responding to this call for evidence

How to respond

A summary of the questions in this call for evidence is included at chapter 5. Responses should be sent to Dympna Kelly by e-mail to indirecttax.projectteam@hmrc.gsi.gov.uk

or by post to:

Dympna Kelly
HM Revenue & Customs
Indirect Tax Project Team
Room 3/35, 100 Parliament Street
London SW1A 2BQ

Telephone enquiries: Peter Rowe 03000 530 933 (from a text phone prefix this number with 18001)

Please do not send responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be

aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This call for evidence is being run in accordance with the Government's Consultation Principles. [If you wish to explain your choice of consultation period, this is the place. Also, if you are holding additional meetings or using alternative means of engaging, please mention this here].

The Consultation Principles are available on the Cabinet Office website:
<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

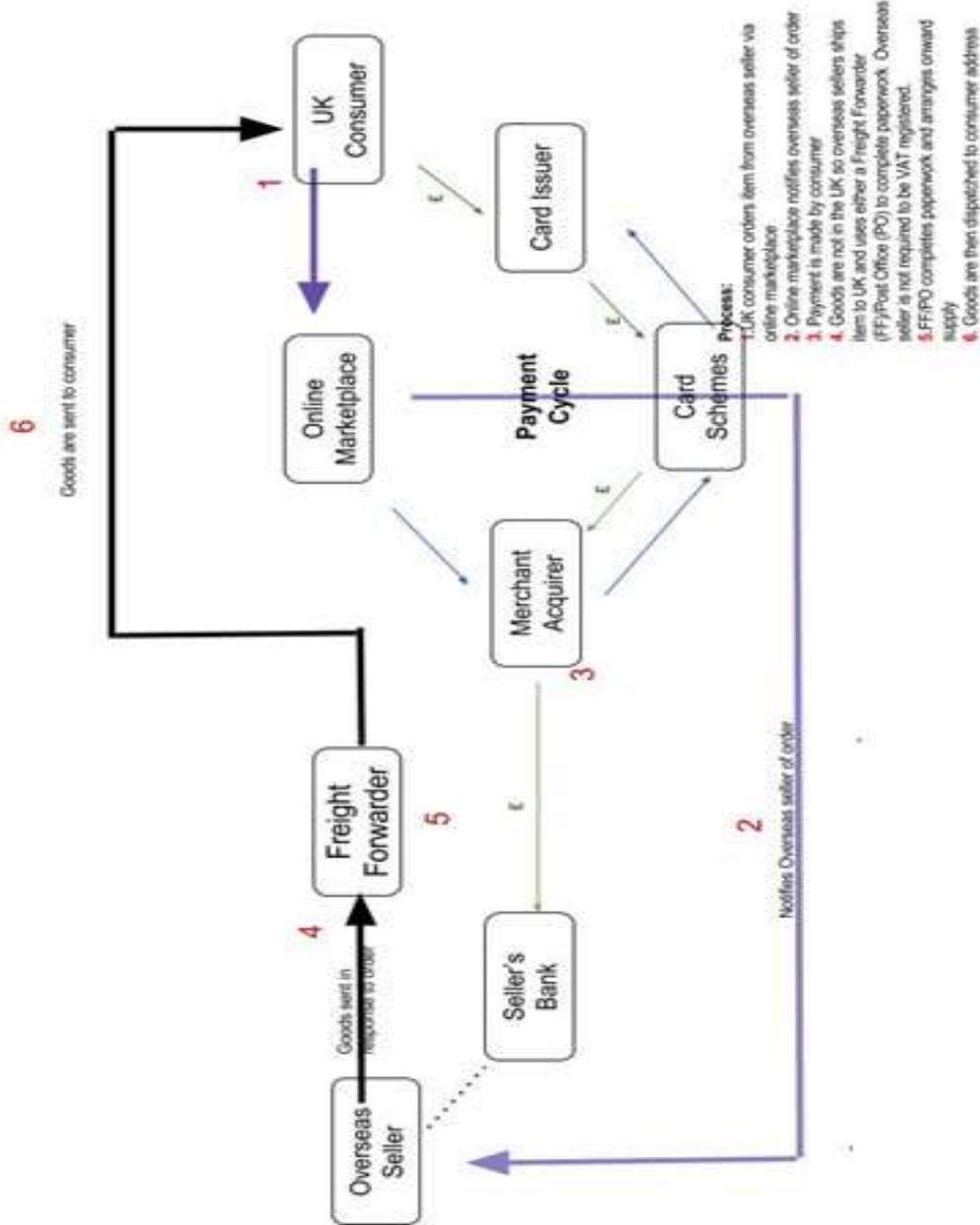
John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

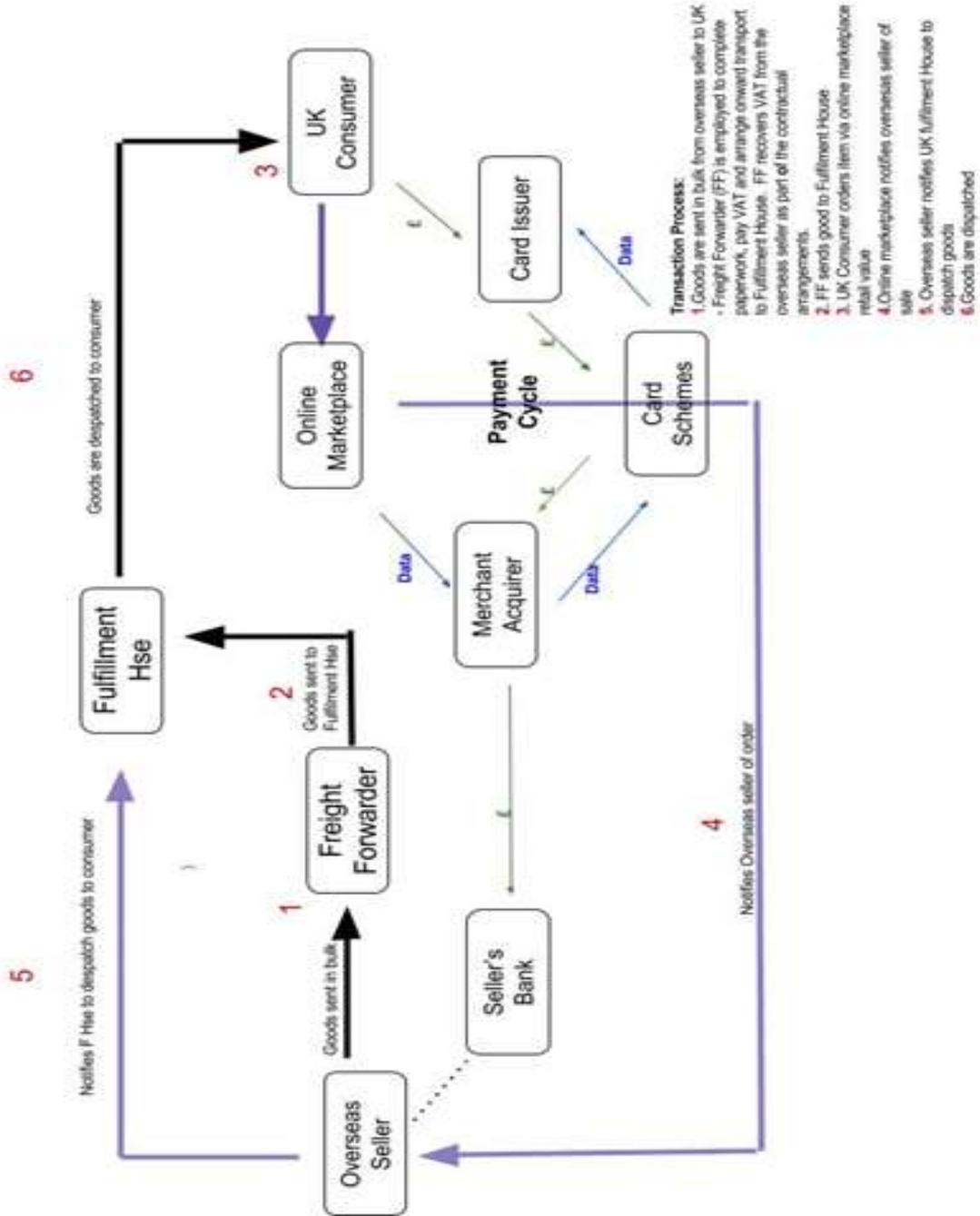
Annex A: Overseas seller selling to UK consumer – Goods outside UK at point of sale

Example of Overseas Seller selling to UK Consumer where goods are dispatched in response to order



Annex B: Overseas seller selling to UK consumer – Goods in UK at point of sale

An example of overseas seller selling to UK consumer via online marketplace



Annex C: Payment Cycle

