HM Revenue
& Customs

Alternative method of VAT collection – split payment

Summary of Responses
7 November 2018

Contents

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Executive Summary

The rapid expansion of the online shopping market over the past two decades has brought unprecedented levels of purchasing power and choice for consumers.

The fruits of digitalisation have also brought challenges for the tax system. Jurisdictions all over the world are currently grappling with the question of how to prevent the large tax losses, in particular for VAT, which can arise from cross-border online sales. This happens when consumers buy goods from outside their jurisdiction from sellers who, through fraud or ignorance, do not comply with their tax obligations. In total, it is costing tax authorities across the globe billions of pounds a year.

How best to deal with this challenge has been the subject of international debate. The UK supports the approach taken by the OECD, which has set out the range of core approaches which jurisdictions can take depending on need and urgency.

The nature of how goods and services are bought online is constantly evolving. This includes the mechanisms through which consumers can pay for products, with many new and innovative financial products being developed for an age of open banking by world-class companies headquartered in innovation hubs in the UK. Therefore, the government believes that any holistic, long-term solution cannot focus solely on online marketplaces. It must take account of a future economy in which many consumers can buy through non-marketplace channels using evolving, alternative payment methods.

By intercepting VAT through intermediaries in the payment cycle, split payment potentially offers a powerful, channel-agnostic means of enforcing VAT compliance on sellers who are outside the UK's jurisdiction. At the outset of this consultation, the government sought to gauge the views of industry on how a system for VAT split payment might best be designed. As a starting point for further discussion, HM Revenue and Customs (HMRC) used a conceptual model that focused on the possible role of merchant acquirers, payment service providers and issuing banks in VAT collection.

HMRC and HM Treasury officials received written responses and met with numerous stakeholders. This document summarises consultation responses from stakeholders and discussions held with them in chapter 2, and then sets out the government's full response to the consultation in chapter 3.

Recognising the importance of the feedback stakeholders provided, especially in highlighting many of the complexities and costs involved in designing a split payment system for VAT, the government will create an Industry Working Group to take the policy forward. This group will explore how government and industry can cooperate to design an effective system, including appropriate remuneration models, which payments businesses can operate with minimum disruption to their core business functions. Further detail is in chapter 4.

HMRC and HM Treasury will engage financial regulators such as the Bank of England and the Financial Conduct Authority. They will explore how existing and planned reforms to regulations might be harnessed to create an enforcement environment conducive to split payment in the long-term.

1. Introduction

Background

1.1 In March 2017 HMRC launched a call for evidence[1] asking for views on proposals for an alternative method of VAT collection. In particular, how payment technology could be harnessed to extract VAT from online purchases at the point of sale and high-level design principles for any future model.

1.2 A summary of responses[2] was published in December 2017. The responses indicated that while split payment is difficult, it would be technologically possible.

1.3 Building on the stakeholder insight gained in the call for evidence, HMRC developed two potential models for how a split mechanism could work and three potential simplifications to determine the amount of VAT to be split from a transaction. At Spring Statement 2018 the Chancellor launched the consultation 'Alternative method of VAT collection – split payment'[3] to further explore these models and to continue evaluating the overall feasibility of split payment.

Context for the consultation

1.4 There has been a fundamental change in the way consumers buy goods and services, with large increases in online shopping in recent years. Many of the goods sold to UK consumers are brought from overseas sellers using online marketplaces. To satisfy consumer demand for rapid delivery, overseas sellers now routinely store their goods in the UK.

1.5 Businesses that are VAT-registered (or that are required to be) must charge VAT on relevant sales to their customers. The businesses collect this VAT and remit it to HMRC at regular intervals, usually quarterly.

1.6 When goods are in the UK at the point of sale, overseas sellers must register for VAT regardless of their turnover. A proportion of such sellers are not registered, or if they are, they do not necessarily collect the right amount of VAT. The government is working to ensure a level playing field, by removing any unfair advantage overseas businesses may have over UK businesses.

1.7 The growth in online shopping has resulted in significant losses of VAT. It is estimated that between £1 billion and £1.5 billion was lost in 2016-17. Enforcement can be particularly difficult if a business is based overseas.

1.8 The government has already taken certain actions to tackle the issue of overseas businesses selling goods to UK consumers without paying the correct UK VAT. At Budget 2016 and 2017 HMRC introduced joint and several liability (JSL) measures to hold online marketplaces responsible for the unpaid VAT of sellers on their platforms. The fulfilment house due diligence scheme (FHDDS), which opened for registration in April 2018 and will come into force in April 2019, requires fulfilment houses to perform appropriate and necessary due diligence on the goods they fulfil and their overseas clients. However, these measures only partially address non-compliance, with overseas sellers collecting sale proceeds

[1] https://www.gov.uk/government/consultations/vat-tackling-fraud-on-goods-sold-online-update-on-split-payment
[2] https://www.gov.uk/government/consultations/vat-tackling-fraud-on-goods-sold-online-update-on-split-payment
[3] https://www.gov.uk/government/consultations/alternative-method-of-vat-collection-split-payment

from UK consumers but not remitting the VAT element of those sale proceeds to HMRC. Split payment aims to prevent this VAT reaching the overseas sellers in the first place, removing the opportunity for non-payment.

Engagement with the consultation

1.9 The government is grateful to all those who took the time and effort to respond to this consultation. HMRC received 24 written responses to the consultation from the following categories of stakeholder:

- an individual;
- tax and accountancy professional bodies;
- payments industry trade bodies representing large groups of members; and
- online merchants and payments industry businesses.

1.10 Informal discussions were held with a wider group of stakeholders; a full summary of respondents can be found in Annex A.

Responses to the consultation questions

1.11 This document sets out the questions asked in the consultation and provides an overview of the responses to each question. Some responses were not specifically attributed to a question or other relevant points outside of the remit of the questions were raised. These have been summarised thematically alongside the questions.

2. Responses

Overview of responses

2.1 Eleven questions were posed in the consultation document. Some respondents were clear to point out that they were not in a position to confirm or deny some or all of HMRC's assumptions on how the payments industry works, and so have provided their answers on the basis that all assumptions made in the consultation document are correct.

2.2 All respondents were sympathetic to the issue the government is trying to tackle. Nevertheless, respondents raised a range of challenges that need to be addressed as part of implementing an operable and proportionate split payment model.

2.3 The overarching points raised by stakeholders were:

- implementing a split payment system is technologically possible;
- splitting a payment and ensuring compliance with the UK's current VAT rules will be complex;
- for any split payment model to work it needs to be both simple for businesses to develop the technology and to comply with it in terms of applying its rules to every transaction in scope;
- cashflow was raised as an important issue particularly for small and medium businesses;
- all payment types should be captured by any split payment mechanism for it to be effective and to avoid driving unintended behavioural distortions among consumers;
- several points were raised on cost: developing the technology to carry out split payment would involve cost to the payments industry, and depending on the costs it raises questions of whether such a mechanism would be proportionate; there is also a question of responsibilities for the cost of implementing and maintaining a split payment model; the EU considered a form of split payment and discounted it on a cost benefit analysis;
- the payments industry is undergoing a period of structural and regulatory change, this limits businesses capacity in the short to medium-term to implement new government proposals;
- payments industry stakeholders raised the potential impact on the competitiveness of the UK payments industry if split payment were to be implemented unilaterally;
- some stakeholders thought the EU's 2021 VAT e-commerce package, would solve non-compliance by deeming online marketplaces liable for their overseas sellers' VAT thereby reducing the need for a split payment system;
- stakeholders thought that if the government were to continue to pursue a split payment policy, a common multi-jurisdictional approach (such as an EU-wide one) would be preferable in terms of cost and complexity;

- some stakeholders put forward alternatives to split payment for tackling non-compliance by overseas sellers, for implementation in the short to medium-term, that they are keen to explore further with HMRC;
- there was mixed opinion about whether the scope should be just overseas online sellers or all online sellers;
- some stakeholders asked for more detail on government proposals on errors, refunds and chargebacks; and
- stakeholders pointed to challenges around determining the correct VAT treatment of transactions and recourse for settling disputes in scenarios where an overseas seller doesn't agree with the amount that has been split.

2.4 A summary of the responses to specific questions in the consultation follows this section. Some of the same points were made in relation to multiple questions so these have been grouped where most appropriate to avoid repetition.

How a split payment could work

***Question 1)* Do you agree that the merchant acquirer is the best placed party to effect the split of VAT from the gross payment? If not, who do you think would be best placed and why?**

2.5 Respondents in all parts of the payment chain were sympathetic to the issue government faces and assessed that the split could be carried out at some point in the chain. The majority of respondents generally agreed that the merchant acquirer was the best placed party in the payment cycle to effect the split (subject to caveats described in more detail throughout this document) for the same reasons suggested by HMRC. Merchant acquirers have better data than other parties in the payment chain because they know the location of the supplier and whether the customer is in the UK. Some respondents added that merchant acquirers are more likely to have visibility of the totality of a business's sales over a range of channels. One issue raised was that having a list of merchants that are approved to enact a split at a simplified rate might be classified as a restriction of trade under World Trade Organisation rules.

2.6 As an alternative, some respondents thought a simpler model would be to always effect the split at the level of the consumers' (UK) card issuer or other (UK-based) source of funds. This would address any jurisdictional issues as the card issuers are in most cases under UK jurisdictional control. Having one clearly defined party carry out the split would remove uncertainty for overseas businesses. Card issuers would need to apply a simplification, in the same way proposed for merchant acquirers.

2.7 A further idea proposed was that card schemes could be best placed to make the split. The reasons given for this were: they would usually be under UK regulatory control; there would be no need for a fall-back option; and, the split could be arranged by the schemes so as not to reduce the notional amount of the transaction on which the card schemes and the merchant acquirers apply their fees. This would address a key concern of payments businesses, who were concerned that splitting tax in the payment cycle would impact the charges levied by card schemes and merchant acquirers, as these are usually based on a percentage of the gross transaction value.

2.8 Other respondents thought that split payments should only apply when an online market place was involved. See the responses to Question 4 for more detail.

2.9 Another suggestion was for online marketplaces to extract the VAT at the point that the marketplaces remitted funds to overseas sellers. When overseas sellers do not have UK bank accounts, some market places require them to set up an account with a payment intermediary to receive their sales proceeds, which are often paid at regular intervals. Marketplaces extract their fees at this point, so VAT due could be extracted and remitted directly to HMRC.

2.10 A more general comment made by many respondents was that the potential model, as it stands, has been designed for the way the payments system operates now – for purchases made mainly by credit and debit card. The payment system is undergoing a period of change and the way payments are made in the future are likely to be different. To be effective, the scope of split payment would have to include all payment methods - current and future - otherwise an incentive could arise for businesses to encourage, or even only accept, payment methods not captured by split payment.

2.11 One point raised was that the more important question was not who 'effects the split' but who decides on the rate of VAT to be split. If the model required human intervention by the overseas seller to determine the rate of VAT to be split, then it would still be susceptible to deliberate misrepresentation by sellers. In this vein, other respondents placed importance on determining the amount of due diligence that the splitter would need to perform to verify the VAT treatment of the overseas sellers.

***Question 2)* Do you think the government's emerging thinking on a mechanism for split payment is workable? If not, how would you improve it?**

2.12 The responses to this question were mixed. Some respondents thought HMRC was on the right track, others were concerned about the viability of a split payment mechanism.

2.13 A common theme from responses was that, if split payment is to work, it is crucial that the mechanism by which the split takes place is simple. Implementation of a split payment system will be challenging if the party conducting the split has to make complex decisions about the amount of VAT that must be split. HMRC received a lot of feedback about the amount to be split, with some stakeholders suggesting a flat rate would assist in solving the issue (this is set out in more detail in Question 5).

2.14 The issue of timing of remittance of payments by the seller to HMRC was also highlighted as an area that might require simplification, perhaps to be made consistent with the typical VAT reporting cycle (e.g. monthly or quarterly).

2.15 Several stakeholders raised concerns that if a split payment mechanism was to be applied broadly, such as to all online sales, this could have an adverse impact on compliant businesses. They would, therefore, prefer that this measure was applied in a way that specifically targets non-compliant businesses.

2.16 While there are a number of challenges to overcome, some stakeholders thought split payment should be considered further as they viewed it as a significant improvement on the EU's 'deemed supplier' model'[4]. This is because responsibility for sellers meeting their VAT liability would ultimately remain with the seller itself even though an intermediary is still liable to enact the split. In addition, the process for managing returns and refunds is likely to be simpler as reconciliations for any over/underpayment of VAT can be undertaken by the merchant with HMRC directly, rather than through the intermediary.

2.17 Other stakeholders, however, thought the EU model was more viable and proportionate. The EU looked at split payment for intra-EU business-to-business transactions and published a report in December 2017[5] which found no strong evidence that the benefits of split payments would outweigh its costs. Several stakeholders highlighted the potential implementation and maintenance costs of a system of split payment. Some suggested that a more proportionate alternative might be for HMRC to adapt existing data gathering powers to enable it to more effectively identify, and take action against, a greater number of non-compliant overseas businesses.

2.18 Concerns were also raised that (in its current form) this idea targets card payments only and therefore, given the variety of payment mechanisms available, non-compliant businesses may be able to circumvent any split payment measure that is introduced for card payments only. There would also need to be safeguards in place to ensure VAT was not doubly split from a transaction by both a merchant acquirer and a card issuer.

2.19 Some respondents thought that the split payment model was not workable as it requires complete restructuring of the current UK payments system. They asserted that most participants in the payments cycle cannot currently tell if a transaction relates to goods or services, or where the goods are located at the point of sale, without level 3 data[6].

[4] 'deemed supplier'- under the EU's approach the online marketplace will be considered to be the supplier and responsible for any associated VAT responsibility http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/

[5] https://ec.europa.eu/taxation_customs/sites/taxation/files/split_payment_report2017_en.pdf

[6] Level 3 card processing is similar to levels 1 and 2 but attaches extra information to a payment such as VAT codes and the delivery postcode.

2.20 To acquire this data, every participant in the international payment network would need to change data standards. These would need to be agreed/standardised across the global industry in order to allow the information required to flow and enable a system of split payment. Difficulties were also flagged in relation to doing this solely for the UK, given the international nature of some payments architectures.

2.21 Some respondents also felt that card schemes should not be responsible for the compliance of payment service providers (PSPs) and merchant acquirers with split payment, as this would impose additional burdens on card schemes, and that therefore this task would be more appropriate for a government regulatory body.

Question 3) **Do you think the use of the card issuer as a fall-back option would provide an effective safeguard for the mechanism by creating sufficient incentive to encourage merchant acquirers or PSPs to register with the scheme?**

2.22 Stakeholders broadly responded to this question in two ways:

1) Some agreed with this proposal as enforceability would be central to the success of any split payment model. Because many, if not most, merchant acquirers and PSPs serving overseas sellers will themselves be based overseas, this also presents similar jurisdictional challenges. As detailed in the response to Question 1, some respondents thought it made more sense to split at the level of the UK issuer to resolve this challenge.
2) Others felt the use of card issuers as a fall back is not appropriate. Some respondents think it will be disproportionate to develop in terms of cost. They view the proposed fall-back as an ineffective form of enforcement and that HMRC should use a statutory footing instead. If HMRC is going to get a party to effect a split payment mechanism it should be limited to merchant acquirers with no fall-back.

2.23 The model HMRC originally designed relies on an assumption that overseas sellers would encourage their merchant acquirers, who are also largely based overseas, to sign up to HMRC's list of approved splitters so that they may split at a lower rate than the standard rate of 20% which would be imposed under the fall-back. Some respondents posed that merchant acquirers were unlikely to sign up to be approved splitters due to the costs of developing the technology.

2.24 A point raised by some stakeholders was that merchant acquirers must be licenced by regulators in each country where the merchant is present. The merchant acquirers our proposal targets are highly unlikely to be based in the UK so HMRC will still face jurisdictional issues, making enforcement more difficult if they don't sign up voluntarily. Some respondents thought this would lead to the fall-back option becoming the norm.

2.25 Payments industry stakeholders think that UK PLC will foot the cost in lieu of participation by overseas payments businesses, thereby competitively disadvantaging the UK payments industry globally and hampering innovation. Some stakeholders queried whether all card issuers would be obligated to effect a split, or only those with a certain volume of transactions. It would cost the same to develop the technology regardless of size of the card issuer, but the cost will fall disproportionately on smaller firms as it will be harder to recoup, and they will experience greater opportunity costs to their competitive disadvantage. It was suggested this could be addressed by costs being met by HMRC.

2.26 Other challenges noted were that the issuer doesn't have enough information and isn't involved enough in the payment cycle to effect an accurate split (based on the true VAT rate of the goods). Issuers do not have contractual relationships with either acquirers or merchants, and in the cases of some schemes, the issuer would not know who the acquirer was.

2.27 Some respondents raised the risk that those PSPs involved in processing payments for the sale of online goods might relocate outside of UK jurisdiction. They hence thought there must be effective international cooperation along the lines of the common reporting standards, for split payment to be effective.

2.28 A further point raised by respondents was that it would be confusing for overseas sellers to identify which party has carried out the splitting of their payment proceeds, when more than one party is able to enact it. Respondents thought this will generate customer contact with HMRC and payments businesses who may have effected the split. Businesses operating in South America where there are forms of withholding on consumer transactions, which are simpler than the split payment model HMRC is proposing, gave anecdotal evidence the withholding regime increased the levels of queries and disputes that they had to raise with the tax authority.

***Question 4)* Do you think that marketplaces, when they are involved in a sale, could have a role to play in effecting the split?**

2.29 As set out in the responses to Question 1, some respondents thought marketplaces have a role in effecting the split and some thought these should be the only party carrying out a split as it was more proportionate. There is a difference between those marketplaces that carry out payment processing and those which don't. Only some online marketplaces process their own proprietary PSP function. For most marketplaces, therefore a third-party payment processer would still need to actually carry out the 'splitting' but under the instruction of the marketplace.

2.30 There were a number of reasons given for why stakeholders felt a marketplace would be a more suitable place to carry out the split:

- currently marketplaces are the main facilitator for imports of consumer goods from third countries into the UK;
- a large volume of goods sold online are done so via marketplaces;

- a split involving marketplaces would be more in line with the EU e-commerce package which will come into force in 2021;
- non-card payments could also be caught;
- generally, marketplaces have more information about the sale: liability; goods or services; location of buyer (they can use the delivery address as a proxy, though not all have this information); they know the location of the overseas business and they already extract fees from the overseas business (notwithstanding that they rely on third parties, usually the merchants themselves, for the accuracy of this information).

2.31 Respondents highlighted issues with a marketplace split. Marketplaces operate using different business models. They hold different information about their merchants and not all have correct information about the tax liability of the goods sold. For example, some marketplaces have a wide mix of wholesale (business) and consumer (non-business) goods.

2.32 Some respondents highlighted that marketplaces can only see the sales made via their own platforms/websites and in e-commerce it is common for overseas businesses to be selling on multiple channels. This would mean marketplaces would not have sight of the totality of a business's sales in the same way that a merchant acquirer is likely to (although, it should be noted that some businesses also have multiple acquirers).

2.33 Some stakeholders commented that having a marketplace potentially involved in a split payment mechanism makes the process more complex and questioned the value it would add. Marketplaces may face difficulty enforcing UK requirements in other jurisdictions.

2.34 Another point made was that HMRC already has significant compliance powers that can be used in respect of marketplaces. Some respondents questioned whether there was a need for additional proposals such as split payment.

Amount to be split

***Question 5)* Do you agree with the government's assessment of these options for determining how much should be split from the gross payment?**

2.35 Responses were mixed. Those not involved in the technicalities of splitting generally preferred HMRC's proposed option 3 (the net effective rate) as the fairest option with the least impact on businesses cashflow.

2.36 Those who would be involved in carrying out a split almost unanimously said that option 3 would be very difficult to implement at this time due to the complexity on operating systems it would introduce. Stakeholders referred to HMRC's key design principles that any split should be simple.

2.37 The preferred option set out by the payments industry for the amount to be split was a type of 'flat rate', although respondents had various interpretations of what this meant exactly. The main thrust of this preference was for a split akin to option 1 (a standard rate split) but at a single lower rate, to account for some input tax recovery and have a smaller impact on cashflow for sellers.

2.38 Respondents acknowledged that the following considerations would need to be addressed or thought through as part of the design of any ‘flat rate’:

- the existing flat rate scheme has various categories for different sectors, has a turnover limit, provides an administrative simplification and is voluntary;
- but for a flat rate to work in split payment context it would need to be mandated and there would need to be no turnover threshold;
- there were mixed views on whether a business should/would still have to submit VAT returns and calculate ‘true ups’; and
- some stakeholders queried whether at the point of the split overseas sellers would be paying and accounting for their VAT or making a payment on account.

2.39 A point made by stakeholders was that introducing a new category of flat rate for overseas sellers without simultaneously introducing an analogous one for UK online sellers could be giving overseas sellers an unfair competitive advantage. It could distort trade, creating an uneven playing field which is directly at odds with one of the main policy objectives.

2.40 Additionally, respondents discussed having a mechanism whereby an overseas seller that only makes exclusively or predominantly exempt or zero-rated supplies could be scoped out of split payment. Use of this mechanism could be subject to agreement by acquirers, PSPs and issuers to undertake due diligence, with consequences for non-compliance by the splitters or fraudulent misrepresentation by sellers of their business model.

***Question 6)* Are there any other options you would suggest to further simplify the process of calculating the amount to be split?**

2.41 Possible options for simplification suggested by respondents were:

- the use of blocked VAT accounts - these might take the form of special VAT-only bank accounts which overseas companies have to use to collect VAT on sales, and can only be used to settle VAT liabilities;
- ways of mitigating the cashflow impact for those who trade below the VAT threshold; and
- there was a suggestion that, rather than exploring the viability of split payments, HMRC should be horizon scanning future technologies that might fundamentally alter the way future payments are made, such as blockchain.

2.42 Some respondents though any future VAT accounting should remain focused on the right amount of VAT being paid. The only exceptions should be in limited circumstances where HMRC have identified systematic non-compliance by a group of taxpayers.

Other Key Considerations

***Question 7)* Do you think the scope of split payment should be limited to overseas sellers, or should HMRC expand the scope to include online UK businesses?**

2.43 The responses to this question were split. Of those that thought the scope should also include online UK sellers they did so because:

- it would be less challenging to introduce split payments for domestic transactions - if the technology is available and the government is intending to introduce it in more complex scenarios, then it also makes sense to do so in the simpler ones;
- to create a level playing field all online sellers should be in scope - HMRC already has joint-and-several liability (JSL) measures which apply to both overseas sellers and UK sellers that operate via online platforms; certain stakeholders suggested there could be a similar justification for the same to apply to split payment; and
- many sellers that operate via platforms struggle to meet their tax obligations and by automating the process, it could mean they have a slightly reduced administrative burden.

2.44 Those that thought the scope should be limited to overseas sellers did so for the following reasons:

- any split payment mechanism would have a negative impact on a seller's cashflow - online businesses selling goods typically operate high turnover, low margin businesses and are often small and medium sized enterprises;
- if the scope was extended to all online sellers, including those based in the UK, then split payment might drive behavioural changes in UK businesses such as using cash-in-hand and direct bank transfers between personal bank accounts to avoid any payments industry based system;
- some UK based sellers may only accept cash payments (for example direct bank transfers) in order to conserve cashflow, which would otherwise be reduced by split payments real time VAT collection;
- the split payment proposals are complex and would require large-scale systems changes - it would be prudent to introduce for overseas sellers first, where the risk is highest to ensure it works as intended, before widening the scope; and
- the introduction of split payments could lead to a potential rise in administrative costs for businesses, so the scope should be limited.

2.45 Some respondents also made the point that scope of split payments should be narrower than overseas businesses. Alternative suggestions for scope were:

- sellers based overseas who were known to be non-compliant;
- sellers based overseas who were not VAT-registered;

- sellers who were based overseas, but who stored goods in the UK, and hadn’t registered for VAT; and
- the scope is irrelevant as split payment shouldn’t be introduced.

***Question 8*) What changes do you anticipate as a result of PSD2? Will the existing parties, such as merchant acquirers, PSPs, or PISPs, continue to have a role to play in the future?**

2.46 Payment companies indicated they are currently undergoing a period of regulatory and structural change, including implementing PSD2 (Revised Payment Service Directive) which largely came into effect in January 2018. They state this limits their capacity to implement further government structural changes, such as split payment in the short to medium-term.

2.47 As well as compliance costs, PSD2 has created opportunities to develop new products. Payment companies said a potential split payment mechanism would draw resources away from developing new technology, which would put firms operating in the UK at a disadvantage to their global competitors, if split payment was implemented unilaterally.

2.48 Respondents said that the high cost of development would have a disproportionate effect on smaller firms. It could act as a barrier to entry to the market, which goes against government policy of encouraging competition and innovation in the UK’s finance sector.

2.49 Payment companies thought the proposals were too focused on card payments. They said there could be a shift towards payments via new technology in the future, which would not be caught by the design of the current split payment model.

2.50 Many respondents from the payment industry thought that split payment would not be possible under PSD2 in its current form which does not allow for a single payment to be made to multiple parties without the explicit agreement of the consumers, with an exception being made solely for the contractually agreed charges of the payment processors, like the merchant acquirers, themselves.

***Question 9)* Do you agree with the government’s thinking regarding how errors, adjustments, and refunds could be handled? Do you think there are better ways of resolving these issues?**

2.51 Many respondents expressed a desire for more detail on how errors, adjustments, and refunds could be handled than was set out in the consultation document.

2.52 Some respondents thought refunds should be handled as the mirror image of payments i.e. - the merchant should refund the net amount and HMRC should refund the VAT, simultaneously. Payment companies emphasised the complexity of processing a refund from two separate entities as it would be difficult to reconnect data once it has been split.

2.53 Payment companies said refunds and adjustments should be as simple as possible, with a minimum amount of human interaction with HMRC or merchants. One option suggested was for the merchant to refund the full amount and claim a refund for the VAT amount from HMRC. Concerns were raised about the cash flow impact this would have on merchants of refunding VAT that they did not receive.

2.54 The majority of respondents agreed with HMRC that the merchant should retain ultimate responsibility for ensuring accurate declarations and that the correct amount of VAT is paid. Some payment companies said they should not be liable for errors. As the ultimate owner of the scheme, they felt HMRC should bear the risk of errors. A few respondents had concerns around one party being responsible for the split (payments business) and another (the overseas business) being responsible for any errors.

2.55 Stakeholders felt that errors, adjustments, refunds and chargebacks would make up the bulk of any administrative burden of a split payment mechanism.

Development and Implementation

***Question 10*) If you or your organisation is involved in the development of new payment technology, how long would you estimate it would take to create a system capable of implementing any of the proposals in this consultation? How much do you think it would cost?**

2.56 Most said respondents thought the proposals would take a long time to develop and implement based on experience with projects of a comparable scale. Stakeholders said it will depend on the detail of the policy, but some estimated it could take a minimum of five years.

2.57 Very few respondents gave figures for the cost of implementing the proposals. Some said they would need more firm detail to be able to assess costs. Most stakeholders stressed that the costs will be high due to the scale of systems changes required and of those who provided estimates these ranged from hundreds of millions to seven billion pounds across the UK financial services sector. Some respondents were of the view that split payment's costs would outweigh the VAT recovered for a significant period of time.

2.58 Some respondents asked whether government funding would be available since the government would be the principal beneficiary from split payment.

***Question 11)* Is there anything else the government can do to enable the implementation of split payment?**

2.59 Respondents said HMRC should continue discussions with EU and global counterparts for solutions to tackle the e-commerce VAT gap on cross border transactions. They did not believe it would be effective for the UK to implement such a large change if the rest of the world moves in a different direction.

2.60 If the government is to take split payment forward, stakeholders wanted to be consulted in more detail on proposals. Respondents are keen for more clarity particularly on the intended target population of any potential split payment model and how the government envisages it interacting with import VAT.

2.61 Some stakeholders said the government should explore how emerging technologies could be used to achieve the same tax collection benefits with a lower cost to the payment industry.

3. Government response and next steps

3.1 The government recognises the complexities involved in splitting a payment under current UK VAT rules. This includes the need to address the concerns raised by stakeholders in this document, particularly around the need for simplicity. The government also acknowledges there are significant changes occurring in the payments sector, which limit business capacity for implementation in the short to medium-term. The UK will continue to lead the way and influence the international debate about the best solutions, including alternative collection methods, to address the challenge of ensuring UK VAT compliance on cross-border trade.

3.2 Due to the changing nature of commerce and increasing shift to digital channels, the government is committed to exploring innovative proposals that have the potential to help ensure tax compliance by those operating across borders. Any split payment mechanism would be a radical departure from the way VAT is collected today. The government is seeking to design a VAT collection mechanism that is fit for a twenty-first century globalised economy. The government views split payment as a potential long-term solution, but accepts it would take both HMRC and industry time to develop and implement successfully.

3.3 As part of the ongoing review of a possible future split payment mechanism, the government will need to take into account the potential costs to businesses, particularly for small and micro businesses, and the need to ensure sufficient lead-in time for businesses to develop any necessary supporting systems.

3.4 The majority of respondents referenced the Deloitte report commissioned by the EU and published in December 2017: '*Analysis of the impact of the split payment mechanism as an alternative VAT collection method*'[7]. Some highlighted that the report concluded that there was: '*no strong evidence the benefits of split payment would outweigh its costs*'. The scope of the UK's proposals is substantially different to those considered in the study, and so the government does not think that the conclusions reached in the report can be automatically applied to our own split payment proposals. The EU's report referenced that its analysis was highly dependent on the specific design of the policy: '*a different design of the mechanism for split payment (e.g. different scope or technological choices) may come to considerably different results*'. The government will continue to evaluate the potential costs and benefits associated with a split payment model when taking the work forward.

3.5 Many stakeholders took the view that the EU's 2021 e-commerce package solves the non-compliance problem, as HMRC has framed it, by deeming online marketplaces liable for their overseas sellers' VAT. They are keen for clarity around whether the UK will be implementing the package in full after EU exit. The government's White Paper on the 'Future Relationship between the

[7] https://ec.europa.eu/taxation_customs/sites/taxation/files/split_payment_report2017_en.pdf

United Kingdom and the European Union'[8] proposes the application of common cross-border processes and procedures for VAT and excise for goods to help avoid the introduction of declarations and border checks. The specifics of the UK's future relationship with the EU are dependent on the outcome of EU exit negotiations.

3.6 The government still believes that a feasible split payment model for VAT, which would allow VAT to be split from online payments in real time, would help reduce the VAT gap from cross-border e-commerce and would revolutionise tax collection. This is because in a future economy many consumers could buy through non-marketplace channels using evolving, alternative payment methods which would be outside the scope of our current compliance powers. It has potential to transform the way VAT is collected more broadly in the future.

3.7 The industry's willingness to work with the government to explore how to best solve the challenges outlined in this document is particularly welcome. HMRC and HM Treasury will set up a formal industry working group to facilitate these discussions. See chapter 4 for details.

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[8] https://www.gov.uk/government/publications/the-future-relationship-between-the-united-kingdom-and-the-european-union

4. Industry Working Group

4.1 The terms of reference for the group are to provide a forum in which HMRC, HM Treasury and industry experts can discuss, refine and explore how a potential split payment model could work for VAT.

4.2 The objectives for this group are:

- to develop customer journeys for how split payment could work in different scenarios, particularly for new and evolving payment types;
- identify potential pilot opportunities to test the concept;
- to explore short and medium-term measures which could facilitate potential longer-term implementation of a split payment system; for example, how data can be utilised for splitting;
- develop a roadmap for how split payment could be implemented; and
- to look at the best options for enforcement.

4.3 HMRC is grateful to businesses who have already indicated that they would like to be a part of a working group. HMRC will be sending out communications in due course to those who have already expressed an interest. If you would like a progress update or think your organisation may have relevant expertise, such as financial services solution architects and/or payments industry experts, that could be beneficial to the working group please contact indirecttax.projectteam@hmrc.gsi.gov.uk by 5 December 2018.

Annexe A: List of organisations who responded to the consultation

The following organisations responded in writing to the consultation:

- Amazon
- Association of Accounting Technicians (AAT)
- Association of International Courier & Express Services (AICES)
- Barclaycard
- Chartered Institute of Taxation (CIOT)
- DAGTVA
- Debenhams
- EBay
- Electronic Money Association (EMA)
- First Rate Exchange
- Grant Thornton
- Hillier Hopkins LLP
- Mastercard
- Mobicash
- Nationwide
- Paybase
- PWC LLP
- Streeva
- Stripe
- UK Finance
- Vanquis Bank
- Visa Europe
- Worldpay

In addition to those who responded formally above, discussions (sometimes as part of wider meetings) were also held with:

- American Express
- ASOS
- EY
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Oracle
- Payoneer
- PayPal
- Taxmen.EU
- Transferwise
- Vocalink
- Worldfirst

Annex B: List of questions

1. Do you agree that the merchant acquirer is the best placed party to effect the split of VAT from the gross payment? If not, who do you think would be best placed and why?

2. Do you think the government's emerging thinking on a mechanism for split payment is workable? If not, how would you improve it?

3. Do you think the use of the card issuer as a fall-back option would provide an effective safeguard for the mechanism by creating sufficient incentive to encourage merchant acquirers or PSPs to register with the scheme?

4. Do you think that marketplaces, when they are involved in a sale, could have a role to play in effecting the split?

5. Do you agree with the government's assessment of these options for determining how much should be split from the gross payment?

6. Are there any other options you would suggest to further simplify the process of calculating the amount to be split?

7. Do you think the scope of split payment should be limited to overseas sellers, or should HMRC expand the scope to include online UK businesses?

8. What changes do you anticipate as a result of PSD2? Will the existing parties, such as merchant acquirers, PSPs, or PISPs, continue to have a role to play in the future?

9. Do you agree with the government's thinking regarding how errors, adjustments, and refunds could be handled? Do you think there are better ways of resolving these issues?

10. If you or your organisation is involved in the development of new payment technology, how long would you estimate it would take to create a system capable of implementing any of the proposals in this consultation? How much do you think it would cost?

11. Is there anything else the government can do to enable the implementation of split payment?