



HM Revenue
& Customs

VAT treatment of refunds made by manufacturers

Summary of Responses

18 December 2013

Contents

1	Introduction
2	Responses
3	Next steps
Annex A	List of stakeholders consulted

On request this document can be produced in Welsh and alternative formats including large print, audio and Braille formats

1. Introduction

1.1 The purpose of the consultation

At Budget 2013, the Government announced its intention to legislate to allow manufacturers to adjust their VAT to take account of refunds they make to final consumers.

Normally it is the retailer that refunds money to the customer if goods are returned or a retrospective reduction in price is agreed. Where the goods are subject to VAT, the retailer is entitled to make an adjustment under regulation 38 of the VAT Regulations 1995 and reclaim the VAT declared on the transaction. A VAT-registered purchaser must make a similar adjustment to any VAT reclaimed on the goods.

However, sometimes the purchaser seeks a refund of some, or all, of the price from the manufacturer and not from the retailer. This might happen, for example, when there is a major fault in the goods. Regulation 38 does not explicitly accommodate this situation.

The measure seeks to equalise the VAT treatment as far as possible and ensure that UK law expressly accords with EU law.

The consultation ran from 31 May to 31 August 2013 and sought views on:

- the extent to which manufacturers make such refunds;
- the range of circumstances that may give rise to a refund;
- how the change should be implemented;
- what impact it may have and what administrative burdens it may give rise to.

1.2 Respondents to the consultation

We received 6 responses and the breakdown of respondents is as follows:

Accountancy and taxation firms and bodies ...	3
Manufacturers.....	1
Manufacturers' representative bodies.....	1
Individuals.....	1

We would like to thank all of the respondents (listed in the Annex) for taking the time to participate in the consultation. Their comments have helped to inform the policy making process.

2. Responses

2.1 Overview of responses

One respondent felt that the VAT at stake is insignificant and that therefore no change is necessary. Aside from that, the responses were supportive of the measure, though most considered that the examples given, while correct, could be added to (e.g. to encompass the provision of additional goods by the manufacturer rather than a cash payment and refunds in respect of business promotions).

One respondent described a number of scenarios in which payments may be made by manufacturers but did not address the specific questions raised in the consultation document. They also suggested that third party payments on behalf of manufacturers - such as those made by credit card providers, insurers and PPI claims companies - should also be included.

Two respondents thought that the consultation document over simplified the supply chain and that the measure should be extended to include importers and distributors (among others).

Comments were also made about the likelihood of error correction claims in respect of historic payments and the need for HMRC to produce guidance.

2.2 The responses and HMRC's comments

The views of respondents and HMRC's responses are set out below. The questions raised in the consultation document are reproduced below together with extracts from the consultation document where necessary to set the context.

Question 1

Objective

The objective of the change is to ensure that the net VAT accounted to HMRC on any given supply of goods is proportionate to the total consideration paid by the consumer for the goods, after adjusting for any refund made.

Do you agree that this is the correct objective?

All but one of the respondents who addressed this question expressed the view that this was the correct objective. The one respondent considered a change unnecessary.

Other comments included:

- the term “consumers” should be defined so as to include taxable persons;
- the legislation should include circumstances where the manufacturer has provided services of installing goods at a customer's premises.

HMRC's comments

We agree that a taxable person can be a final consumer in this context.

If a supplier's agreement with its customer includes installation of the goods as part of a single supply that will constitute a supply of goods. The legislation will specifically relate to a decrease in consideration in respect of a supply of goods. However, the separate provision of installation services will not be covered.

Question 2

Do you agree that the correct scope and meaning of "refund" is a payment that relates to the supply of the goods and not any other matters and that it must be a monetary refund?

Most respondents agreed with this point.

One respondent considered "refunds" for which an adjustment could be made should include the provision of additional goods (e.g. filters for the purchased vacuum cleaner), the provision of face value vouchers and payments to consumers for consequential loss.

The same respondent specifically agreed that any VAT adjustment could not exceed the VAT included in price paid by the final consumer. However, they pointed out that the manufacturer does not necessarily know the retail price. and that obtaining evidence of this would create considerable burdens. They suggested two simplification measures:

- a de minimis limit, where the manufacturer is entitled to reduce its output VAT without further enquiry as to the retail price;
- an automatic entitlement for the manufacturer to reduce its output VAT where the refund is no greater than the trade price (subject to capping for high value goods).

HMRC's comments

Article 90 of the VAT Directive sets out the circumstances in which a VAT adjustment may be made:

(1) In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.

(2) In the case of total or partial non-payment, Member States may derogate from paragraph 1.

We do not agree that the provision of additional goods or face value vouchers amount to a reduction in price. Where the manufacturer provides a cash refund to the final

consumer then the price paid by that consumer is effectively reduced; if the manufacturer instead provides additional goods to the consumer it is not.

In order to obtain a refund there will be a dialogue between the manufacturer and consumer, which will typically involve the consumer evidencing how much they paid at the retail stage. We think, therefore, that it would be rare for the manufacturer not to know the retail selling price of the goods.

In our opinion the simplifications suggested would not be compliant with the principal VAT Directive as any adjustment must reflect the actual position.

In our opinion payment for consequential loss represents compensation unrelated to the original price paid for the goods.

Question 3

Examples HMRC will accept as refunds

The following are examples of where HMRC accept that a refund within the meaning of the proposed changes can be made:

- *faulty products;*
- *damaged products;*
- *where the customer is generally dissatisfied with a product rather than being able to demonstrate a fault or damage; and*
- *product recalls for safety, health or quality issues.*

Do you agree with the examples given?

There was general agreement to these examples.

However, one respondent suggested the monetary payments in respect of the following are also examples of “refunds”:

- promotion schemes e.g. money off coupons and similar. Though they acknowledged that manufacturers could already adjust their VAT to take account of such payments they submitted that no provision is currently expressly made for this in UK legislation;
- faults outside the warranty period;
- faults within the warranty period where the original supplier disputes liability;
- volume discounts;
- refunds to consumers who undertake a related action (e.g. entering a finance agreement).

HMRC's comments

Although it is arguable that current UK legislation does provide for adjustments for the promotions described, HMRC agrees that the matter would be put beyond doubt if the proposed legislation specifically provides for such circumstances.

HMRC believe that the second and third examples above fall within the 'faulty products' category of the consultation.

Volume discounts seem unlikely to involve final consumers and adjustments where parties have a direct contractual relationship are already covered by Regulation 38. However, if payments for volume discounts are made by manufacturers to final consumers with whom they do not have a direct contractual relationship, they would be covered by the new legislation.

We are unable to comment in general terms on refunds to customers who undertake a related action. The circumstances of each case would need to be considered in order to ascertain if a VAT adjustment was required.

To clarify our position on product recalls, we agree that the VAT treatment of product recalls for health, safety or quality reasons is unaffected by whether the goods are returned to the manufacturer or destroyed, or whether the recall is required by legislation.

Question 4

As a manufacturer, to what extent have you made refunds in the above categories and are there any other examples that you think HMRC should consider to be refunds?

While only one manufacturer responded to the consultation, most respondents provided a response to this question. Two gave details of complex supply chains in the motor industry, potentially involving manufacturer, importer, distributor, retailer, lease or fleet entity, finance provider and insurer, with roles in the final transaction.

One respondent gave examples of retrospective reductions in price -

- retrospective bonuses paid by importers/distributors to parties further down the supply chain;
- deposit contributions paid by manufacturers or importers/distributors to end customers on the proviso that they fund their purchase through a nominated finance house.

Another respondent gave the example of refunds given by the manufacturer where the retailer has gone out of business.

One respondent identified three specific areas where a third party would make goodwill type payments to an end customer under a contractual obligation to the manufacturer -

- payments made by credit card companies under the Consumer Credit Act;
- payments made to consumers by insurance companies, where the business has appropriate insurance cover;
- payments to consumers who had been mis-sold payment protection insurance in relation to goods.

HMRC's comments

We accept that suppliers who make refunds to final consumers are not restricted to manufactures, for example they might include a UK importer who initiates the supply chain. We accept that they should also be able to reduce their output tax and so the new legislation will refer to “first suppliers” rather than manufacturers.

The consultation was specifically about refunds made to final consumers. However, in the case of intermediate B2B adjustments HMRC believe that the scope already exists for VAT adjustments to be made. It may be that this gives rise to some administrative burdens but this is a reflection of the complexity of the supply chains rather than the VAT treatment.

A deposit contribution where it takes the form of a “cash-back” type arrangement will entitle the manufacturer to claim a VAT refund. However, where the payment is contingent upon the customer entering into a separate transaction the full facts would need to be considered.

We accept that refunds made by manufacturers/first suppliers where the retailer has gone out of business will in principle be covered by the legislation, providing both are UK taxable persons.

We do not accept that payments by third parties such as credit card or insurance companies lead to a VAT adjustment. The party making the payment did not account for VAT and so has no relevant VAT to re-visit.

Question 5

Examples HMRC will not accept as refunds

The following are examples of where HMRC do not accept that a refund within the meaning of the proposed changes can be made:

- *payments to the extent that they exceed in value the total consideration paid by the consumer - if the consumer receives a refund in excess of the original consideration, any excess is of a compensatory nature and outside the scope of VAT;*

- amounts for consequential loss, for example damage to a carpet following a washing machine leak – such a payment is made in compensation for the damage/loss and not an adjustment to the consideration paid for the goods;
- vouchers or other credit token redeemable against future purchases – a voucher or credit token does not represent a refund against the original consideration but is a discount offered against the purchase of future goods, which may not be taken up;
- payments to third parties to repair the goods and a free supply of parts to effect a repair - the test is whether the customer has received a refund against the consideration he or she paid for the goods and, if that is unaltered, then there is no adjustment to be made.
- payments to customers covering the cost of repairs the customer paid to third party repairers. This is "out of pocket" compensation to the consumer, the original cost of the goods remains unaltered.
- cases where the goods are repaired, exchanged or replaced without any refund of the purchase price.

Do you agree that the examples given should not be classed as refunds and are there any other examples that you think that HMRC should consider?

There was general agreement to the list of examples. However, two respondents considered that some relief should be available to the manufacturer for payments to third party suppliers for repairs to the goods.

HMRC's comments

Where a manufacturer/first supplier enters into a contractual relationship with a taxable person who repairs the goods, the manufacturer/first supplier may reclaim any VAT charged to them as input tax, subject to the normal rules.

We do not consider the manufacturer is entitled to adjust its output tax in such circumstances.

Question 6

How does the fact that the goods have been sold under a finance agreement affect your policy for making a refund direct to the consumer?

Respondents noted that this scenario is complex given: the relatively longer supply chains, the lack of the scope for credit notes, and the possibility of retailers acting as a conduit for payments, as well as providing refunds in their own right.

HMRC's comments

In principle, we consider that there may be scope for VAT adjustments, although it would turn upon the facts of each case.

Question 7

Input tax

Consumers that were entitled to an input tax deduction will be required to make a corresponding input tax adjustment. Partly exempt consumers will need to adjust the amount according to their method. The amount by which a customer is or is not required to adjust their VAT should not affect the treatment by the manufacturer.

Do you agree that this is the correct treatment of input tax?

There was general agreement to this point, though one respondent noted that there may be a tax risk owing to the lack of VAT documentation, such as a credit note.

HMRC's comments

As the parties are not in a direct contractual relationship there is no scope for the issue of credit notes. We consider that the business records of those making payments and (where they are taxable persons) those benefitting from them, should provide a proportionate safeguard against fictitious adjustments.

Question 8

Do you have any comments or suggestions that have not already been covered?

One respondent asked HMRC to comment on how an overseas manufacturer, not registered for VAT in the UK, could obtain credit for the VAT element of refunds made directly to the customer of a UK retailer.

One respondent noted that claims for goodwill adjustments over the past four years may need to be made.

HMRC's comments

A manufacturer who is not a UK taxable person, by definition, has not paid VAT and so has none it can re-visit in the event that it makes a payment to a final consumer.

In principle, we accept that - where the amended legislation applies - businesses will be able to submit claims for refund of overpaid VAT, subject to the relevant conditions being met.

Question 9

Do you agree that the proposed change will have no impacts other than those set out [in the impact assessment] above? If not, what additional impacts do you think will result from the proposed change?

One correspondent believed that the impact assessment underestimated the time it would take for businesses to familiarise themselves with the legislation, given the potential complexities. It was also suggested that some further formal or informal consultation be undertaken. One respondent suggested that HMRC could convene a panel of tax practitioners to achieve good design of the legislation, a workable framework for implementation, and to monitor the change.

HMRC's comments

We are grateful for the responses we have received. We consider that the consultation has provided an excellent basis on which to produce draft legislation and that draft will also be consulted on. HMRC will provide detailed guidance on the operation of the legislation once it is finalised.

3. Next steps

3.1 Publication of draft secondary legislation

The draft legislation has been published for comment at <http://www.hmrc.gov.uk/drafts/>.

The legislation will be introduced on 1 April 2014.

3.2 Guidance

We will provide publicity of the new legislation via our website and produce guidance on how the legislation will operate.

Annexe A: List of stakeholders consulted

Association of Accounting Technicians

Chartered Institute of Taxation

KPMG

Society of Motor Manufacturers & Traders Ltd

Volkswagen

1 individual respondent