HM Revenue
& Customs

VAT:
Prompt Payment Discounts

Summary of Responses
10 December 2014

Contents

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1. Introduction

1.1 At Budget 2014 the Government announced changes to UK legislation relating to prompt payment discounts (PPD). These became law in the Finance Act 2014. They take effect for supplies made on or after 1 April 2015. From that date, the way many businesses account for VAT when offering PPD will change.

1.2 For supplies of telecommunication and broadcasting services where there is no obligation to provide a VAT invoice, the measure took effect from 1 May 2014.

1.3 Currently where businesses offer PPD terms (i.e. where the time of supply pre-dates payment) to customers they may calculate the VAT due on the discounted price. If the discount is not taken up HMRC does not require businesses to alter the amount of VAT invoiced and accounted for.

1.4 After the change, businesses must account for VAT on the full consideration received for supplies of goods and services. This change protects the revenue and puts it beyond doubt that UK legislation is aligned with EU legislation.

1.5 A consultation took place between 17 June 2014 and 9 September 2014 which asked affected businesses for their views and suggestions on how the changes should be implemented. In particular would the requirement for revised invoices or credit notes cause difficulties and were there better ways to implement the change.

1.6 Many respondents suggested that issuing credit notes would be a considerable burden and suggested other ways of making the adjustments that might work better. These included the use of a single invoice, with suitable wording of the terms of any discount, which would mean each party only needing to make appropriate internal accounting adjustments. There would therefore be no need for a revised invoice or credit note when payment is made within PPD terms.

1.7. We consider that businesses may comply with this change in more than one way. Businesses that wish to adopt an arrangement that does not require the issue of a revised invoice or credit note will be able to do so provided they are able to evidence a reduction in consideration. Guidance will be published explaining how businesses may do this.

1.8 Information received during the consultation has enabled HMRC to provide a more accurate assessment of the impact of the change. When considering all businesses together, the total costs are higher than initially calculated. However, as businesses will not be required to issue credit notes, the costs for individual businesses are lower than they would otherwise have been. The updated figures are in Appendix A.

2. Responses

Respondents to the consultation

2.1 HMRC received 38 responses from 32 organisations. The breakdown of respondents is as follows:

Accountants ……………………………………….2

Software Companies …………………………….5

Manufacturers…………………….…………….1

Wholesalers and Retailers………………………17

Financial Products and Services………………..1

Local Authority Body………………….……….1

Construction ……………………………………….1

Invoice Clearing Services………………………..1

Professional Bodies……………………………….9

We would like to thank all of the respondents (listed in Section 4) for taking the time to participate in the consultation.

Overview of responses

2.2 Respondents in general had concerns about administrative burdens, how PPD would be processed and the cost of implementation.

Wholesalers and retailers in particular expressed concerns about re-issuing invoices or issuing credit notes, especially where the volume of invoices was very high.

Accounting software developers provided detail of practical and cost implications, along with some suggested solutions, which like many others referred us to systems which already operate in other EU Member States.

Several respondents including one large accountancy firm asked how “contingent discounts” rules might impact on PPD. This is considered below.

Whilst all respondents responded to the PPD Consultation questions, most did not limit themselves to those questions and introduced other issues. These are considered at the end of Chapter 2.

Summary of responses by question

Question 1
Are there particular issues or difficulties in raising and issuing credit notes or revised invoices where a PPD is taken up after an invoice is issued? If so what are they?

2.3 42% of responses indicated that if PPD adjustments are to be made using credit notes or replacement invoices, this will create a disproportionate amount of administration compared to the amount of VAT involved.

The following concerns were mentioned:

a) Training of Accounts Payable staff.

b) Higher postage costs (unless there is electronic invoicing).

c) Software development costs.

d) Cost of implementing and maintaining systems.

e) Additional accounting entries will increase Accounts Payable clerks' workloads.

2.4 16% of respondents were in sectors with a high take up of PPDs so having to issue credit notes or replacement invoices on every discount that is taken up, as originally proposed in the consultation document, would be very burdensome.

<u>HMRC's comments</u>
HMRC agrees that requiring businesses to reissue invoices or issue credit notes when payments are made within the PPD terms offered is likely to cause a high administrative burden.

2.5 5% of respondents suggested there would be an increased risk of fraud or VAT manipulation if credit notes were to be used. This is because there would be an incentive for customers not to process credit notes received as they would thereby be reducing their input tax recovery. This would remove the tax revenue benefit.

<u>HMRC's comments</u>
We acknowledge that there is a risk that credit notes may be ignored by vat registered customers. This risk exists currently where credit notes are issued but we believe the vast majority of businesses will comply with their legal obligations.

Question 2
If you have answered yes to Question 1 have you identified any solutions which still ensure that output tax is declared by the supplier on the consideration received and that the customer can only claim the corresponding input tax?

2.6 13% of respondents pointed us to processes which already work in other EU Member States which they thought would cause less administrative complexity than requiring a credit/debit note to be issued. Software company respondents also pointed out that accounting programs for these countries are already designed to work with this approach, which require a single invoice to evidence both the full price and the PPD price.

2.7 5% of respondents referred us to the German and Netherlands' systems in particular.

i. Germany: businesses issue a single invoice and have a choice of wording they can use on that invoice which set out the terms of any PPD. The supplier accounts for the output tax they actually receive and the customer can only deduct the amount they pay.
ii. Netherlands: they apply a late payment surcharge and not an early payment discount. If payment is not made on time a surcharge, which is part of the consideration on which VAT is payable, must be paid. This is detailed on the original invoice. In theory if the purchaser wishes to deduct the VAT associated with the surcharge they must obtain an additional invoice.

2.8 A respondent also referred us to France's approach to PPD. It involves only using a single invoice, and businesses do not have to issue a credit note where a PPD is taken up providing the initial invoice mentions that, where the PPD is taken up, only the price actually paid gives rise to a right of VAT deduction.

<u>HMRC's comments</u>
We agree that reissuing invoices or issuing credit notes when PPDs are taken up may add to a business's administrative burden. We agree that a system for adjusting consideration without the need for a credit note would reduce this burden. We will shortly issue guidance on how this may be done.

Question 3
Are there any particular challenges involved in processing payments and adjusting VAT when discounts are taken up? If so what are they? How might they be overcome?

2.9 16% of respondents suggested there might be matching difficulties if credit notes were used to make corrections. It might not always be easy to trace payments to individual invoices (especially if a payment covered more than one invoice).

<u>HMRC's comments</u>
We acknowledge that in some cases there will be disadvantages to using credit notes to adjust for PPD taken up by customers.

Question 4
Are there any particular types of supply or arrangements, e.g. self-billing, which may result in other implementation issues? If so what are they? How might they be overcome?

2.10 11% of respondents referred to self-billing, but none identified any particular problems. If it is the customer that issues the invoices they decide whether to make payment according to the discount terms and conditions and raise the invoice accordingly. Once the supplier receives the invoice and payment, they make the appropriate entry in their accounts. Credit notes are not necessary.

No other issues were raised in relation to other types of supply or arrangements.

HMRC's comments No new issues were raised by respondents.

Question 5
Are there any other implementation issues that may cause businesses difficulties? If so what are they? How might they be overcome?

2.11 45% of respondents raised issues of how processes would work, for example, should the supplier record the discounted price as the amount paid if it was usual within a sector or industry to always pay the discounted amount within the time allowed?

2.12 Also, would there be any transitional arrangements, where invoices are issued prior to 1 April 2015, discounted payments are received after that date and then credit notes issued for the discounted amounts?

HMRC's comments For supplies made prior to 1 April 2015, VAT can be accounted for on the discounted amount, unless the supplier has already accounted for VAT on the amount actually received. For supplies that are made on or after 1 April 2015, VAT is due on the consideration payable. VAT will be due on the undiscounted amount, unless and until the discounted amount is paid in accordance with the PPD terms. We consider there is sufficient time for businesses to make the changes to their systems and ways of working prior to the date of change. There will be no transitional arrangements.

Additional points raised by respondents

The following points were also raised by respondents;

a) Costs of implementation as stated in the Tax Information and Impact Note (TIIN).

2.13 The costing in the TIIN stated that there would be a one-off cost to businesses for familiarisation and system changes due to issuing revised paperwork where PPD arrangements are in place. It was estimated that the one-off costs to these businesses would be about £8 million. There would be on-going costs of £3.5 million per annum from 2015/16 but that would depend on the mechanism chosen for adjusting VAT.

2.14 16% of respondents suggested the costings were low. Some suggested that the costings may be higher or lower depending on the preferred way of implementing the changes.

<u>HMRC's comments</u> HMRC considers an updated costing is appropriate. See the revised table of impacts in Appendix A below.

b) Time of Implementation

2.15 8% of respondents suggested that making the necessary changes by 1 April 2015 was unrealistic. They suggested that it would not be possible to change and test accounting systems or train staff within the time frame should there be a requirement for credit notes. Some respondents pointed out that to develop, test and introduce a single invoice method, where only internal accounting adjustments might be required, would be quicker.

<u>HMRC's comments</u> Businesses will be able to issue an invoice without any need for a credit note to make adjustments. HMRC will shortly issue guidance on how this may be done. We consider this gives sufficient time to make the necessary changes before 1 April 2015.

c) Contingent Discounts

2.16 19% of respondents suggested that the wording in HMRC guidance (Contingent Discounts - Notice 700, section 18.2.1) could be used to achieve the same outcome as the original PPD legislation, i.e. if both parties agree they are free to choose whether the VAT they declare or recover is based on the full or discounted price.

<u>HMRC's comments</u> Where a PPD is taken up, the contingent discount policy will not apply as the revised legislation provides that the value of the supply is the discounted price paid and it is therefore this price on which VAT must be calculated. The contingent discount guidance may still be used to assist businesses with other types of discount offered to customers, e.g. volume rebate discounts.

d) Time of adjustment

2.17 A respondent suggested that accounting for the VAT simply upon payment would be preferable, as it is only at that point that the VAT becomes 'fixed'.

HMRC's comments The normal tax point rules will apply. PPD affect the price not the time of supply.

3. Next steps

3.1 HMRC agrees that businesses should not be required to issue credit notes when there is a reduction in consideration because a PPD is taken up.

3.2 We consider that the suggested use of a single invoice setting out the terms of the PPD together with other documentary evidence to prove the price paid and the date of payment, e.g. a bank statement, is a sensible way forward. HMRC will have no objection to businesses operating in this way if they choose to do so and will issue a Revenue and Customs Brief containing guidance on this shortly.

4. List of respondent organisations

Respondents Name	*Type of Business*
'A Guernsey business'	Construction
Active Music Distribution	Wholesaler/Retailer
Association of Accounting Technicians	Professional Body
Association of Taxation Technicians	Professional Body
B Fudge	Accountant
Billionaire.com	Wholesaler/Retailer
BP International Ltd	Wholesaler/Retailer
Business Application Software Developers Association	Trade Body
Casio Electronics Co Ltd (Electronic Supplier)	Manufacturer/Wholesaler/Retailer
Chartered Institute of Taxation	Professional Body
Edmundson Electrical	Wholesaler/Retailer
EDP	Accounting software specialists
Epicor	Accounting software specialists
Federation of Petroleum Suppliers	Trade body
Gallagher	Manufacturer
GE Capital Europe Ltd	Financial Products and Services
ICAS, Chartered Accountants	Professional Body
Institute of Chartered Accountants in England and Wales	Professional Body
Institute of Credit Active Music Distribution Management	Professional Body
John Lewis	Wholesaler/Retailer
Local Authority National VAT Consultative Group	Local Authority Body
National Merchant Builders Society	Invoice Clearing Services
Optimise System Ltd	Accounting software specialist
Prima Solutions	IT Specialists
PWC	Accountant
Quantus	Accounting software specialists
Sonic Distribution	Wholesaler/Retailer
Sound Technology Ltd	Wholesaler/Retailer
Time Products (UK) Ltd	Wholesaler/Retailer
Vasanta Group	Wholesaler/Retailer
VAT Practitioners Group	Professional Body
Vodaphone	Wholesaler/Retailer

More than one response was received from some groups.

Appendix A

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
<tr><td>-</td><td>nil</td><td>nil</td><td>nil</td><td>nil</td></tr>
<tr><td colspan="5">This measure is not expected to have an Exchequer impact. This measure supports the Exchequer in its commitment to protect revenue.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure is not expected to have any significant macroeconomic impacts.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">This measure will principally affect businesses. Individuals may be impacted in that prompt payment discounts are less likely to be offered to them.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">There is no specific impact identified for any equalities group.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">There will be an impact on businesses that currently offer or receive prompt payment discounts. Although the number of businesses using prompt payment discounts is not known, a survey by the British Chambers of Commerce on supply chains suggests that 13 per cent of businesses offer prompt payment discounts. It is therefore estimated that up to 260,000 businesses (i.e. 13 per cent of the VAT-registered population of 2.0 million businesses) could be affected by the change because they offer prompt payment discounts. It is also estimated that an additional 500,000 businesses which receive prompt payment discounts will be affected.

It is anticipated that there will be one-off familiarisation and system changes, as well as ongoing administrative costs for making VAT adjustments when prompt payment discounts are taken up. It is estimated that the one-off costs to businesses are likely to be significant at about £23 million. The ongoing costs are also likely to be significant at about £5 million per annum from 2015/16. These estimates assume that businesses will not need to issue revised invoices or credit notes in connection with prompt payment discounts.
<table>
<tr><td></td><td>Cost</td><td>Time Period (years)</td></tr>
<tr><td colspan="3">Compliance Costs</td></tr>
<tr><td>One-off Costs</td><td>£23m</td><td>N/A</td></tr>
<tr><td>Average Annual Costs</td><td>£5m</td><td>4</td></tr>
<tr><td>Total Costs (PV)</td><td>£42m</td><td>N/A</td></tr>
<tr><td colspan="3">Compliance Benefits</td></tr>
<tr><td>One-off Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Average Annual Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Total Benefit (PV)</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Net Benefit (NPV)</td><td>-£42m</td><td>N/A</td></tr>
<tr><td colspan="3">Impact on Administrative Burden (included in Net Benefit)</td></tr>
<tr><td>Increase</td><td>Decrease</td><td>Net Impact</td></tr>
<tr><td>£5m</td><td>£0m</td><td>£5m</td></tr>
</table>
</td></tr>
</table>

Operational impact (£m) (HMRC or other)	This measure is not expected to have an operational impact on HMRC.
Other impacts	Small and micro business assessment: the measure will impact on all businesses that offer or receive prompt payment discounts including small firms. Other impacts have been considered and none have been identified.