HM Revenue
& Customs

VAT Accounting Rules- Regulation 38

Who is likely to be affected

Businesses that are making adjustments to their VAT liabilities after a sale has taken place.

General description of the measure

This measure will amend rules on how and when a business is entitled to adjust its output tax when price adjustments are made after the end of the VAT accounting period in which the sale took place. It will do this by tightening the definitions within the legislation, and requiring businesses to issue a credit note and give a refund to customers when a price reduction occurs.

Policy objective

The government's objective is to ensure that businesses which reduce the price of a sale retrospectively can only use Regulation 38 in the circumstances for which it is intended, i.e., when there has been a genuine price reduction, and money has been refunded to a customer.

Background to the measure

Under current UK VAT Regulations, where a change is made to the value of goods or services after they have been provided (e.g., because the supplier and the customer agree a reduced price between them due to faulty goods), Regulation 38 requires that an adjustment shall be made to the VAT return covering the period in which the change takes place. This changes the output tax the supplier is liable to pay to HMRC.

There is no time limit imposed by Regulation 38 so that, for example, it is possible for a business to reduce the value of a supply ten years after it was made. However, in situations where businesses have accounted for too much VAT, but no change in price has taken place (e.g., where a zero-rated supply has incorrectly been treated as standard-rated), suppliers must use the error correction provisions to make adjustments. Such adjustments are limited to four years following the time of the original supply.

There is evidence that some businesses are attempting to abuse Regulation 38 by applying it to situations which should properly be dealt with under error correction provisions. They claim this enables them to make adjustments to their output tax even when no refund is given to the customer, and to circumvent the 4-year time limit. This is currently the subject of litigation. The change will ensure it is clear when adjustments under Regulation 38 can be made, and that customers must benefit from price reductions if the supplier is allowed to adjust the VAT they have charged.

The draft Statutory Instrument will be published for consultation in early 2019.

Detailed proposal

Operative date

The measure will be implemented by negative Statutory Instrument, coming into force on 1 September 2019.

Current law

Provisions for adjustments to output tax following changes to consideration are found in Regulation 38 of the VAT Regulations 1995.

Regulation 38 is subject to interpretative provisions in Regulation 24 and 15.

Proposed revisions

Regulations 15, 24 and 38 of the VAT Regulations 1995 will be amended by Statutory Instrument. The changes will ensure that adjustments can only be made under Regulation 38 when the supplier has issued a credit note to the customer, and has given them a refund.

Regulations 24 and 38 will also be amended so that adjustments must be made in the same accounting period that the triggering increase or decrease in consideration occurs. It will also ensure that errors resulting from a failure to make adjustments must be corrected in accordance with the existing error correction provisions under section 80 VATA.

Summary of impacts

Exchequer impact (£m)

2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022	2022 to 2023	2023 to 2024
-	+70	+120	+115	+110	+105

These figures are set out in Table 2.1 of Budget 2018 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Budget 2018.

Economic impact

This measure is not expected to have any significant macroeconomic impact.

Impact on individuals, households and families

This measure has no impact on individuals as it only affects businesses. The measure is not expected to have any impact on family formation, stability, or breakdown.

Equalities impacts

This measure affects businesses rather than individuals, and is not anticipated to have impacts on groups with protected characteristics.

Impact on business including civil society organisations

This measure will have no impact on business and civil society organisations who are undertaking normal commercial transactions; it will only impact on businesses or civil society organisations that are currently seeking to avoid tax by applying the existing regulation inappropriately.

All businesses and civil society organisations will, however, have to familiarise themselves with the changes.

Operational impact (£m) (HMRC or other)

There are no operational impacts for HMRC associated with this measure.

Other impacts

Other impacts have been considered and none have been identified.

Monitoring and evaluation

This measure will be kept under review through information collected from tax receipts, and reviewing selective businesses VAT accounts.

Further advice

If you have any questions about this change, please contact Richard Lay on Telephone: 03000593190 or email: richard.lay@hmrc.gsi.gov.uk

Declaration

Mel Stride MP, Financial Secretary to the Treasury has read this tax information and impact note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.