Summary: Intervention & Options

Department /Agency: HMRC	**Title:** Impact Assessment of a change to the standard rate of VAT	
Stage: Implementation	**Version:** 1.0	**Date:** 22 June 2010
Related Publications:		

Available to view or download at:

http://www.hmrc.gov.uk/better-regulation/ia.htm

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What is the problem under consideration? Why is government intervention necessary?

The most urgent task facing the country is to implement an accelerated plan to reduce the deficit. Reducing the deficit is a necessary precondition for sustained economic growth. Given the scale of the fiscal challenge, tax must contribute to the task of cutting the deficit.

What are the policy objectives and the intended effects?

The proposed increase in the standard rate of VAT will result in increased tax revenue, which will contribute to the necessary tackling of the deficit, and it will support a rebalancing of the tax system from direct to indirect tax.

What policy options have been considered? Please justify any preferred option.

As part of the Budget process, the Government concluded that the package including a VAT increase was consistent with a sustainable and economically efficient reduction in the deficit. To minimise the costs to business, the Government is implementing the increase in the standard rate of VAT from 17.5% to 20% in one step, rather than increasing it in a number of phases. Recognising the problems for retailers and others in implementing a rate change over the New Year, it will take effect on 4 January 2011.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? For all policy changes, compliance costs are routinely reviewed one to three years after implementation.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Date: 22 June 2010

Summary: Analysis & Evidence

Policy Option: 1	Description: Change to VAT standard rate

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' Expected costs are from familiarisation with the changes, re-pricing, book-keeping and accounting checks, and system changes. The revenue effects of the policy are discussed in the Budget document.
One-off (Transition)	**Yrs**	
£ 300m	1	
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 300m**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' The overall benefits of the policy are discussed in the Budget document.
One-off	**Yrs**	
£ -		
Average Annual Benefit (excluding one-off)		
£ -		**Total Benefit** (PV) **£**

Other **key non-monetised benefits** by 'main affected groups' The key benefits will be felt in terms of the wider public finances as the increase in the standard rate of VAT reduces the UK budget deficit.

Key Assumptions/Sensitivities/Risks This Impact Assessment looks at the one off compliance costs to business to implement the increase in the VAT rate. The Exchequer effect is not included in the costs and benefits figure above as in economic terms it represents a "transfer" being both a cost to the individual taxpayer and a benefit to the public finances.

Price Base Year 2010	Time Period Years	**Net Benefit Range** (NPV) £	**NET BENEFIT** (NPV Best estimate) £

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			4/1/2011	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ not quantifiable	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro **£0**	Small **£0**	Medium **£0**	Large **£0**
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	**Net Impact**	£ 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

1. The Issue

1.1 The Government recognises that action to tackle the fiscal situation is essential.

2. Policy objectives and intended effects

2.1 The objective of increasing the standard rate of VAT to 20 per cent is to contribute to the key objective of deficit reduction. Increasing the standard rate of VAT from 17.5 per cent is estimated to result in around £12.1 billion in additional Exchequer revenue in 2011-12, rising to around £12.5 billion in 2012-2013.

2.2 The increase in the standard rate is also expected to bring forward business and consumer spending, before the rate change takes effect.

2.3 In order to minimise the costs to business we are implementing the increase in the standard rate of VAT from 17.5 per cent to 20 per cent in one step rather than increasing the rate in a number of phases.

2.4 This Impact Assessment (IA) focuses on the identified compliance costs for business to implement the increase in the VAT rate. The Exchequer effect is not included in the costs and benefits figures in this IA as in economic terms it represents a "transfer", being both a cost to the individual taxpayer and a benefit to the public finances.

3. Data and evidence

3.1 Following the temporary change in the standard rate of VAT from 17.5 per cent to 15 per cent on 1 December 2008, HMRC contracted the research company ORC International to undertake a telephone survey of 2,000 VAT-registered businesses. The survey focused on obtaining detailed information on costs incurred by businesses as a result of the rate change to 15 per cent, in order to gather a stronger evidence base. It included gathering data on time taken, shares of businesses undertaking certain activities, and the level of personnel involved. Hourly rates are derived from the Annual Survey of Hours and Earnings (Office for National Statistics).

3.2 The main quantitative fieldwork took place in May and June 2009, and so the research does not measure the impacts of the return on 1 January 2010 to the 17.5 per cent standard rate of VAT.

3.3 The evidence used in this IA draws strongly on this external research. In summary, the key findings of the research are:

- Following the VAT rate change in December 2008 the majority of businesses took less than five hours to adjust to the new VAT rate, but nearly a third took more than five hours.
- Following the VAT rate change in December 2008 businesses undertook a number of activities in order to implement the rate change. Over three quarters of businesses surveyed had to familiarise themselves with the details of the rate change, and just over two thirds had to make system changes and pay more attention to book-keeping arrangements. Just over one quarter had to make additional changes to prices.

Activity	Percentage of businesses surveyed
Familiarisation	78
Extra book-keeping checks	71
System changes	67
Extra operational activities*	43
Extra changes to prices	27

*"Operational activities" are tasks thought not to be essential to implement the rate change, but tasks businesses decided to do.

- o In terms of overall compliance costs looking at both time and activities together, familiarisation represented the largest proportion of the total burden.

Activity	Percentage of overall time taken
Familiarisation	38
Extra book-keeping checks	31
System changes	23
Extra changes to prices	8
Total	100

- o Larger businesses were more likely to spend longer complying with the rate change.
- o The impact of implementing the rate change varied across sectors. The research found that the public administration and defence sector, the human health and social work sector and the electricity, gas, steam and air conditioning sector showed a larger compliance burden.
- o Across all sectors, managers and senior officials were commonly involved. This was particularly the case for familiarisation-type activities, since this category, in the external research, captured time spent making commercial decisions.

3.4 At face value, the research suggests a total cost to business of the VAT rate change in December 2008 (as perceived and reported by businesses) of around £500 million. However, it is not appropriate to use this face value figure directly in this IA for two key reasons:

- o It includes time taken by businesses to undertake discretionary activities such as deciding whether to pass the VAT rate change on to customers and other commercial decisions. While it is acknowledged that businesses may choose to do these things, they do not have to do so in order to comply with a change in a rate of VAT. For this reason, the IA focuses on those activities a business <u>must</u> carry out in order to implement the VAT rate change.
- o The research also includes a number of outliers within the results; for example, businesses with atypically high reported compliance costs. Since impact assessments aim to examine the impacts of regulatory changes on typical and normally efficient businesses, the effects of these outliers should not be included within the headline figures of the IA. However, we recognise that some businesses with particularly extensive and/or complicated business arrangements will face higher compliance costs compared to others.

3.5 We have carried out detailed analysis of the research, with the aim of quantifying discretionary activities and atypically high reported compliance costs. Our cautious estimate is that accounting for both of them together decreases the original £500 million estimate to around £350 million.

3.6 Our internal analysis of the research has also identified a number of other broad findings, including:

- o Half of the surveyed organisations reported compliance costs of below £85. A significant minority of businesses did report very high compliance costs, around 10 per cent of those surveyed reported costs greater than £1,200. Consequently it is clear that there is a wide range of costs surrounding the broad figures for typical businesses as set out in this IA.
- o As identified in the research, we found that there was a positive link between compliance costs and business size which was statistically significant. This is in line with the expectation that larger businesses have more staff to inform, more goods and services that might be affected, and are more likely to have complex systems to adapt.

- Businesses reporting that the VAT rate change was passed on in full or in part tended to experience higher compliance costs. The expectation is that businesses passing on the VAT rate reduction to their customers are more likely to have spent time deliberating on their course of action, increasing the time taken and therefore the cost.
- Businesses supplying goods and services to final consumers rather than to other businesses tended to incur higher compliance costs. The rationale for this is that businesses supplying to final consumers are likely to have had to take more time and effort to re-price goods and services and re-print promotional materials. Businesses selling mainly to other businesses are more likely to be trading in terms of VAT-exclusive prices (since in many cases VAT can be recovered at this stage in a supply chain) and may have only had to focus on altering invoices.
- In addition to those sectors identified in the research (see paragraph 3.3), the education, manufacturing and accommodation & food sectors particularly seemed to face relatively high compliance costs. However, sectors such as agriculture, forestry & fishing, administration & support services, transport & storage, and arts, entertainment and recreation appeared to face particularly low compliance costs compared to other sectors. The reasons for these results are likely to vary from sector to sector, but broadly seem to reflect the type of customer and/or likely re-pricing costs (with some exceptions).

3.7 The research dealt with the initial VAT rate change to 15 per cent, and did not cover the subsequent rate rise. Although the survey asked businesses if they thought the costs of subsequent changes would be reduced as the experience of implementing a change became more familiar (and at the time only around a quarter of responses thought there would be such an effect), it cannot tell us whether businesses actually found the reversion in January 2010 to 17.5 per cent to be easier and less costly.

3.8 However, the initial change to 15 per cent in December 2008 was the first change in the standard rate of VAT for more than 17 years, whereas there have now been two VAT rate changes in the last two years. We expect that this will have helped reduce compliance costs for future VAT rate changes below the levels described by the survey. This is for a number of reasons:

- Businesses will have more direct experience of VAT rate changes; the degree of learning involved in this should help make the process more efficient.
- Some IT systems may now be more flexible and less costly to alter, having dealt with two recent VAT rate changes.
- HMRC has published extensive guidance to business for the last two VAT rate changes and will do so again for this VAT rate change. See section 8 of this IA.
- The lead-in time for a further VAT rate change (from both press and industry speculation and the gap between the time of announcement on 22 June 2010 and implementation on 4 January 2011) can reasonably be expected to help businesses manage this rate change more efficiently.

3.9 As a result of greater familiarity and efficiency with rate changes, we anticipate that the non-discretionary costs of this rate change as measured by this IA are likely to be lower than the cautious starting value of the estimated £350 million referred to above. Based on the research along with our own further analysis of the data our best estimate is that the total compliance cost for a further rate change is more likely to be in the order of £300 million. The detailed breakdown of that figure between the different types of compliance costs is set out in section 5 below.

4. The Options

VAT rates and exemptions

4.1 VAT is a tax on the final consumption of goods and services, collected at every stage of production and distribution. It is currently charged on the majority of goods and services at the standard rate of 17.5 per cent. The announced change to the standard rate will permanently increase this to 20 per cent with effect from 4 January 2011.

4.2 VAT is charged on a select group of goods and services at either a zero rate (including most food and non-alcoholic drinks, books and magazines, children's clothing and footwear, construction of domestic dwellings, domestic passenger transport, and drugs and prescriptions) or a reduced rate of 5 per cent (including domestic fuel and power). These rates will be unaffected by the proposed change. A number of goods and services are exempt from VAT because it is considered inappropriate to tax them (including public services such as health, education and welfare) or they are too technically difficult to tax (including financial services). There will be no change to the VAT exemptions.

Flat Rate Scheme and Payment on Account (POA) regime

4.3 Following on from the increase in the standard rate of VAT there are consequential legislative changes that will be made to the Flat Rate Scheme (FRS).

4.4 The FRS is an optional simplification scheme available to businesses with a VAT exclusive turnover not exceeding £150,000. Instead of paying HMRC the difference between tax charged on sales and tax they can reclaim on purchases and expenses, users account for VAT by multiplying their gross turnover by a single percentage. There are 55 different sectors with flat rates currently ranging from 3.5 per cent to 13 per cent, calculated by reference to the actual net VAT paid by all eligible businesses in the sector who use normal VAT accounting. The flat rate percentages will be increased in line with the increase of the standard rate of VAT from 17.5 per cent to 20 per cent.

4.5 Until the 4 January 2011 increase in the standard rate of VAT takes effect, businesses have to leave the FRS when their VAT inclusive turnover exceeds £225,000 (unless that is due to a one off transaction and there is an expectation of falling back below a VAT inclusive threshold of £187,500 in the following year) or it is likely to exceed £225,000 in the next 30 days. With effect from 4 January 2011 these thresholds will be increased to £230,000, £191,500 and £230,000 respectively to ensure that no business has to leave the FRS solely as a result of the increase in the standard rate of VAT to 20 per cent.

4.6 The POA regime requires all VAT-registered businesses with a current annual VAT liability of £2 million or more to make interim payments on account at the end of the second and third months of each VAT quarter. A balancing payment for the quarter (the quarterly liability less the payments on account made) is then made with the VAT return. The level of interim payments that apply for one year is based on the VAT liability of the business in the previous year. Businesses whose annual liability falls below £1.6m can apply to leave the POA regime.

4.7 The POA thresholds will be revised at a later date to reflect the increase in the standard rate.

4.8 Accordingly these consequential changes maintain the status quo in terms of businesses who choose to join/leave the FRS or are required to operate the POA regime. Therefore we consider that there are negligible compliance or administrative burden costs for businesses in respect of either of these consequential changes.

Number of businesses affected

4.9 There are currently around 1.95 million businesses registered to pay VAT in the UK. There are also an estimated 2.9 million businesses in the UK that are not registered for VAT. All UK VAT registered businesses will be affected to some degree by the proposed changes, and will have to make appropriate changes to their business systems.

5. Costs

5.1 There is no ongoing increase in the administrative burden (measured by the Standard Cost Model) of the VAT regime as a result of the rate change because the obligations to register for VAT, complete returns and pay VAT are unchanged. However, administrative burdens are only a subset of overall compliance costs. Other compliance costs include the one-off costs of transition and change (such as time spent becoming familiar with new VAT rules). It is these wider one-off costs which cover the impacts of a VAT rate change and which are the subject of this IA.

5.2 As set out in section 3 above this IA includes our best estimates of compliance costs for typical, efficient businesses. Therefore, we recognise that there will be businesses whose compliance costs are either higher or lower than the ones quoted in this IA, due to variations from business to business. It is accepted that there will be a significant one-off compliance cost for businesses in implementing the rate change, currently estimated at around £300m in total.

<u>Caveats and risks</u>

5.3 It is recognised that consumer facing businesses, such as retailers, incur the biggest costs when there is a VAT rate change. Furthermore it is acknowledged that every business is different, and that there can be a very wide variation in many business characteristics not explicitly captured by describing them, for example, simply as “small” or “large” businesses. We expect a very long tail in the distribution of small businesses; with the very smallest having very simple VAT affairs and potentially much lower costs than one towards the other end of the range of “small” businesses. In view of this, for each size group of affected businesses, we aim to describe the impact on a "typical" business within each size band. However, we recognise that because of this, many businesses may feel they are not described by the necessarily broad analysis in this IA.

<u>Categories of costs</u>

5.4 The expected one-off compliance costs fall into the following categories:

- o Familiarisation
- o Re-pricing and invoicing changes
- o Extra accounting and book-keeping checks
- o System changes/upgrades

5.5 All monetary amounts given in the sections below are in 2010 values. Although there is no administrative burden impact, the Standard Cost Model has been used to inform some details such as the distribution of VAT registered businesses between size bands, and the basis for hourly rates for various grades of personnel. The data on time taken by businesses are derived from averages within the research after excluding particular outliers. Information on the split of businesses across the size bands undertaking particular activities and the typical level of personnel involved are also taken from the core research data, after controlling for outliers. Typical wage levels are derived from the Annual Survey of Hours and Earnings, by the Office for National Statistics (uprated to include overheads and including a standard assumption of wage growth of 3.5 per cent per year).

<u>Familiarisation</u>

5.6 This category focuses on the time businesses will need to spend reading about and understanding the nature of the changes, as well as briefing staff.

5.7 It is recognised that there could be other potential familiarisation costs to businesses such as:

- o deciding whether to pass on any increase in full to their customers, and if so to what extent across the whole of their business;
- o consulting advisors, and

- o (if businesses have contracts inclusive of VAT) potentially renegotiating terms of contracts.

5.8 However, while it is recognised that, in practice, some businesses may decide to incur such costs in light of commercial realities, since these costs arise from commercial decisions rather than being required in order to implement a VAT rate change they are not analysed as part of this IA.

5.9 Section 3 of this IA detailed the rationale for expecting further VAT rate changes to be less costly than the VAT rate change in December 2008. It is expected that this will apply in particular to costs related to familiarisation. To reflect this, the research estimates of familiarisation time in respect of the December 2008 change have been reduced by 25 per cent for the purposes of this IA.

5.10 Working from the survey data after the adjustment mentioned directly above, our estimates for familiarisation costs are based upon a range of between 1.3 hours for a small business with the simplest VAT affairs to 33 hours for a large business (taking into account that large businesses may also want to consult advisors).

5.11 According to the research, senior staff tend to be the majority of personnel involved in all size categories, though the trend is for more junior staff to play a part as businesses increase in size. The research indicates that nearly 85 per cent of familiarisation activities for the very smallest businesses were by senior staff, declining to around 50 per cent for the largest businesses.

5.12 Overall, the estimated familiarisation cost for the typical smallest business is around £15 per business, rising to around £500 for a typical larger business. In total, the cost of all familiarisation activities is estimated at around £65 million.

<u>Re-pricing and invoicing changes</u>

5.13 To prepare for the increase in the standard rate of VAT all VAT registered businesses selling standard rated goods, and particularly for those selling to final consumers, will need to re-price their products. The identified costs are, for example, re-labelling the prices of goods and altering bar code system databases, including on tills.

5.14 Traders are required to display clearly their prices inclusive of VAT. For a period up to 28 days they are permitted under the Price Marking Order 2004 (the Order) to let consumers know, by way of a general notice, that an adjustment in price, to take account of the VAT change will be made at the till. Following a consultation by the Department of Business, Innovation & Skills the 28 day period was increased from the previous 14 days allowed under the Order specifically in time for the last VAT rate change.

5.15 Businesses will also need to update their invoicing arrangements to reflect the increase in the VAT rate. It is expected that this update will be relatively straightforward, and should not take long to implement. However there will be some more complex changes, for example continuous supplies spanning the rate change, credit and debit notes, advance payments, returns of goods and contracts with fixed interval payments, where an affected business will need to establish which rate of VAT should apply to the particular transaction.

5.16 We expect that businesses affected by the two recent rate changes will make use of their experience when undertaking re-pricing which may reduce the costs they incur. The increased notice period under the Price Marking Order 2004 also allows traders more time to re-price their products in order to comply with the VAT rate change. We understand that businesses in certain sectors require a certain minimum lead-in time in order to update price list material that they make available to their customers. Such businesses are expected to incur higher re-pricing costs. Since this rate change is being announced on Budget Day, to take effect from 4 January 2011, we consider that this gives all businesses sufficient notice to make these changes.

5.17 Re-pricing is an exercise that will take a significant amount of time for businesses that have a large number of product lines, and its complexity will depend, in part, on how simple it is to update the existing system to reflect any increase in prices passed on to customers. It is recognised that certain sectors are likely to be hit harder than others in respect of re-pricing costs, such as restaurants and catalogue and mail-order businesses.

5.18 Based on the research, it is thought that the typical smallest businesses might each spend around one hour making these changes, while a typical large business could spend around 13 hours. Again, it is expected that senior personnel will be involved the most in making these changes; analysis of the research suggests that senior staff carried out 100 per cent of the re-pricing activities for the smallest businesses, falling to around 40 per cent for larger businesses.

5.19 Costs per business may be in the region of £5 and £125 for the typical smaller business to the typical larger businesses respectively.

5.20 In total re-pricing and invoicing costs are estimated to be around £35 million.

Extra accounting and bookkeeping checks

5.21 VAT registered businesses supplying standard rated goods and/or services where manual records are maintained in order to complete the VAT return may incur additional costs in checking that the correct amounts of VAT are included on the first VAT return due following the rate change. This is because businesses keeping manual VAT records will need to take extra care with their billing and accounting systems to take account of both supplies subject to the 17.5 per cent rate and those subject to the new rate of 20 per cent.

5.22 We consider that, generally, businesses will only need to make the changes to their accounting arrangements once, in time for their first VAT return after the rate increase. However, for businesses with a lot of product lines this can create a lot of work which is simpler to undertake in advance of transactions taking place. We expect that those businesses which were required to implement the recent VAT rate changes will have developed or improved processes to minimise costs in this area.

5.23 We expect that electronic accounting systems which can alter the VAT rate (see below) will include these checks automatically. Based on recent HMRC research it is expected that relatively few businesses use non-electronic accounting systems and that the vast majority of businesses that maintain paper records are small businesses with relatively simple VAT affairs.

5.24 Affected businesses will also need to pay extra attention to checking their accounts and VAT returns when the rate changes. This may lead to extra in-house costs for those businesses performing their own accounts work. Other businesses are likely to incur additional accountancy fees because they rely on an accountant or similar to complete their VAT return, whose services will need to be employed for longer in order to ensure that returns are correct.

5.25 From our further analysis of the research, we estimate that these extra accounts and bookkeeping checks could take around one and three quarter hours for the typical smallest businesses and up to around 33 hours for a typical large business. In keeping with the other categories of compliance cost, the research shows that senior personnel tended to be involved the most; around 85 per cent of the smallest businesses used senior staff to carry out these extra checks, while around 66 per cent of larger businesses used senior staff.

5.26 Costs per business may be around £20 - £25 for the smallest affected typical businesses, rising to around £650 for the larger typical businesses. In total it is estimated that the cost would be around £115 million. This total compliance cost is expected to be the largest out of all the identified categories.

System changes/upgrades

5.27 This category focuses on the costs involved in changing systems and upgrading software to cope with the rate change. Some businesses' electronic accounting systems may not be able to automatically alter the VAT rate and new systems or upgrades will be required. This might include either purchase costs and/or time costs for installing those new systems.

5.28 Following the two recent VAT rate changes it is assumed that the vast majority of VAT accounting packages will have the flexibility to adapt to the change and consequently full upgrades will not be required. However, it is expected that VAT registered businesses will need to alter systems in some form.

5.29 In general, smaller businesses might have to purchase patches or upgrades to accounts packages; on the other hand, these upgrades might be provided free by software providers as part of existing upgrade processes. Larger businesses might have to purchase upgrades to systems to accommodate the changes, while on the other hand these changes may be captured by terms of existing IT support contracts and not represent an additional cost.

5.30 However, purchase costs are not expected to be significant in the wake of the previous two VAT rate changes. It is expected that most businesses will, by now, have sufficiently flexible systems and will not need to make additional purchases. The research into the December 2008 rate change indicated that time-based costs accounted for around 95 per cent of all costs incurred, indicating that purchase costs were comparatively small even then.

5.31 Analysis of the research suggests that typical smaller businesses might take just over one hour and typical larger businesses with more complex systems might take around 35 - 40 hours. Smaller businesses again tend to carry out these activities with senior staff; however, according to the research, some businesses in the middle of the size distribution seem to give the job to junior staff, whereas larger businesses rely on intermediate-level staff. This pattern may be an anomaly in the research.

5.32 The estimated costs are estimated to range from £10 for a smaller typical business to around £650 for a larger typical business. In total, the estimated total cost of system changes is around £85 million. This is the second highest category of compliance cost.

6. Summary of total business cost impacts

Table 1: Total estimated compliance costs summary (2010 values, £ millions)

	2010-11
Familiarisation	65
Re-pricing and invoicing changes	35
Accounting and book-keeping checks	115
System changes	85
Total	**300**

7. Impact on HMRC

7.1 HMRC computer systems will require updating to reflect the change in the rate. However, the cost of these changes is minimal. There will be some costs in providing the additional advice and guidance on rate changes.

8. Implementation plan

8.1 HMRC will publicise the VAT rate change to all VAT registered businesses.

8.2 For the last two VAT rate changes HMRC published extensive guidance to businesses on what they would need to do to comply with the rate change. The feedback was that the guidance was helpful to business. Therefore HMRC will again publish extensive guidance to assist businesses in complying with this rate change. It will include general guidance on charging and accounting for the rate change, the rules for sales spanning a rate change, and special VAT accounting schemes such as the Flat Rate Scheme and Payment on Account regime. It will also provide specific guidance for particular sectors including retail businesses and the construction sector and guidance on transactions that are particular to certain business sectors. The guidance will be published on HMRC's website on Budget Day, so that it is available as soon as possible for businesses to familiarise themselves with the impact of the rate change.

8.3 HMRC intends to operate a light touch in relation to errors arising from the rate change and will publish details of the light touch guidance provided to HMRC staff on Budget Day. In summary HMRC will not target change of rate errors made in the first VAT return after the change where such errors are unlikely to lead to a material net revenue loss. If HMRC finds errors that relate to a change of rate issue HMRC will not seek an adjustment unless HMRC has reason to suppose that there is an overall revenue loss. Where HMRC needs to adjust, consideration will be given to difficulties faced by a business in adjusting to the rate change in terms of whether penalties apply.

9. Specific impact tests

Competition assessment

9.1 All VAT registered businesses selling standard rated goods and services will be affected equally, so competition between these businesses will not be affected. VAT charged on supplies to fully taxable businesses can usually be reclaimed in full, regardless of what rate of VAT applies. There may be marginal competition effects (becoming more competitive in terms of relative prices) where standard-rated products sold to final consumers can be substituted for zero-rated or reduced rated products. Aside from general economy-wide substitution effects, this factor may be concentrated in areas in which 'borderlines' exist between standard-rated goods and services and products with other VAT liabilities within particular sectors, such as in the VAT treatment of food.

9.2 There may also be marginal effects on the degree of competition between VAT-registered and unregistered businesses supplying goods and/or services that (if sold by a VAT registered business) would be standard-rated. However, this would be tempered to an extent by the fact that unregistered businesses cannot reclaim VAT they pay on their own expenses and costs, and the 20 per cent rate of VAT would increase the amount of non-recoverable VAT they incur.

9.3 Changing the standard rate of VAT should not limit the number or range of suppliers, directly or indirectly. Subject to the expected marginal effects noted above, changing the standard rate of VAT should also neither significantly limit the ability of suppliers to compete, nor significantly reduce incentives to compete. The long lead in time may result in increased incentives and opportunities to compete.

Small Firms Impact Test

9.4 An estimated 2.9 million of the smallest businesses are not registered for VAT. These businesses would not incur compliance costs.

9.5 For small businesses registered for VAT their compliance costs may represent a slightly higher burden relative to larger businesses as a percentage of turnover. However, small businesses are less likely to incur the relatively more expensive compliance costs involving advisors and system changes/upgrades. VAT arrangements for small businesses are also expected to be simpler than those of larger businesses, which should mean that a small business will require less time to implement the changes. Given this, we do not expect small businesses to incur any material competitive disadvantage by the increase in the standard rate of VAT, relative to larger businesses.

Other impacts

9.6 The economic impact of the increase in the standard rate of VAT is set out in the Budget documentation.

9.7 The increase in the standard rate of VAT will impact on (to a greater or lesser extent depending on the type of business) all UK VAT registered businesses supplying standard-rated goods and services in the UK in terms of compliance costs.

9.8 Retail businesses are expected to incur higher compliance costs, particularly in relation to the re-pricing changes that will be required as a result of the rate change. For example where they decide to pass the increase on to their customers they will need to re-price all their product lines. This is something which will take more time for businesses that have a large number of product lines. It is also recognised that certain sectors require a minimum lead in time in order to update the price list material that they make available to their customers, for example restaurants and catalogue and mail order businesses.

9.9 In addition, feedback from business, particularly those in the retail sector, was that a change in rate effective from 1 January creates additional compliance costs for those businesses that trade over New Year's Eve and New Year's Day.

9.10 In order to minimise the compliance cost impact of the rate change for businesses, the rate change will not take effect until 4 January 2011. This will give all affected businesses both sufficient time to decide and implement their pricing polices, and businesses will not be faced with having to apply two different standard rates of VAT where they trade between New Year's Eve and New Year's Day.

10 Monitoring and evaluation

10.1 For all policy changes, compliance costs are routinely reviewed one to three years after implementation.

10.2 The Government is always looking to improve its compliance cost assessments and is interested in feedback.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes