1. Tax reforms. As our Election Manifesto made clear, a major reform of the tax system is a central feature of the Government's policy. One of the main aims is to make a substantial reduction in the burden of personal taxation and a start has been made with the reduction in the standard rate of income tax which I announced on 27 October. In addition, it is desirable to reform the structure of indirect taxation and, indeed, essential if we are to honour our pledge to abolish the Selective Employment Tax (SET).

2. Decision to introduce a Value-Added Tax (VAT). In our Election Manifesto we stated:--

"We will abolish the Selective Employment Tax, as part of a wider reform of indirect taxation possibly involving the replacement of purchase tax by a value-added tax."

There were two elements to this: a clear commitment to abolish SET, and a wider reform of indirect taxation in which the introduction of a VAT was mentioned as a possibility. After much consideration I have concluded that the introduction of a VAT, with the abolition of SET and purchase tax, is the most satisfactory way of carrying out the necessary reform of indirect taxation. Indeed, I have come to the conclusion that it is the only way in which we can honour in full our pledge to abolish SET. VAT has the advantage that it can be applied to both goods and services, in contrast to purchase tax which is essentially a tax on goods; VAT is by nature a comprehensive tax and it does not distort the consumer's pattern of expenditure; at the same time it can, if necessary, be adapted to permit reliefs (though these will need to be limited to a small number of vital areas e.g. food); and VAT is the system of turnover taxation which Member States of the European Economic Community (EEC) are required to adopt, so that, if our application to join the Common Market succeeds, we shall in any case have to have a VAT. As it applies over a very wide base VAT has the capacity to raise sufficient revenue to replace purchase tax and SET and this is the reform which I propose we should introduce.
3. Of equal importance is the fact that if extra revenue were required beyond that needed to replace purchase tax and SET, for example to facilitate a further reduction in direct taxation by making a significant switch from direct to indirect taxes, the revenue raising potential of VAT is very great and would enable this to be done. The extent of such a switch would, of course, depend on the demand situation at the time and the extent to which it was decided to reduce the burden of direct taxation. This, of course, is not a matter for consideration now.

4. Green Paper. I am not enamoured of too many Green Papers, but I am sure that, in this case, there should be one to facilitate discussion and the work of preparation. A copy of the proposed Green Paper is attached. It explains the main features of VAT, points to some of the major problems in particular areas and invites consultation on the detailed operation of the tax.

5. Revenue from VAT. The revenue which a VAT would produce depends on the exact coverage of the tax and on the rate or rates of tax adopted. No firm figures of likely yield can be given until decisions are taken on these questions and in particular on what classes of goods, services or persons would be relieved of VAT. The draft Green Paper attached to this note indicates the main areas where special provision might be made. I will report orally on the options concerning rates and yields, and the consequences for the cost of living.

6. Administrative cost. A VAT scheme on the lines envisaged in the Green Paper would require a net increase (after abolishing purchase tax and SET) of some 5,400 to 5,900 in civil service staff. There is however a prospect of a major simplification of PAYE resulting in savings of staff, after the mid-1970's, at least as great as this or possibly greater. On reasonable assumptions about rates and yields the cost of collection might be about 1.4 per cent of the revenue. This is somewhat above the average percentage cost of collection of all Central Government revenue, but no more than that of the Inland Revenue service.

7. Work involved in the introduction of VAT. The introduction of VAT will be a major operation. It will apply to all goods and services (except where reliefs are granted), to raw materials, semi-manufactures, finished products, to consumer goods and capital goods, to commercial services and to consumer services, and so on. (The operation of the VAT is such, however, that the ultimate burden of the tax falls on consumers' expenditure on goods and services.) I do not intend to launch such a wide-ranging tax without proper consultation with those affected; the lack of adequate consultation was one of our objections to the introduction of major tax changes by the previous Government. Consultations with trade and industry will therefore be held so that the tax can be built on firm foundations, taking into account the practical problems of particular sectors of the economy. In the light of these consultations the manifold details of the coverage and operation of the tax will be settled.
and the necessary legislation drafted. A major Bill will be required early in the 1971-72 Session. When this becomes law it will be necessary before the tax is introduced to mount a large-scale exercise involving the registration of all traders affected and their education in the details of the new law and its requirements. A large computer installation will have to be designed and accommodated.

8. Need for early announcement of VAT decisions. The whole process of introducing a VAT is bound to take considerable time - most Members of the EEC took several years. It is important, however, that we should complete the process in the shortest possible time - first to permit the associated abolition of SET and reduction in direct taxes to be made as soon as possible, and secondly because a VAT whatever its ultimate benefits, is bound to give rise to some criticisms from those affected by its requirements, and it would be desirable to get that phase over earlier rather than later in the life of this Parliament.

9. After discussion with the Customs and Excise I have persuaded them to cut the timetable to the bare minimum. The time required for preparation, including the passage of legislation, is two years, and if my colleagues agree in principle, it is therefore necessary to launch the process of introducing the VAT as a matter of urgency. This requires an early announcement of the decision in principle to introduce it, so that the discussions with trade and industry can begin. My intention is to make the announcement in the House before the end of the month.

Treasury Chambers, SW1

30 October 1970
CHAPTER 5: VALUE-ADDED TAX

A POSSIBLE SCHEME

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CHAPTER 5

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FOREWORD

The Government is committed to undertake, during the life of this Parliament, a major reform of the taxation system that will include the abolition of the selective employment tax and a radical simplification of a tax system which has been allowed to become too complex and discriminatory. An important contribution to the achievement of these objectives would be secured by the replacement of the present system of indirect taxation by a more broadly-based structure which, by discriminating less between different types of goods and services, would reduce the distortion of consumer choice.

The replacement of the present purchase tax and the selective employment tax by a broad-based value-added tax was therefore a clear candidate for inclusion in the Government's tax reform programme. Such a changeover would spread the burden of indirect taxation in a more equitable fashion.

The Government has now decided to do this, and the necessary detailed preparations have been put in hand. Legislation will be required in due course. It is clearly necessary that the nature of the tax should be widely understood and that its details should be the subject of public debate, so that the final decisions can be taken against the background of an informed public opinion. This Green Paper is published to provide a basis for such general public debate.
The Green Paper is also intended to give trade and professional associations and other interested parties an opportunity to consider and comment on those aspects of the value-added tax that will particularly affect them.
CHAPTER 1 - INTRODUCTION

1.1 The existing pattern of indirect taxation in this country is open to the objection that it is selective and is based on too narrow a range of expenditure. Selective taxation gives rise to distortion of trade and of personal consumption patterns, and can lead to the inefficient allocation of resources. To remedy this shortcoming in our system, we have to extend the coverage of existing taxes or to introduce some new form of tax. Existing taxes do not readily lend themselves to extension. The Customs and Excise duties on tobacco, hydrocarbon oil and alcoholic drink are specific to these products and cannot be extended. A significant proportion of indirect tax revenue is raised by the selective employment tax, which the Government is pledged to abolish. The remaining indirect tax of importance is the purchase tax.

1.2 Purchase tax is at present levied at four different rates at the wholesale stage in the distribution of specified consumer goods. The tax is efficient and industry and trade are accustomed to it. It falls almost wholly on consumer expenditure. It is not levied on goods for export, though it has some hidden effect on export prices because tax charged on for example business stationery is not rebated. The possibility of extending it to a wider range of goods has some attractions. But in practice it would not be easy to extend purchase tax to goods generally, and of its nature purchase tax could not be applied to services. The
retention of purchase tax has led to the separate taxation of services, eg SET, and in practice to the exclusion from the tax base of a significant proportion of consumer expenditure on goods. This has led to tax distortions and anomalies as between different categories of goods and between goods and services.

1.3 A different approach is necessary. Instead of a system which taxes some forms of consumer spending but not others, there is need for a form of tax which falls more evenly on a much wider range of consumer spending in the domestic economy (with specific reliefs for certain basic items such as food) without the highly differentiated tax structure arising from purchase tax on goods and SET on services. A general employment (or payroll) tax to replace purchase tax and SET would not be satisfactory because, other considerations apart, it cannot be rebated on exports nor charged on imports. It would then leave us at a competitive disadvantage in all markets.

1.4 There are three forms which a comprehensive consumption tax could take. It could be a retail sales tax which could cover services as well as goods. But such a tax, at the rates that would be required, would introduce a very considerable burden of taxation at the stage at which goods or services pass to the final consumer. Experience in other countries has shown that this would present very serious difficulties of collection and control. Indeed, it is clear that a retail sales tax can be successful only if the rate is kept low. A tax at the retail stage at the level necessary to replace purchase tax and SET is now widely regarded as impracticable.
1.5 Then there is a multi-stage "cumulative" (or "cascade") tax, applying at each stage in the production and distribution process but without relief given for tax paid at earlier stages. Such a tax has well-known disadvantages - the amount of tax depends on the number of stages, it creates internal economic distortions, both of trade and industrial structure, it acts as a disincentive to capital investment, and it is difficult to give effective relief to exports or to apply a countervailing charge to imports. These disadvantages have led many Continental countries to replace taxes of this kind with value-added tax.

1.6 Value-added tax avoids the disadvantages both of a selective tax like purchase tax and of "cumulative" taxes. Abroad, an increasing number of countries are adopting the value-added tax. In France and Germany value-added tax is well established. Holland, Luxembourg, Denmark, Norway and Sweden all have value-added taxes; Belgium, Ireland and Italy will introduce the tax shortly.

1.7 The economic arguments about the effects of value-added taxation on the balance of payments, efficiency and growth have been the subject of a good deal of public debate following the publication of earlier studies*. Any examination of the effects of VAT on these fields must be related to the taxes which it is intended to replace. The passage of time has altered the

NEDO Report on Value Added Tax 1969
situation which the Richardson Committee in particular was examining. It was concerned with the arguments for a VAT in substitution for either purchase tax or profits tax. It could find no valid case for the first substitution; but there was then no SET, and purchase tax was narrower in coverage than it is to-day and had fewer and lower rates. It considered that the balance of argument was against the substitution of a VAT for the profits tax. The NEDO Report argued that the case for considering the introduction of a VAT in the immediate future must rest primarily on whether it provided a viable basis for other adjustments in taxation and for extending the tax coverage to goods and services not at present included. The present proposition is that on the introduction of VAT, SET and purchase tax will be abolished. The change proposed would benefit the balance of payments, since VAT can more fully be remitted on exports. Some elements of purchase tax (for example on stationery and office equipment) are an indirect burden on exports. SET on business (other than on those businesses where it is repaid) is wholly unrelieved on exports even in cases where services are specifically related to exports. By removing the economic distortions of selective indirect taxation VAT will improve the efficiency of our industries.

1.8 The chief objection levelled against VAT has been its possible effect on the cost of living. This argument is often over-stated. It ignores the fact that against increases attributable to the introduction of VAT there have to be set corresponding reductions following the abolition of purchase tax and selective employment tax.
1.9 The general outline of a possible VAT scheme for this country is described in the following Chapters of this Green Paper. Chapter 2 discusses the basic principles of value-added taxation, and Chapter 3 the general scope of a possible scheme. Certain special cases are discussed in Chapter 4. Chapter 5 deals with some transitional problems.
CHAPTER 2 - BASIC PRINCIPLES OF VALUE ADDED TAXATION

2.1 VAT is a form of turnover or sales tax. Like purchase tax and some other forms of turnover tax, VAT is a tax on final consumer expenditure in the domestic economy. But unlike purchase tax, which is collected at a single stage in the production and distribution chain, VAT is collected in instalments: liability to tax arises at each stage in the chain, whenever taxable transactions are carried out by taxable persons. VAT, like purchase tax, also falls on imports of goods. On exports VAT is not only not charged directly but, unlike purchase tax, provides machinery for rebating tax entering indirectly into export costs.

2.2 The VAT system described in this Green Paper is that known as the "invoice" (or "tax from tax") system. The reason for the latter term is that tax invoiced to a taxable person is deducted from tax invoiced by him to arrive at his net tax liability. This is the system prescribed in the EEC Directives on value-added tax. All the countries which have introduced VAT have adopted this form of the tax.

2.3 Subject to any provisions for relief in particular cases, the tax applies to "taxable transactions", which include -

a. The delivery of goods or the provision of services in the home market by a "taxable person";
b. Appropriations to private and certain business uses by a "taxable person";

c. Imports of goods, whether or not by a "taxable person".

2.4 The precise scope of these expressions will need to be defined in legislation. For present purposes they should be understood in a very wide sense. "Taxable person", for example, includes companies, individuals and partnerships engaged in business, and also members of professions. As a general guide, and subject to any special VAT inclusions or exclusions, "taxable persons" has much the same meaning as those persons chargeable to corporation tax or to income tax under Cases I and II of Schedule D (see paragraph 3.8). The expression "trader" as used in this Green Paper has a similar wide connotation. The use of these terms in the VAT scheme discussed in this Green Paper is considered further in Chapter 3.

2.5 Liability to tax arises whenever a taxable transaction (see paragraph 2.3) is performed, and does not depend on the profitability or otherwise of the transaction nor on whether the tax is recovered from the customer.

2.6 Although it is paid by traders, the tax falls in principle on final consumer expenditure. Subject to special (and simplified) provisions for small traders it works in the following way. If a taxable person (A) delivers goods or provides a service to another person (B), A is accountable to the tax authorities for the tax on that transaction and if B is also a taxable person, A
gives him an invoice showing that tax as a separate item. If B sells to another taxable person (C), B too is accountable for tax and must give C an invoice showing the tax as a separate item; and so on down the line of production and distribution, until the final stage when a taxable person sells to a final consumer. At the end of each VAT accounting period each taxable person totals (a) all the tax invoiced to him or paid by him at importation; and (b) all the tax arising on taxable transactions which he himself carries out; and remits to the tax authorities the amount by which the latter exceeds the former. If (a) is more than (b) he may make a claim for credit for the excess from the tax authorities (see paragraph 3.20). Thus a taxable person has to account for the tax on all the goods he delivers or services he provides (called outputs) in each accounting period, but in paying tax to the tax authorities he can take credit for the tax on goods delivered or services provided to him (called inputs) whether of a capital or current nature. The effect of this "credit mechanism" is that the tax "rolls forward" at each stage until the point of sale to the consumer. The amount of tax collected in this way is thus equal to the amount that would have been collected had the tax been a single-stage tax on sales to final consumers, though to collect in the latter way would be impracticable for the reasons already set out in paragraph 1.4.

2.7 The net VAT liability of a taxable person in a given accounting period might be illustrated by the following example:-
a. Tax on taxable transactions carried out by him in the period within the UK £1000

Less:

b. Tax invoiced to him in the period by taxable persons supplying him with goods and services for use in his business (e.g., purchase of plant and machinery, raw materials, stock for resale, transport services, power etc.) £900

and c. Tax paid by him on taxable goods imported for his business £20

£920 £ 920

Net amount to be paid to the tax authorities (a.-b.-c.) = £ 80

2.8 Another way of looking at the credit arrangements is to consider the progress of a particular article down the production and distribution chain. Tax will be charged on the raw materials, perhaps when they are imported; as they are worked up into a semi-manufactured and then a final product, and sold on at successive stages, the tax falls on the value added at each stage.

2.9 To illustrate this let us take the hypothetical example of an article, costing 40s retail before tax, on which the rate of
VAT is 10 per cent of the tax-exclusive price. The VAT, which the consumer would pay, would be 4s, giving a total retail price of 4h4s. The 4s tax would have been collected in a series of fractional payments. The number of payments, i.e., the number of stages in the production and distribution chain, is immaterial. The following table shows how the tax on the article might build up, starting from the raw material stage and ignoring, for the sake of simplicity, other taxable inputs.

<table>
<thead>
<tr>
<th>Tax exclusive price</th>
<th>Tax on transaction</th>
<th>Tax remitted to the tax authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>s  d</td>
<td>s  d</td>
</tr>
<tr>
<td>Producer of inter­mediate product imports raw materials having an import value of</td>
<td>5 0</td>
<td>6  d</td>
</tr>
<tr>
<td></td>
<td>Producer pays 6d tax at importation</td>
<td></td>
</tr>
<tr>
<td>Producer makes inter­mediate produce and sells it to a manufac­turer for</td>
<td>10 0</td>
<td>1 0</td>
</tr>
<tr>
<td></td>
<td>Producer is account­able for 1s tax but takes credit for 6d tax paid at importation and invoices 1s tax to his customer</td>
<td></td>
</tr>
<tr>
<td>Manufacturer makes final article and sells it to retailer for</td>
<td>25 0</td>
<td>2 6</td>
</tr>
<tr>
<td>Manufacturer is account­able for 2s 6d tax but takes credit for 1s tax invoiced to him by producer and invoices 2s 6d tax to the retailer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retailer sells article to consumer for</td>
<td>40 0</td>
<td>4 0</td>
</tr>
<tr>
<td>Retailer is account­able for 4s tax but takes credit for 2s 6d tax invoiced to him by manufacturer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total paid by final consumer</td>
<td>40 0</td>
<td>plus 4 0</td>
</tr>
</tbody>
</table>
2.10 **Imports and exports.** - As the foregoing example brings out, VAT applies to imports of goods as well as to deliveries in the home market. Tax at importation is payable whether or not the importer is a "taxable person". But importers who are taxable persons take credit for VAT paid at importation in the same way as they do for tax invoiced to them by domestic suppliers of goods and services. Conversely, exports of goods are relieved of tax. The underlying principle is that export sales are not chargeable with VAT, while exporters who are taxable persons can take credit for, or have repaid to them, the tax invoiced to them (or paid at importation) on the inputs to those sales. The arrangements for relief are described more fully below. The territorial application of the tax to services follows a similar pattern. The underlying principle is that all services provided within the tax territory would be taxable.

2.11 **Reliefs.** - There are several ways in which relief from VAT can be given to particular classes of goods or services, or particular classes of traders, eg exemption, zero-rating, the application of a lower rate of tax than the standard rate, or some combination of these methods. All these procedures feature in the VAT scheme described later in this Green Paper. It should be borne in mind that a VAT is in principle a comprehensive tax and that reliefs reduce revenue and complicate administration. The more reliefs there are, the more others have to pay to raise a given revenue. Further, the implications of reliefs may go beyond the particular traders to whom they are directed, and affect other
traders with whom they deal or with whom they compete. Any case for relief must therefore be judged against stringent criteria.

2.12 Exemption. - Exemption for a transaction means that no liability to account for tax to the tax authorities arises when the transaction is performed. Equally, the trader undertaking the exempt transaction is given no credit by the tax authorities for any tax invoiced to him by his suppliers, or paid at importation, in respect of the goods and services he uses for his exempt business. The operation of the credit mechanism throughout a chain of transactions is thereby interrupted.

2.13 If a trader providing exempt goods and services wishes to recoup the tax invoiced to him by his suppliers (or paid at importation) he is free to do so through the prices he charges to his customers. But since he is not accountable to the tax authorities he is not allowed to show any element of tax as a separate item on his sales invoices. The tax paid at earlier stages and entering in this way into the price of exempt goods and services is thus a "hidden tax". If the exempt goods and services are acquired by a taxable person the latter is unable to take any credit for this hidden tax. Thus, exemption is by no means always an advantage. It may, however, provide a simple way of relieving from tax in appropriate cases the value added by the provider of a service to final consumers.
2.14 An important administrative advantage of exemption is that a trader whose only business consisted in carrying out exempt transactions would not need to be registered by the tax authorities. This would be a saving in work both for the trader and for the authorities. If, however, part of a trader's outputs were exempt and part taxable he would need to be registered in respect of his taxable transactions. He would be entitled to take credit for tax falling on the inputs to his taxable outputs, but not for tax falling on the inputs to his exempt outputs. If such a trader were allowed to take credit for tax on all his inputs he would have an unfair advantage over the wholly exempt trader, who would not be entitled to any credit for tax. Establishing the credit entitlement of partially exempt traders can be a complicated matter. This is explained further in the Appendix to this Green Paper.

2.15 Zero-rating. - Zero-rating a transaction means that it is brought within the scope of the tax, but the rate applied to the output is zero. If the person carrying out the transaction is a taxable person he is accountable in the usual way; but the result is that his outputs carry no tax because a zero rate is applied to them, while he is allowed credit for or repayment of tax on his inputs. Exports of goods will be relieved from tax by means of this technique. Transactions other than exports could also be zero-rated, but the technique is one that could only be justified in very exceptional circumstances. Where relief to particular kinds of transaction is contemplated, exemption might
be considered, but to go further and remit tax on all the inputs as well by zero-rating would be a very different matter. This would reduce the size of the tax base, so that other transactions by other traders would have to bear a higher rate of tax to raise the same total revenue. It would also mean that scarce resources would have to be deployed by the tax authorities to register and control the traders carrying out the zero-rated transactions with no corresponding benefit to the revenue.

2.16 Lower Rates. - Some relief for particular classes of transactions can be given by subjecting them to a lower rate of tax than the standard rate. This is a practice found in the VAT systems of all the EEC countries. In such cases full credit for tax on inputs is given even when this was at the standard rate so that the effective rate of tax on the transactions is the lower rate.
CHAPTER 3 - GENERAL SCOPE OF A POSSIBLE SCHEME FOR THIS COUNTRY

3.1 General.- Matters such as the rate or rates of tax and details of coverage can be decided only in the light of all the circumstances at the time of introduction of a VAT. Without prejudging such issues in this Green Paper it is desirable to focus attention on certain special problems and to indicate possible solutions to them. This Chapter gives a general outline of how the principles in Chapter 2 might be applied to a VAT in this country. It should not be assumed that the detailed issues discussed in this and the following Chapter will necessarily be settled in the way here described. However, for the purposes of the Green Paper it has been assumed that while VAT will replace purchase tax and SET, other customs and excise duties (e.g., those on tobacco, alcoholic drinks and hydrocarbon oils) will in general be retained, with any necessary adaptations.

3.2 Taxable Transactions.- The scope of the charging provisions (see paragraph 2.3) will need to be widely drawn. The underlying principle will be a tax applying to all business transactions of whatever kind (including retail trade), with specific exceptions, rather than a tax applicable to a selected list of transactions.

3.3 Goods.- The expression "goods" will need to be carefully defined, particularly in relation to land and buildings. The distinction familiar in direct taxation between expenditure on capital items (which is only relieved, if at all, by capital allowances) and expenditure on non-capital items (which is generally allowed) would not apply in the case of VAT, except in some special
cases, eg partially exempt traders (see paragraph 3.16).

3.4 Deliveries.- In addition to sales, deliveries of goods would cover other transactions involving transfer of ownership and, for example, hiring and hire purchase. Certain transactions in relation to goods (eg process work) might be treated either as deliveries or as the provision of services.

3.5 Appropriations.- This term refers in general to transfers by a taxable person of items from his business to non-business use, eg to the use of his family or employees, or to himself in his private capacity; or to certain business uses. These transactions might be brought within the scope of the tax either by treating them as deliveries or services and so subject to a specific tax charge or, in some cases, by disallowing credit for tax on the inputs to them (see paragraphs 3.22 and 3.23).

3.6 Services.- In principle, the provision of a service should be understood as any business transaction not amounting to a delivery of goods or appropriation in the above sense. Consumer services such as hotels and restaurants, entertainment and hairdressing would be covered, as would services used by business (for example management consultancy, office cleaning services) and services, such as those of lawyers and accountants, used by both private persons and business.

3.7 The expression "services" might well include, inter alia, repairs and maintenance; transactions involving patents, designs, trademarks and industrial know-how; the services of architects and surveyors; advertising, transport and storage services; employment
agency services; the services of consultants, engineers and planning offices; the services of forwarding agents, brokers, business agents etc.

3.8 Taxable persons.— Except for importations of goods, transactions would in general be taxable only when undertaken by "taxable persons" (see paragraph 2.4). This expression should be understood as applying not only to companies, but also to individuals, partnerships and other bodies engaged in trading or professional activities in a wide sense. The expression does not, however, include employees acting in that capacity.

3.9 Registration.— For the purposes of control all persons delivering chargeable goods or providing chargeable services will have to be registered with the Tax authorities whether they actually pay tax or not, and to enable this to be done they will be required to give the authorities certain particulars of their business activities. Thus small traders, whether or not below the exemption limit (see paragraph 4.4) will be required to register, but persons dealing wholly in exempt goods will not.

3.10 The process of registration will take several months and will need to be completed before the date on which the tax becomes operative. In addition, traders will need time to familiarise themselves with the details of the tax procedure.
3.11 **Accounts.**—Persons accountable for tax will have to maintain the accounts necessary to establish their VAT liability, their entitlement to issue invoices showing tax and their entitlement to credit for tax on inputs.

3.12 **Tax point.**—Liability to tax will arise when the transaction takes place, e.g. when the goods are imported or delivered or the service is provided; but in certain cases, e.g. services provided over a period of time, or the delivery of a major installation with payments on account, special rules will be needed to determine the times at which the tax becomes due and at which credits may be taken.

3.13 **Value.**—The value for tax would in general be the invoice price, inclusive of other duties and taxes, but exclusive of VAT; however, where the price consisted wholly or partly of a consideration other than money, or where there was no consideration, a notional value would need to be assessed. A notional value might also be needed if the buyer and seller were not dealing at arm's length. Provision would also be needed for adjustment, e.g. if goods were not up to sample and a lower price was negotiated.

3.14 **Accounting periods.**—The assessment of the tax will be based on prescribed accounting periods, which might be of three months. To give an even flow of tax returns and remittances, arrangements might be made under which returns were staggered, with about one third of the traders making them each month. Traders
would be accountable in respect of taxable transactions undertaken by them in each accounting period. In any period a trader’s net liability (or net credit) would be equal to tax at the appropriate rate on his taxable transactions in the period minus tax paid at importation and minus tax invoiced to him by accountable suppliers of taxable goods and services in the period. Thus the taxable transactions effected by a trader in a period would not be directly related to his inputs in that period. For the purpose of assessing liability this would not matter: credit for tax on purchases would not be tied to the re-sale of those items, and would be allowed in respect of capital inputs as well as current ones.

3.15 Invoices.- Most retail sales apart, each trader accountable for tax will give each of his customers an invoice showing the amount of VAT on the transaction, in addition to the particulars needed for the purposes of his business. If the goods and services provided were taxable at different rates, or included exempt items, details would be shown on the invoice to enable the transactions in each category to be identified. A copy of the invoice would be retained by the trader who issued it. In their own interests traders accountable for tax will need to ensure that their suppliers provide them with invoices in this way, so that they are in a position to support the claim for credit of tax in their own tax returns. Traders not accountable for tax will not, of course, be entitled to deliver invoices showing the tax separately.

3.16 Partially exempt traders.- A trader undertaking taxable transactions as well as exempt ones will be entitled to claim credit
for tax on the inputs to his taxable transactions but not on the inputs to his exempt transactions. In some cases particular types of input might be related to particular types of outputs (e.g., stock for resale) but for the rest rules will be needed to determine the proportion of tax on inputs in respect of which credit may be claimed (see the Appendix to this Green Paper).

3.17 **Imports.**— The procedure for charging VAT at importation will need to include the provision of evidence of payment of VAT to support subsequent claims for credit by traders entitled to make those claims. Ancillary questions which arise include the treatment for VAT purposes of goods temporarily imported, or taken into warehouse on importation.

3.18 **Exports.**— Exports by taxable persons will be relieved from tax by zero-rating, as described in paragraph 2.15.

3.19 **Payment of tax.**— Each trader accountable for tax will be required to pay VAT to the tax authorities on the basis of a return made at the end of each accounting period. In addition to other details the return would show the amount of VAT on the trader's taxable transactions and the amount of credit claimed in respect of tax on inputs.

3.20 **Repayments.**— For some traders the tax on their purchases of goods and services will exceed the tax on the taxable transactions carried out by them. Traders with a large export business will regularly be in this position. Others may find
themselves in this situation from time to time. It will of course be necessary to have rules governing credit for or repayment of the excess of tax on inputs over tax on outputs.

3.21 Annual statement.—Traders accountable for tax might be required to complete an annual declaration including a summary of sales and purchases during the preceding year. This would provide the basis for any necessary adjustment of tax already paid. Other traders including those paying under a simplified arrangement (see paragraphs 4.2 and 4.3) might also be required to provide annual statements.

3.22 Special restrictions.—In a few cases the right to claim credit for tax on inputs might be restricted as an alternative to taxing the transaction as an appropriation (see paragraph 3.5). Examples are:

a. goods and services which have both a business and a private use eg business cars; business entertainment; electricity, gas and telephones in flats combined with shops. The reason for the restriction would be to safeguard the interests of other taxpayers, and of the revenue, in cases where business and private use could not be satisfactorily distinguished.

b. goods and services acquired for, or produced by, a trader's business which are transferred to private use.
3.23 Intermediate goods and services. – In some countries with a VAT tax is chargeable on certain deliveries by the trader to himself for the purpose of his business. For example, if a trader purchased exempt goods or services and used them to carry out taxable transactions there could be a hidden tax on his purchase which he might wish to avoid by making the exempt goods or providing the exempt services within his own business. Conversely, a trader with exempt outputs might wish to avoid paying tax to his suppliers of taxable goods and services by making the taxable goods or providing the taxable services within his own business. If there were the possibility of such activities resulting in serious distortion of trade or revenue loss it might be necessary to have a special provision in the VAT system.

3.24 Administration. – VAT will be administered by HM Customs and Excise to whom any questions or comments on the administrative aspects of the tax should be addressed.
CHAPTER 4 - SPECIAL CASES

4.1 General. As has been explained, the scope for giving special treatment under VAT is limited. However, special treatment would be required in some cases and this Chapter describes the principal items which might be concerned. The presumption would be that any business activity in an area not covered by this Chapter would be within the scope of the tax. One of the purposes of this Green Paper is to invite attention to the question whether there are any other areas which ought to be subject to special rules.

4.2 Nationalised Industries. In principle nationalised industries should be treated in regard to their trading activities in the same way as commercial firms. The precise coverage of the tax in the fuel, transport and communication sectors (including, where appropriate, corresponding private activities) will require consideration, and it may be found appropriate to have a reduced rate applying to some of these activities.

4.3 Government Departments and Local Authorities. An appropriate principle would be to subject the outputs of these bodies where they compete with the private sector to arrangements corresponding with those applicable to their competitors. To that end, Government Departments would be liable to the tax, and goods and services provided by local authorities to the public in competition with the private sector would also be liable. Arrangements could be made to relieve from tax other activities of local authorities.
4.4 Small traders. On administrative grounds an exemption for "small" traders would be desirable when their taxable turnover was below a specified annual amount. This could substantially reduce the number of traders accountable for VAT and relieve those exempted from the obligation to keep full VAT accounts. The turnover limit for such an exemption would need to take into account (a) administrative cost to both taxpayers and the tax authorities, (b) possible revenue loss and (c) competition between exempt traders and traders accountable for VAT.

4.5 In other countries with a VAT the exemption is generally fixed at a relatively low level and is accompanied by some tapering provision for those traders just outside the exemption. A possible method in this country would be to provide an alternative tax (an annual charge based on turnover) which would apply to traders with small turnover; they would of course have to remain outside the VAT system (ie they would not be able to claim credit for tax on their inputs, and they would not be able to show tax as a separate item on their sales invoices so that their customers would get no credits). Following the purchase tax precedent, very small traders with turnover below a specified figure would not be required to pay either VAT or this alternative tax.

4.6 Food; farmers and fishermen. In EEC countries with a VAT in operation food is taxed, though at a reduced rate for at least basic agricultural products. If our application to join the Community is successful, we shall, of course, within such period of transition as may be negotiated, have to come into line with other Members in so far as taxation is harmonised. In the
meantime we are free to consider also other ways of giving relief to food and food products. They might be zero-rated, but then all farmers would still have to be brought within the VAT system; this would involve them in keeping records and making regular returns and would also lead to extra administrative costs in controlling and making repayments to them. A better course, which would substantially relieve from tax most food and food products - apart perhaps from those at present chargeable with purchase tax, and the food element in catering services - would be to exempt them and at the same time to zero-rate main specialised inputs of farmers, such as some animal feeding stuffs, lime, fertilisers, insecticides, farm machinery and tools, specialist agricultural services and farm buildings. Main specialised inputs of the fishing industry could be similarly zero-rated.

4.7 The effect would be that in so far as farmers produced only non-taxable food or food products, they would be outside the scope of the tax. They would of course be required to account for tax if they undertook any taxable transactions, unless they came within the scope of a "small trader" exemption.

4.8 Housing and accommodation. Other countries with a VAT make special arrangements of various kinds for housing; these differ in different countries, both in the nature of the reliefs provided and the circumstances in which they apply. Similarly special arrangements for housing would be needed in a VAT in this country and these would have to be related to our own circumstances. Relief from VAT in some form might be provided in respect of sales
and rents of houses and other domestic accommodation, though repairs
and maintenance of buildings and letting of short-term accommodation
for example in hotels and holiday camps, would be within the tax.

4.9 Finance. A VAT which is an appropriate method of taxing
flows of goods and services is not appropriate for taxing flows of
money and paper representing money. Other countries with a VAT
exempt financial services, though these services are sometimes
subject to a special tax. For administrative reasons a number of
transactions in this sector would probably have to be exempt from
VAT, including life assurance and the services of banks. Somewhat
similar considerations apply to other transactions in this sector
such as dealings in securities and in commodities (eg futures).

4.10 Health. Some relief from VAT will be needed here. Thus
doctors could be exempted and arrangements could be made to relieve
from tax services and drugs provided by the National Health Service.

4.11 Education. A somewhat similar problem arises in regard to
education. But many educational supplies are at present subject
to purchase tax, and these might be liable to VAT.

4.12 Charities and religious institutions. The principle would
be that the trading activities of charities should be subject to
VAT in the same way as those of other bodies operating in the same
field. Consideration could be given to ways of relieving from
tax purchases by charities of certain specialised capital assets,
for example church buildings, hospitals, and schools, and to the
question of exempting certain other inputs of charities related to their fund-raising or other non-trading activities.

4.13 Second-hand goods, antiques, etc. In most VAT countries sales by way of trade of second-hand goods are taxable in the same way as sales of new goods. Thus although sales by members of the public to dealers would not be taxable, tax would be charged on sales by dealers, whether to other dealers or to members of the public. It is common to apply special rules to second-hand cars, so that, for example, a trader buying a used car from a private seller and then reselling it would be liable to VAT only on his gross margin, i.e. the difference between his buying price and his selling price. Antiques, like original works of art, are usually exempted.

4.14 Books, journals, newspapers, etc. If it were considered appropriate to give relief to books, newspapers, journals, magazines, music scores, etc, this could be done by exemption. Advertising services could, however, remain taxable. Publishers of newspapers, etc selling advertising services would then be accountable for tax on those sales (with appropriate credit for tax on inputs) while their customers, if accountable for tax, would be entitled to take credit for this tax against the tax on their own outputs.
CHAPTER 5 - SOME TRANSITIONAL PROBLEMS

5.1 General. The introduction of VAT will involve a major change both for the trading community and for the tax authorities. Solutions will have to be found to a number of novel problems, many of which require further consideration and consultation with those affected.

5.2 Termination of purchase tax. If only to raise essential revenue, purchase tax will need to continue to be chargeable until VAT is introduced and will be payable by registered purchase tax traders in the usual way.

5.3 Tax paid stocks. Goods in stock on the introduction of VAT would be chargeable with VAT when sold after that date. If the goods had already borne purchase tax the question might arise whether any relief should be given against VAT liability, and if so what method to adopt.

5.4 Existing contracts. Under existing legislation, any increase or reduction in a rate of customs or excise duty or purchase tax, or the imposition or abolition of a new duty or purchase tax charge, may be passed on in the price of the goods supplied, notwithstanding the terms of the original contract in respect of the goods. A similar provision will no doubt be required in VAT legislation.
APPENDIX

PARTIALLY EXEMPT TRADERS

1. As noted in paragraph 3.16 a trader providing taxable as well as exempt goods or services would be entitled to claim credit for tax on his inputs only in so far as they related to taxable outputs. In some cases particular types of inputs could be related to particular types of outputs; but where this was not practicable an alternative, adopted in other countries, might be to allow credit for tax on inputs in the ratio of taxable to total outputs ("Pro-rata rule"). Taxable outputs would include exports and other zero-rated sales, and taxable appropriations. The ratio would provide the percentage of the total tax on the trader's inputs for which he could claim credit. In some cases, however, this alternative might not be practicable and it might then be necessary to calculate the ratio by reference to the proportion of taxable to total inputs.

2. A period of 12 months might be an appropriate base period for these calculations. For any given year the necessary data could not be ascertained until that year was completed and a provisional assessment of the percentage would therefore have to be made. When the full year had elapsed a reassessment could be made on the basis of the trader's outturn for that year, and any adjustment made by way of credit or repayment to the trader or additional payment by the trader.
3. Capital inputs. If credit for tax on capital inputs could be taken in the same way as credit for tax on other inputs, it would be necessary to provide for adjustment of the amount of tax on capital inputs for which credit was initially claimed, because a trader's ratio of taxable to total outputs might fluctuate considerably during the lifetime of the capital asset. In the EEC countries, the possibility of adjustment runs for the five years following acquisition of the capital asset, and at the end of each of those five years one fifth of the amount initially claimed as credit can be increased or reduced according to the actual pro rata percentage calculated for that year. Such an arrangement for capital items would add considerably to the complexity of the pro rata arrangements, both as regards the calculations and as regards the need to distinguish between capital and non-capital inputs. However, without such an arrangement it would be open to a trader with both taxable and exempt outputs to purchase his capital assets in a year in which he undertook only taxable transactions, and to claim credit for the whole of the tax on those assets. This kind of distortion could be corrected only by an adjustment of the credit entitlement in respect of tax on the asset over a period of years following its acquisition.