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Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

VAT ON IMPORTS

At our meeting on 10 February I promised to send you a copy of the report by officials on the possibility of abolishing the Postponed Accounting System for VAT on imports. This is attached. As I see it, the main considerations are as follows.

2. The proposed change was originally conceived in the context of a review of non-tariff barriers. It was then suggested that the present VAT accounting arrangements gave a financial advantage to imports over home produced goods which should be reviewed. The detailed examination which has since been under-taken suggests, however, that the practical effects of the present arrangements make little difference as between imports and home-produced goods. The change would be seen as a positive discrimination against imports, and in favour of domestic manufacturers. But the effect would be very tiny; and the best estimate is that imports might be reduced by £100 million a year at most.

3. Against this background the main results of the change would be a once-and-for-all revenue and PSBR gain of about £600 million (plus or minus £200 million allowing for the many uncertainties involved), but this would mean a corresponding reduction (on average) in business liquidity. These are very large figures compared with the very small continuing effects of the change. In present difficult circumstances this is the way we could expect industry to perceive it.

Effects on industry

4. The effects on business liquidity are likely therefore to be crucial. Unless UK importers were able to pass any of the effect back to their foreign suppliers, their own business liquidity could be reduced by up to £600 million in the long run. And in the initial months after the change this figure could be as high as £800 million. Almost half of the effect would fall on UK manufacturers who would not be able to pass all of it on in higher prices. Any manufacturers who stood to lose particularly would complain that they were being penalised by the change.

Effects on traders' accounting the Customs and Excise

5. There would be a significant price to pay in terms of the costs of VAT. The change would involve both Customs and Excise and traders in processing an additional 4,500,000 documents a year, a burden which would remain long after the main revenue gain had been dissipated. The new system would be much less economical than the present one and would go against the drive for greater efficiency and cost-consciousness in the Civil Service which we are pursuing through our policies on manpower and the Rayner exercises. Indeed, it would require a substantial addition to Customs and Excise staff at a time when efforts are being made to reduce numbers as much as possible.

Conclusion

6. When this was first raised, it had an immediate superficial attraction. But now that I have seen the likely implications, I feel that the balance of argument is firmly against making the change. This is particularly so in the context of a Budget in which I shall be seeking, within very limited room for manoeuvre, to provide immediate assistance to the company sector without appearing unduly to add to its burdens. I doubt whether it could be presented convincingly. I hope you will agree that it should not be pursued further this year.

7. I have no reason to think that Keith Joseph or John Biffen are particularly attracted to this, but if you did wish to take the matter further, you would no doubt wish me to consult them.

G.H.

(G.H)
12 February 1981

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CONFIDENTIAL

SUMMARY

A. THE ISSUE

Traders are not required to account to Customs and Excise for VAT on imported goods until they make their normal quarterly return. It was suggested that this could provide a financial advantage compared with the purchase of domestically produced goods and services on which VAT is paid when the supplier s account is settled. We were asked to examine the implications of a change in these arrangements.

B. REASON FOR CHANGE

This proposal originated from an examination of possible non-tariff barriers by the Industrial Policy Group of officials. It was commended to Ministers on the grounds that it would bring the VAT arrangements for imports more into line with those for domestically produced goods. On further examination, however, we believe that the practical effects of the present arrangements may be little different as between imports and home produced goods. Nevertheless, it remains true that some of our main competitors in Europe require VAT to be paid on imports at the time of importation, and that a move in that direction would not be incompatible with our EEC obligations.

C. WITHDRAWAL OF THE POSTPONED ACCOUNTING SYSTEM

Our report therefore considers the effects of replacing the present Postponed Accounting System with an arrangement whereby VAT would be required to be paid on imports either at the time of delivery or by direct debit on the 15th of the month following.

D. EFFECTS OF THE CHANGE

1. Revenue and PSBR

(a) Withdrawal of the Postponed Accounting Arrangements would accelerate the payment of VAT on imports by, on average, 6-8 weeks.

(b) This would provide a once-for-all revenue gain of about £600 million (plus or minus £200m) with a corresponding benefit to the PSBR. For the full effect to be felt in the first financial year the change would need to be implemented not later than 1 December. Later introduction would mean that a pro portion of this gain would come through in the follow ing year.

(c) Once the change had been fully absorbed, the gain(or loss) to the PSBR in succeeding years would mainly depend on the size of the increase (decrease) in the value of UK imports.

2. Monetary

Despite the large initial gain to the PSBR, the effect on companies' cash flow means that the benefit to the money supply would be likely to be small.

3. Trade

(a) The cost of financing earlier payment of VAT would be equivalent, at most, to an increase in import prices of 0.3%. This would have negligible effects on the volume of imports, amounting at most to a reduction of about £100 million a year.

(b) In practice this reduction might be smaller to the exte that the current strength of sterling permitted UK manufacturers to pass more of the resulting cost increase back to overseas suppliers.

4. Effects on industry

(a) There would be a once-for-all adverse effect from the change in the cash flow of importers (or their foreign suppliers) corresponding to the gain to the revenue.

(b) In the early months this could fleetingly reach something of the order of £800 million at the peak, but should settle within a matter of months to around £600 million.

(c) £600 million represents an average figure equivalent to 6-8 weeks of revenue. The aggregate financing burden on traders would fluctuate within any one month, quarter, or financial year.

(d) Individual traders would require additional finance varying each quarter up to a peak of a full quarters VAT on their imports. The transitional cost would be greatest for traders who opt to pay on entry rather than by later direct debit covered by bank guarantee.

(e) The cost to traders of financing these payments (at current interest rates) would be up to £100 million a year, of which almost a half would fall on manufac turers.

(f) The effects would vary significantly between different sectors and between different firms within a particular industry.

(g) In general, the financial consequences for the manufacturing sector are likely to be more significa than for services and the distributive trades which are generally more profitable and for the most part not subject to foreign competiton.

(h) Within the manufacturing sector, the impact of the change would be likely to be greatest for the oil, motor vehicle, electrical goods, metal manufacturing, alcohol, air transport, tobacco, chemical and paper industries.

(i) Within each industry, the effects on company liquidit and competitiveness would vary significantly betwee individual companies depending on variations in their pattern of trading. On the limited informati available we have not been able to identify any major UK manufacturer who would be critically affected; but we are not able to rule out the possibility of serious effects on some individual companies.

(j) The implications for traders would need to be considered against the background of the poor outlook for corporate liquidity.

5. Administration and manpower

(a) It would still be necessary to retain the PAS for certain postal imports and some services where there is no "point of entry".

(b) Withdrawal of PAS for other imports would require a continuing addition of 85 Customs and Excise staff, plus a temporary need for a further 15 staff until computerisation in mid-1982.

(c) In addition, overtime would be necessary in the transitional stage, and on a continuing basis in smaller VAT offices.

(d) The change would be a move away from the direction of simplifying procedures and reducing administrativ burdens on traders.

(e) There would be increased compliance costs for business especially customs agents and warehousekeepers, as a result of the new procedures.

6. Legislative requirements

The change could be implemented by Statutory Instrument subject to negative resolution.

7. Implementation

The change would require a minimum of three months to implementonce a decision to proceed was taken. Implementation reasonably quickly following an announcement in the Budget Speech would bring the full benefit to the PSBR in 1981/82. Implementation in time to have a substantial effect on this year's PSBR would require early decision For the full effects to come through in 1980/81 the change would need to operate from 1 December: this requires a decision by the beginning of September.