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UK Government Consultation: Draft
regulations: VAT provisions for
drink deposit return schemes



ICAS response

About ICAS

The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 23,600 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

1. The following submission has been prepared by the ICAS Tax Board.

Background comments

2. ICAS is grateful for the opportunity to contribute its views on this HMRC consultation, entitled "Draft regulations: VAT provisions for drink deposit return schemes".

General Comments

3. ICAS is responding to this consultation to comment on the scheme more generally rather than responding to specific questions, as follows:
4. Overall, ICAS welcomes the proposals on the basis that they remove the VAT reporting and accounting requirements from most elements of the supply chain and restrict them to those who are producing and importing drinks in and into the UK. However, we consider that there are several areas of difficulty in this scheme which may present considerable problems to the industry and possibly give rise to disputes, avoidance behaviours and ultimately, to tax tribunals.
5. We have grouped our response into themed headings from paragraph 7 onwards. Due to the announcements by the Scottish First Minister that the scheme will commence in Scotland from 1 March 2024, this response also relates to discrete Scottish aspects of the scheme to highlight particular practical issues in that jurisdiction arising from the DRS proposals.
6. ICAS notes the VAT accounting rules as set out in the Value Added Tax Act 1994 and Value Added Tax Regulations 1995 do not currently legislate for VAT accounting for DRS deposits.
7. **Changes to the scheme, including concessions, risk creating an uneven playing field**
 - The scheme started out as an "all-in" scheme, meaning all producers and materials were in scope of VAT at the same price (for containers from 50ml to 3l).
 - Certain concessions have already been made around day 1 / month 1 fees, with speculation around other concessions for small suppliers.
 - Concessions for smaller producers will see the costs being passed on to larger producers, which makes planning difficult.
 - More generally, the scheme is continuing to evolve, which also makes VAT and accounting planning challenging.
 - If concessions are given at this stage, it would be likely to create an anti-competitive marketplace with producers below the threshold able to supply their product at a more competitive price than ones just over the threshold. This is due to the reality that producers will need to pass on scheme costs, for example, producer fees, as well as the deposit itself onto the consumer.

- It should be noted that this has potential to hit mid-sized producers (ie those over any threshold for exemption but not large multinationals) hardest, with the cashflow impact well into the millions. It will create significant challenges to their financial situation.
- Further, it's difficult to see how such concessions are workable, with consumers needing to differentiate between bottles that can be returned vs ones that can't, both in the shops and at home.

8. The impact on business of delaying the scheme and harmonising across the UK needs to be carefully considered

- There has been a lot of media speculation around delaying the scheme based on the impact on smaller producers and a perceived lack of clarity/ transparency around certain matters. There is also discussion on a UK-wide scheme and how various schemes across the UK would comply with the UK Internal Markets Act.
- While the decision to roll out a Scottish scheme prior to the remainder of the UK is one for the Scottish Government, the financial and VAT implications and impact on business must be considered independently.
- While delaying the scheme should be considered, there are financial implications to producers of doing so due to Circularity Scotland's operating cost, plus the contract between Circularity Scotland and Biffa (the latter having invested significantly in infrastructure) and the existence of clawback clauses from producers who have signed up to already. This could increase their costs significantly.
- Certain scheme assumptions, particularly around cross-border fraud provisions, have increased the cost to producers. There is potential for a UK-wide scheme to be more cost-effective for producers.
- However, the final details of the English scheme are not fully known. The details that are publicly available show differences, such as an exclusion for glass. Wales has proposed a different scheme again. These differences create complexity and administrative burden for businesses that want to sell across the UK.

9. The mechanics of the scheme are disproportionate and punitive to businesses and may result in annual accounts that are challenging to audit

- There are three main income streams available to Circularity Scotland; selling the recyclable materials, the producer fee and unredeemed deposits. The only one of these that relates directly to the producer is the producer fee.
- Producers cannot influence the collection rates and the market value of recyclable materials, yet these items impact on their producer fee, which is essentially a balancing number.
- These mechanisms result in a lack of visibility of fees, which will become estimates in producers accounts. Consideration will need to be given to how to track sufficient data to allow these estimates to be audited.
- It is unclear how producers should invoice their customers to consider matters such as deposits. Aside from the complexity associated with tracking this data, it is unlikely that systems will be set up to process this new information. This data will result in significant volumes of transactions that must be processed, which will impact on business cashflow. This may result in a significant transfer of working capital from producers to retailers.
- Other estimates that are likely to be challenging include assumptions around location of customers. As an example, a producer may ship a pallet of product to a supermarket distribution centre in Scotland. However, this pallet could ultimately be distributed to supermarkets in England. It is possible that businesses will need to hire more analysts to deal with this complexity. It also makes working capital forecasting very challenging, which has the potential to impact investment.

10. The environmental and financial impact, including the impact on public finances, appears to be unknown

- The environmentally focused aims of the scheme are laudable. However, they must be subject to rigour and challenge.

- It appears that local councils are taking different approaches to the scheme, which could impact on kerbside collection. This could in turn impact on the number of cars and lorries on the road as both consumer behaviour and the distribution and logistics network changes.
- These changes will need to be quantified in terms of the direct and indirect impact on CO2 emissions. It is currently unclear whether emissions will increase or decrease under the proposed scheme.
- Local councils will lose an income stream due to recyclable material being sold by Circularity Scotland rather than local government. With different councils potentially taking different approaches, it's difficult to quantify the impact on public finances.
- One of the reasons for the scheme appears to be to tackle littering. It may be a worthwhile exercise to use data to quantify the proportion of litter that is currently attributable to scheme items to calculate a collection cost per item. This would provide transparency to the public around the extent to which the DRS represents value for money and whether it will achieve its stated aims. This should be assessed against other alternatives to improve litter collection.

11. Inflation

- A common phrase sometimes used to describe the scheme is that the “producer pays”. This does not reflect the commercial reality that costs will be passed onto consumers through price increases, which will impact inflation.
- It appears logical that premium products may find it easier to absorb price increases without significantly impacting demand, compared to cheaper products. This could impact on the availability of supply of more affordable products.
- It is currently unclear how existing mechanisms to calculate inflation will be adjusted for deposits. This may be challenging to do for many reasons, not least because of the likely price increases noted above.
- If inflation statistics are not adjusted to account for this, there could be a significant impact on obligations that are inflation-linked, such as pensions. A wider exercise should be conducted to understand the financial impact.

12. There are unanswered questions relating to VAT

- From a VAT perspective, DRS remains flawed in several ways. Fundamentally, no deposits are now subject to VAT, except in the hands of the producer (only) where a container subject to the levy is not returned.
- Ultimately no deposit charged under the Scheme should be subject to VAT, because:
 - Regulation 5(1) of the DRS Regulations states that “a deposit is a redeemable sum of 20 pence that does not form part of the consideration paid for the scheme article”;
 - The value of a supply for VAT purposes, pursuant to s.1(2)(a) and s.19(2) of the VAT Act 1994 is the amount as, with the addition of VAT, is equal to the consideration; and
 - Therefore, the deposits charged under the Scheme should not be subject to VAT at any point, based on this analysis.
- Furthermore, or alternatively, the deposit should not be treated as consideration for any supply, based on established case law, as:
 - There is no benefit provided in return for the deposit; and
 - The charge is imposed because of a statutory levy.
- These principles are not altered merely because ultimately a container is not returned and treating one charging of the deposit as subject to VAT, potentially and retrospectively, feels open to challenge.
- If VAT is to be paid by any person in this chain, in Scotland, would it not be better to impose any VAT charge on Circularity Scotland as they are ultimately responsible for ensuring that the recycling takes place, and this would be an incentive for them to complete their remit? This may also assist with the issues we raise in point 10 above.

13. Input tax and invoicing

In the latest version of government guidance, it's held that VAT is due on deposits, only in the hands of producers, and only to the extent Scheme containers are not returned by final consumers. In high level terms, we see this as creating the following two main challenges for both producers and their immediate customers:

1. **Liability to VAT:** If producers are required to ultimately account for output tax on deposits received in respect of drinks, whose containers are not ultimately returned, this creates challenges and complexities.
 - a. How does the producer initially invoice for the deposit?
 - b. If a container is not returned, and VAT (according to current guidance) becomes due, does this create a notional or actual input tax credit position for the producer's immediate customer?
 - c. If so, does the fact that this intermediate supplier will not – in any circumstances (container redeemer or not) – be required to account of VAT on the deposit it charges its customer complicate the position here? If “input VAT” is created, how is it reversed?
2. **Timing and VAT accruals:** It appears from the wording of the latest guidance that VAT will be due from producers on the value of their DRS sales, less their DRS redemptions. The current version of guidance is silent on timings here, but we assume from the existing wording that this will effectively be DRS sales in a VAT return period, less approved DRS container returns made in the same period. Whilst in theory, this may be acceptable, the guidance as written does not confirm this is the case, and if the guidance does intend this, producers who have by their own real-time records accounted for VAT on the deposits received could suffer a significant cash flow loss, where containers have been returned before the end of a VAT return period, in respect of which, this data reaches them after this information can affect the VAT return for a particular period. We would therefore question whether HMRC will consider a new VAT Retail Scheme for DRS producers, or an approved accruals mechanism to mitigate the cash flow impact of the scenario outlined above. Alternatively, an output tax charge outside of the standard VAT return periods could be considered.

Broadly, it appears the latest iteration of the DRS interaction with VAT as inconsistent with established law, will be likely to be open to taxpayer challenge, and potentially at odds with the intended VAT-neutral aims of the Scheme as stated in the TIIN.

Conclusion

Our comments pose prompt the question of whether VAT is the correct mechanism to use to encourage compliance with the scheme and thereby reduce littering and improve the environment. It's true that Deposit Return Schemes in other countries utilise VAT in different ways; however it may be the case that a new type of tax could be utilised more effectively without the unintended consequences arising that we have described above. VAT is not necessarily the silver bullet in this scenario, and especially not where there are cross-border issues and there is possibility that Scotland will start its DRS journey before other tax jurisdictions in the UK.



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