



BRIEFING PAPER

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VAT on postal packages

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Summary

Generally imports into the EU are charged VAT. VAT is normally due at the same rate as on the supply of those goods in the relevant Member State. Under European VAT law all Member States are required to exempt from VAT commercial consignments worth €10 or less. This is known as 'low value consignment relief' (LVCR). Member States may apply a higher threshold up to €22 and the UK has done this in the past. Provision is made for a higher limit to apply for personal gifts. VAT is not chargeable if the value of a gift is €45 or less, if it has been sent from one person to another, if there is no commercial or trade element, and it is of an occasional nature only – say, for a birthday or anniversary. For gifts of alcohol, tobacco, perfumes or toilet waters, an additional limit is set to the volume or quantity sent. The €45 limit for gifts has been in place for many years, though it has had to be adjusted to take account of changes in exchange rates. Since 1 January 2017 the limit has been set at £39.¹

For VAT purposes the Channel Islands lie outside the EU. For some years there were concerns about the ability of some UK retailers to exploit LVCR by selling goods over the internet VAT-free from subsidiaries based in Jersey and Guernsey.² For its part the Labour Government was reluctant to tackle this by cutting the threshold for imports, because of the extra demands this would place on HM Revenue & Customs, to calculate and collect VAT on a much larger number of parcels. As an alternative approach, it sought to persuade the authorities in both Jersey and Guernsey to discourage companies setting up this type of business, with some success.³

Despite this the practice continued with some retailers setting up subsidiaries in the Channel Islands to sell CDs and DVDs online.⁴ The Exchequer costs of the exploitation of this relief were estimated to have risen to about £140m by 2009/10.⁵ In the 2011 Budget the Coalition Government announced it would cut the LVCR threshold from £18 to £15 from 1 November 2011 and "explore options with the European Commission" to prevent the relief being exploited "for a purpose it was not intended for." At the time it was estimated that the £3 cut in the threshold would raise £5m in 2011/12, rising to £10m in 2012/13.⁶ In November 2011 the Government announced that it would legislate to withdraw LVCR entirely from mail order goods imported from the Channel Islands, with effect from 1 April 2012.⁷ In March 2012 a legal challenge to this selective withdrawal of LVCR, brought by the Governments of Jersey and Guernsey, failed, and the changes took effect from 1 April as planned.⁸

This note gives a short summary of the way that VAT is charged on commercial consignments and gifts posted from outside the EU, before discussing this reform.

¹ For guidance see, HMRC, [A guide for international post users – Customs Notice 143](#), March 2017

² For example, "Jersey to crack down on tax loophole", *Financial Times*, 28 June 2005. On estimates of the tax lost to the Exchequer see, [HC Deb 12 February 2009 c2148W](#); [HC Deb 23 June 2009 c830W](#).

³ *Budget 2007*, HC 342 March 2007 para 5.142

⁴ "Sainsburys and Best Buy set up Channel Island websites", *Observer*, 21 November 2010

⁵ [HC Deb 28 March 2011 c39W](#)

⁶ *Budget 2011*, HC 836 March 2011 para 2.158 (Table 2.1 : item 38)

⁷ [HC Deb 9 November 2011 cc15-16WS](#); HM Treasury press notice 122/11, *Government ends exploitation of Channel Islands VAT rules*, 9 November 2011

⁸ [\[2012\] EWHC 718 \(Admin\)](#). See also, [HC Deb 25 April 2012 cc899-900W](#). Provision to this effect was made by [s199 of the Finance Act 2012](#).

1. VAT relief on low value commercial imports and gifts

VAT is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt. All businesses must register for VAT if their turnover of taxable goods and/or services is above a given threshold, which is currently £85,000.⁹ VAT is charged either at the basic rate - currently 20% - or the zero rate.¹⁰ VAT is charged on the additional value of each transaction, and is collected at each stage of production and distribution. A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax. It will settle up with HM Revenue & Customs (HMRC) for the difference between the two. In the end the cost of the tax is borne by the final consumer.

VAT law in this country – in line with all other Member States – is based on European VAT law. Common criteria for the VAT base across all Member States were agreed in 1977, though this legislation was consolidated in a new principal EC VAT directive (2006/112/EC).¹¹

Generally imports into the EU are charged VAT. VAT is normally due at the same rate as on the supply of those goods in the relevant Member State.¹² Under European VAT law all Member States are required to exempt from VAT importations of commercial consignments of a total value not exceeding €10. Member States may, if they wish, exclude mail order goods from the €10 exemption – though the UK has not done this. The exemption does not apply to alcoholic products, perfumes and toilet waters, and tobacco or tobacco products.¹³ If they wish Member States may impose a higher limit up to €22, and the UK has done this.¹⁴ Member States may grant these exemptions subject to the condition that they are not liable to affect “the conditions of competition on the market.”¹⁵ Clearly setting the ceiling for low value consignment relief represents a trade-off. More tax would be collected if the limit was €10, but more Customs and postal staff would be needed to process packages and impose charges, as many more consignments would no longer qualify for relief.

Provision is made in EU VAT law for a higher €45 limit to apply to gifts. Under EC Directive 2006/79/EC, goods “in small consignments of a non-commercial character” sent from outside the EU may be exempt from VAT if they are worth no more than 45 Euros. In these

⁹ With effect from 1 April 2017. The threshold is set by Order ([SI 2017/290](#)).

¹⁰ A 5% rate is charged on a small number of supplies, including the supply of domestic fuel & power. Details of VAT rates on various goods and services are given [on Gov.uk](#).

¹¹ Council Directive 2006/112/EC of 28 November 2006 (OJ L 347, 11 December 2006). Article 131 of the Directive specifies those goods and services to be exempted from tax.

¹² For detailed guidance see, HMRC, [Imports - VAT Notice 702](#), May 2017.

¹³ In the past this has been under articles 22 & 23 of EC directive 83/181/EEC. The legislation is now consolidated in [Council Directive 2009/132/EC](#) (articles 23 & 24).

¹⁴ Prior to 1 November 2011 the limit was set at £18. Provision was made by secondary legislation (1995/3222), which amended item 8 to group 8, schedule 2 of the *Value Added Tax (Imported Goods) Relief Order* SI 1984/746.

¹⁵ Recital 5 of Council Directive 2009/132.

circumstances a gift must have been sent from one private person to another, there must be no commercial or trade element, and it must be of an occasional nature only – say, for a birthday or anniversary. The directive consolidated earlier legislation, and the €45 limit has been in place for over 20 years.¹⁶

Limits also apply to the size of any gift of alcohol, tobacco, perfumes or toilet waters. For tobacco products these limits are: 50 cigarettes, or 25 cigarillos, or 10 cigars, or 50g of smoking tobacco. For alcohol, gifts may be up to 1 litre in size, or 2 litres in the case of still wines. Any gift in excess of these limits is given relief of import duty only up to the relevant limit, but no relief for import VAT would be given. In addition, excise duty is payable on all alcohol and tobacco products even if they are a gift. For perfumes and toilet waters, import VAT is chargeable if the gift is over the €45 limit, or exceeds a given quantity (50 gms, and 0.25 litres respectively).¹⁷

This legislation was implemented in the UK by secondary legislation – specifically SI 1986/939, which set the limit at £36, with effect from 1 July 1986. The limit has been changed several times since then to ensure parity between the UK limit expressed in £ and the EU-wide limit expressed in Euros¹⁸ – and is now set at £39.¹⁹

The UK, as with other States, does not have discretion in setting this limit; also, as with EU VAT law generally, any changes to the directive would have to have unanimous support. As the €45 ceiling has been fixed for many years, constituents are often surprised to receive a gift on which there is tax to pay because its value exceeds the limit. Though the issue has not generated much comment in the House, the Government were asked about their position on the limit being increased in a PQ in December 2012:

Simon Hart: To ask the Chancellor of the Exchequer if he will make representations to the European Commission and other member states in support of an increase in the limit set for goods imported into the EU which are exempt from VAT under Council Directive 2006/79/EC.

Mr Gauke: When deciding where to set the threshold for this import VAT relief on small non-commercial consignments, careful consideration has to be given to balancing the tax impact on individuals, with the impact on small UK businesses who are

¹⁶ Provision was initially made under EC directive 78/1035/EEC, which set the limit at 30 EUA, that is, 'European unit of account', the common European monetary value, based on a basket of European currencies. In turn the EUA was replaced by the 'European currency unit', or ECU, which was subsequently replaced by the Euro. The limit was 30 EUA from 1 January 1979, replaced by 35 ECU from 1 January 1982, and increased to 45 ECU from 1 July 1986. Council Directive 78/1035/EEC [(OJ L 366, 28.12.1978, p. 34]; Council Directive 81/933/EEC [OJ L 338, 25.11.1981, p. 24], & Council Directive 85/576/EEC [OJ L 372, 31.12.1985, p. 30].

¹⁷ [Customs Notice 143](#), March 2017 paras 2.5-6. Gifts for separate persons, such as members of a family, may each qualify for the €45 limit, if part of a multi-gift package, provided they are separately wrapped and marked as such on the customs declaration (para 2.7).

¹⁸ £40 in April 2010 by SI 2010/1185; £36 in January 2013 by SI 2012/3060; £34 in January 2016 by SI 2015/2015.

¹⁹ From 1 January 2017 by [SI 2016/1199](#). See also, HMRC, [Customs Information Paper 69 \(2016\)](#), 30 December 2016

required to account for VAT on similar goods regardless of their value. As there is no evidence that the current threshold is causing difficulties to individuals, whereas there is recent clear evidence that a high import relief threshold has an adverse impact on small businesses, the UK has no plans to raise this issue with the European Commission.²⁰

These limits apply to goods that have been sent to the recipient, from someone outside the EU. However, for *travellers* coming into the EU, separate allowances are set for goods that they may bring in with them for their own use without paying tax or duty: limits are set for alcohol, tobacco and perfume products, as well as a general allowance for other goods, which is much higher than the limit for personal imports. Some shoppers buying goods over the internet have confused the two, and in October 2005 HM Revenue & Customs launched a campaign on this issue.²¹ At this time the monetary limit for personal allowances was £145. In 2007 Member States agreed to substantially increase this limit, and, for travellers coming to the UK, the limit is now £390.²²

Recipients of postal gifts may have to pay a handling charge, in addition to VAT and customs duty. In its guidance for postal users, HMRC explains the procedure for checking postal packages, and why a handling charge may be imposed:

Why do I have to pay a handling fee to Royal Mail?

If customs charges are payable upon importation, Royal Mail will charge a handling fee to cover the costs for carrying out customs procedures, which includes paying any customs duties or VAT due and collecting it from you. If customs examination is required, or if information is missing from the declaration, Royal Mail open, repack and reseal the package. All international courier and postal operators charge fees for their services and HMRC and Border Force doesn't have any authority over the level of charges they apply.

Note that if there is no duty and/or tax to pay, you won't be charged a handling fee.

The customs charges and handling fee will be itemised separately on the charge label, and Royal Mail will contact you to let you know how much you need to pay, and the available payment methods. Once payment has been received, you'll be able to request delivery of your package or pick it up from your local delivery office or depot. You can read more about how to pay charges on either the [Royal Mail](#) or [Parcelforce Worldwide](#) websites.

As they are completely separate from any customs charges, any queries about the handling fee should be raised with Royal Mail or Parcelforce Worldwide as appropriate. Please note: Royal Mail doesn't answer queries about customs charges. If you have any queries about the charges raised on your specific parcel you should contact Border Force ... General queries on customs

²⁰ HC Deb 17 December 2012 c567W

²¹ HM Revenue & Customs press notice NAT 39/05, *Online shoppers warned - 'don't let parcels cost you a packet'*, 17 October 2005

²² Directive 2007/74/EC set the limit at €430 from 1 December 2008. The sterling equivalent of this limit was updated from 1 January 2010 to £390 by SI 2009/3172. Further guidance is on Gov.uk ([Bringing goods into the UK](#), ret'd June 2017).

charges should be made to the HMRC Customs International Trade and Excise enquiries service.²³

HMRC's guidance also explains that the arrangements for processing postal packages are a little different for packages from some territories, including the Channel Islands:

Prepayment of import VAT on goods purchased over the internet or by mail order

HMRC has special arrangements that allow some overseas traders to charge, collect and pay over to us the import VAT for goods purchased by mail order, that would normally be chargeable at the time the goods are imported. These arrangements operate under Memoranda of Understanding (MoU) signed with certain overseas customs and postal authorities. The countries that have a MoU with HMRC are - the Channel Islands, Hong Kong, Singapore and New Zealand. Overseas traders wanting to use this procedure must be authorised to do so by their authorities.

Once authorised, foreign businesses are issued with a unique authorisation number, which they must show on the customs declaration or packaging. They will include the statement 'Import VAT Prepaid'.

Where these arrangements are used you won't be charged a Royal Mail handling fee when you receive your package.

If you're a VAT registered business and purchase goods for use in your business you should keep the outer wrapper and invoice from the supplier to support your claim to input tax.²⁴

Finally, one issue that constituents often raise is the fact that when calculating whether a parcel's value exceeds this monetary limit, postage costs may well be included. HMRC's guidance underlines the point that it is EU legislation which specifies that when calculating the value of something 'for customs purposes', generally one *includes* postage costs.²⁵ If the item is a gift then postage costs are included only if the sender has used the Express Mail Service. Two further extracts from HMRC's guidance are reproduced below – first on setting out how import charges are calculated ...

Charges : How are import charges calculated?

Charges are calculated by Border Force officers at the postal depots where the packages are received. However, in some cases special arrangements are in place for goods purchased on the internet or by mail order ...

Customs Duty - becomes payable if the goods are over £135 in value. The amount of Customs Duty charged will depend on the type of goods imported and the value stated on the customs declaration CN22/CN23 (converted to pound sterling using the rates of exchange for the month of importation as shown on the HMRC website). The percentage varies depending on the type of goods and their country of origin. Duty is charged on:

- the price paid for the goods, plus
- any local sales taxes, plus

²³ [Customs Notice 143](#), March 2017 para 3.5. HMRC's Customs, International Trade and Excise enquiries service is contactable by phone on 0300 200 3700.

²⁴ [Customs Notice 143](#), March 2017 para 3.4

²⁵ This is set out in Article 165 to [EU Regulation \(EEC\) 2454/93](#).

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- postage, packing and insurance

However, the cost of postage is excluded from the calculation for Customs Duty on gifts except where the sender has used the Express Mail Service (EMS) as opposed to a standard mail service. Where the value of gifts is below £630 per consignment, a flat rate of duty of 2.5% will be applied, but only if it is to your advantage.

Excise Duty - this is charged on alcohol and tobacco products and is additional to Customs Duty. The Excise Duty on alcohol products such as wines and spirits depends on the alcohol content and volume. In the case of wine and cider it depends on whether they are sparkling or still. Duty on cigarettes is based on a percentage of the recommended retail selling price plus a flat rate amount per 1,000 cigarettes. On other tobacco products, for example, cigars or hand rolling tobacco, Excise Duty is charged at a flat rate per kilogram.

Value Added Tax (VAT) - Import VAT is charged at the same rate that applies to similar goods sold in the UK and applies to commercial goods over £15 in value, and on gifts that are over £39 in value. However, please note that commercial consignments sent to the UK from the Channel Islands do not benefit from any relief of import VAT. The value of the goods for import VAT is based on the:

- basic value of goods, plus
- postage, packing and insurance, plus
- any import (Customs or Excise) duties charged

As with Customs Duty, the cost of postage is excluded from the calculation for VAT on gifts except where the sender has used the Express Mail Service (EMS) as opposed to a standard mail service.

... and second on summarising the statutory provisions for these rules:

Extracts from the law

Opening of postal packages - Regulation 21 of the *The Postal Packets (Revenue and Customs) Regulations 2011* gives authority for an Officer of Customs to require the Royal Mail to open for examination any postal packet being imported or exported.

Relief from import VAT on commercial consignments, excluding alcohol, tobacco, perfumes and toilet waters, with a value below £15 - *The Value Added Tax (Imported Goods) Relief Order 1984:746*, Schedule 2, Group 8 item 8 provides relief from import VAT on consignments of goods not exceeding £15 in value.

Please note:

- 1) Legislation was introduced under Section 77 of *the Finance Act 2011* to reduce the relief from import VAT on commercial consignments, excluding alcohol, tobacco, perfumes and toilet waters, from £18 to £15. This came into effect on 1 November 2011;
- 2) Legislation was introduced in *Finance Act 2012* to remove the application of the relief on commercial goods sent to the UK from the Channel Islands.

Relief from import VAT on gifts of goods with a value not exceeding £39 - *The Value Added Tax (Non-Commercial Consignments) Relief Order 1986:939* (as amended), Article 3, provides that no tax is payable on the importation of goods forming part of a small consignment of a non-commercial character sent from a third country by a private person to another private person if the value of the goods does not exceed £39, subject to specified limits for alcohol,

tobacco, perfumes and toilet waters as listed in the Schedule to the order ...

Inclusion of postage charges in customs value - Article 165 of EC Regulation (EEC) 2454/93 requires all postal charges levied up to the place of destination in respect of goods sent by post to be included in the customs value of the goods. However, this does not apply to gifts other than those sent by Express Mail Services.

The limit before the rate of duty taken from the Common Customs Tariff - Consignments of gifts with a value less than £630 for which the rate of duty of the Common Customs Tariff is other than 'free' attract a flat rate of duty of 2.5% Council Regulation (EC) No 275/2008.²⁶

²⁶ [Customs Notice 143](#), March 2017 para 3.1, para 7

2. Reforming 'Low Value Consignment Relief' (LVCR)

2.1 Concerns over the abuse of LVCR

The Channel Islands are not part of the VAT territory of the EC – so the islands do not fall under European VAT law – although the islands are part of the EC's customs territory.²⁷ As a consequence exports to the EC are liable to import VAT but not customs duty. Some UK retailers took advantage of the rules for low value consignment relief (LVCR) to sell goods over the internet from subsidiaries based in Jersey and Guernsey to UK consumers. If goods were worth £18 or less – the cash limit set to LVCR in 1995 – then the retailer was able to sell them VAT-free.

In evidence before the Treasury Committee in February 2005, the then Economic Secretary John Healey discussed the size of the revenue loss from this practice:

Q489 Norman Lamb: Mr Healey, could I just ask you while you are here about the important issue that has been raised by the Forum of Private Business about this practice of stores such as Tesco's and possibly Specsavers as well setting up operations in Jersey and selling to the domestic market in the UK DVDs, CDs and so on and managing to avoid payment of VAT and thereby managing to sell a CD for £8.90 or something, completely undercutting traders within this country. Do you first of all agree that that is unfair competition essentially and that it is something that has got to be addressed and attempts should be made to close down what looks like a loophole?

John Healey: Certainly it is the case that some countries are using what is in this country an £18 threshold for imports of goods from outside the European Union which if they are below that value do not attract VAT or customs duty. Now it is the case that some businesses are arguing that this is an avoidance, it is not illegal but it is an avoidance and it undercuts their ability to compete effectively in the UK market. It is also the case that this is at present leading to a not insignificant revenue loss of about £80 million a year ... As things stand at the moment, that is set to grow over the next few years to a couple of hundred million but on the other side we also see arguments from consumer groups that would like us not to reduce the threshold, as some businesses argue, but to increase it because of the benefits that would bring to the consumer. These are matters that, as you would expect, like other tax issues, we keep very carefully under review.²⁸

In February 2006 the All-Party Parliamentary Small Shops Group published a report on the long term prospects of the small retail sector, finding that among those giving evidence "there is widespread belief ... that many small shops across the UK will have ceased trading by 2015 with few independent businesses taking their place." One of the many

²⁷ under s 93 of *VATA 1994* & reg 136 of SI 1995/2518

²⁸ *Fourth Report: Excise Duty Fraud*, 15 March 2005 HC 126 2004-05 Qs 489, 491 Ev57. A subsequent PQ stated that £40m of the £80m loss was attributable to imports from Jersey (HC Deb 25 October 2005 c310W).

issues the report discussed was the impact of VAT-free imports from the Channel Islands:

There are also rising concerns about the VAT loophole created by ... [LVCR] in the Channel Islands ... This VAT loophole is being exploited by large UK retailers who are simply channelling the orders through the island VAT free. The Internet has exacerbated this situation, as expressed by an Internet music retailing company: "It is affecting us to such a degree that -- we are a specialist retailer, but we cannot move into mainstream products because we could not possibly compete with the price... If they were to sell their products for no profit whatsoever, and you would sell yours at no profit, they would be still making money on the VAT margin." Examples of retailers who are exploiting this loophole include Asda and Tesco. Both retailers are selling CDs for £8.99 and DVDs for £11.89. The normal online price of a CD is between £9.99 and £11.53. Consumers may benefit from this but there are wider negative effects. For example the impact of this revenue loss to the Treasury is enormous, an estimated £80m a year rising to £200m in the next few years.²⁹

The Group recommended that, "the UK Government should immediately apply the lowest threshold applicable for the relief of low value consignments and permissible in the directive, which is currently 10 euros, (approximately £7) – this would eliminate the vast majority of exploiting trade almost immediately."³⁰

At this time the Forum for Private Business also campaigned on the issue, arguing that the ceiling for LVCR should be cut to €10, or that the UK should obtain dispensation from the EU to close the loophole similar to one granted the Danish Government.³¹ In a report on VAT on e-commerce published in May 2006, the National Audit Office gave some details of the Danish arrangements:

Denmark currently provides relief from import VAT for imports of small consignments of a commercial nature from outside the EU. The Danish European Community reliefs limit is DKK80 (€10). The Danish Tax Authority found that some Danish publishing companies were re-routing the distribution of certain magazines and periodicals via a third country. Random checks showed that many consignments were printed in the EU, exported at a zero-rate of VAT to a country outside the EU (mostly the Åland islands³² and Norway) and from there sent to subscribers in Denmark free of import VAT, as each consignment was valued below Denmark's European Community Relief limit. The Danish Tax Authority's investigations in the first nine months of 2003 found that some 3.5 million magazines and periodicals were imported from the Åland islands, with an estimated loss of revenue of some DKK47 million, or around £4.5 million.

The Danish government obtained a derogation from the European Commission to remove the relief on magazines and its VAT law was changed accordingly from 1 June 2005. The Danish Tax Authority is seeking a change in the EU rules to abolish the relief

²⁹ All-Party Parliamentary Small Shops Group, *High street Britain: 2015*, February 2006 pp38-9

³⁰ *op.cit.* p73

³¹ for example, "Letter: Treasury must plug this VAT loopholes", *Financial Times*, 11 February 2006

³² Åland is an autonomous, Swedish-speaking region of Finland.

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and introduce a new and simple VAT-collection system for small consignments, or if that is not possible a change of the EU rules allowing Member States to exclude certain goods such as magazines from the European Community relief for small consignments.³³

In March 2006 the authorities in both Jersey and Guernsey made moves to restrict the scope of this activity. In Jersey the Government stated that it would not issue new licences to allow UK companies to create Jersey-based distributors; some licences have been issued on an annual basis, although the *Financial Times* reported that some retailers had been granted licences with no time limit.³⁴ Similarly the Guernsey government announced it would not give planning permission for any new warehouses for distributors acting for UK retailers.³⁵

In their 2006 report on e-commerce, the NAO did not make any formal recommendations about the level of LVCR, though it suggested that HMRC should do more work to ensure VAT was charged correctly on imports worth more than the de minimis limit:

9. On the payment of import VAT on goods ordered from outside the EU, some suppliers incorrectly describe or value the contents of commercial packages to take advantage of UK reliefs exempting from import VAT consignments valued below £18 or to reduce the amount of VAT due. While it is difficult to quantify the extent to which overseas suppliers seek to evade VAT on behalf of the recipient in this way, controls operated by Royal Mail and express carriers together with the Department's selective checks provide a safeguard which the Department views as proportionate to the VAT at risk. It could do further work to confirm that this remains the case. The Department is increasingly working in partnership with overseas organisations to operate checks at the point of dispatch on goods which are liable for import VAT. This is a more cost-effective way of ensuring the payment of import VAT, compared with operating checks at the time of importation into the UK. The Department has also run publicity campaigns to inform UK shoppers of the import VAT due on consignments ordered over the internet and these will assume greater importance if the growth in trade continues.

10. Around 45 million small commercial consignments are imported by post into the UK each year. Around half of the sales by value are from the Channel Islands where some UK-based retailers have set up business operations to take advantage of the UK reliefs in selling goods to UK customers ordering online. The Department accepts that the VAT reliefs may be claimed on this trade provided the goods are supplied by a business established outside the EU, and are imported by a private person or a business that is unconnected with the supplier. In Budget 2006 the Government announced that it is keeping under close review the way in which some UK businesses have restructured their activities to take advantage of the VAT-relief that applies to commercial consignments imported from outside the EU and will consider options for changing the relief if it continues. The States of Jersey

³³ National Audit Office, *VAT on e-commerce*, 26 May 2006 HC 1051 2005-2006 p12

³⁴ "Jersey cracks down on retailers exploiting loophole in VAT rules", *Financial Times*, 1 March 2006

³⁵ "Guernsey to turn away online retailers", *Financial Times*, 2 March 2006

Government has recently announced measures which are being implemented to curb the trade by UK-based retailers.³⁶

2.2 The Labour Government's approach

In the 2006 Budget the Labour Government acknowledged that LVCR "costs the Exchequer around £85 million a year", and that "if the relief continues to be exploited by businesses using offshore locations, the Government will consider changes to prevent this type of behaviour."³⁷ Commenting on the tax avoidance provisions in the Budget the tax justice campaigner Richard Murphy observed, "maybe the government is relying on the pressure it has brought to bear on the governments of the islands in question to tackle or at least limit this abuse without further legislation being required, but it remains a surprise that such a blatant scheme has not been tackled when some very obscure arrangements attract attention."³⁸

In November 2006 Andrew Love put down an EDM on the issue, calling for the LVCR threshold to be cut to £7, which 35 Members signed.³⁹ The then Paymaster General, Dawn Primarolo, discussed the Government's options in a debate in Westminster Hall at this time:

Should the Government decide to reform the relief, a number of options will be available. We could reduce the threshold to £7, or we could seek a derogation from the European Commission to disapply the relief to imports from the Channel Islands; or we could disapply the relief specifically to CDs and DVDs from the Channel Islands. Various combinations of those and other options will be available. In deciding which options to use, the Government will need to consider not only the impact of small UK retailers but the knock-on effects on other stakeholders and larger suppliers.

The Government will have to consider the effect that changes may have on the costs to business. For example, the Royal Mail and similar express carriers would be responsible for the carrying and delivery of such packages and would incur additional costs in collecting charges from those receiving the packages. Of course, consumers and businesses would face an increase in the cost of goods purchased, not only in respect of increased VAT but from charges that those carriers would incur when clearing packages through Customs. Indeed, the Government, who are responsible for collecting it, would then have to increase charges as a response. The Government take the view that we need to balance all of those interests.⁴⁰

³⁶ *VAT on e-commerce*, 26 May 2006 HC 1051 2005-2006 p6

³⁷ *Budget 2006* HC 968 March 2006 para 5.107. Answers to a series of PQs at this time simply stated that the Government was keeping the matter "under close review" (eg, HC Deb 6 July 2005 cc 438-9W; HL Deb 20 July 2005 c 258WA; HC Deb 25 October 2005 c310W; HC Deb 7 November 2006 c1048W).

³⁸ Richard Murphy, "Budget 2006: The anti-avoidance non-event", *Accounting Web.co.uk*, 22 March 2006. Mr Murphy continued to criticise LVCR on his Tax Research blog – see, for example, "[Why the Channel Islands' VAT wheeze is illegal and has to stop](#)", Tax Research UK, 9 July 2010.

³⁹ EDM 305 of 2006/07, 27 November 2006. 67 Members signed a similar motion which Mr Love put down in the previous Session (EDM 2668 of 2005/06).

⁴⁰ HC Deb 1 November 2006 cc 145-6WH

The Minister also explained that both Jersey and Guernsey had taken some action to reduce this type of export to the UK, although she called it “disappointing”:

Jersey announced earlier this year that UK companies operating in the CD and DVD market through third party suppliers based in Jersey would need licences to run their businesses, and that those without a licence would be required to obtain one. Such companies would be granted time-limited licences, and our understanding is that such licences will not be renewed after 28 February 2007. The state of Guernsey is unable to apply a similar rule, but it will no longer encourage new UK companies to set up and operate through third parties. Frankly, both proposals are disappointing.⁴¹

In the 2007 Budget it was noted that the Jersey authorities had made a commitment “in discussions with the Government, to limit the activities of companies continuing to operate on the island, with the associated revenue loss to the Exchequer” and that the UK remained in “discussion with the Guernsey authorities on this issue.”⁴² Nevertheless Members continued to raise concerns about the cost of this relief, and its impact on certain sectors, such as independent music retailers and specialist health food stores.⁴³ In answer to a PQ in June 2008 the Government noted that the total cost of LVCR was “estimated at around £90 million” and that “HMRC tentatively estimates that around three quarters of this cost is attributable to imports from the Crown dependencies.”⁴⁴

In January 2009 Janet Dean raised the issue in an adjournment debate, arguing that major companies were continuing to abuse these rules: part of her speech is reproduced below:

Information supplied to me by the independent CD and DVD sector suggests that Jersey is now the fulfilment base for Asda, Play.com, CD101 and BlahDVD. Tesco, which was excluded from the island in 2006, is now reportedly operating again through a Jersey-based fulfilment business, TheHut.com. HMV and Amazon, under a sister company name of Indigo Starfish, operate out of Guernsey. The trend of major corporate names shifting their fulfilment to the Channel Islands continues, and the only benefit of the so-called tighter regime is to guarantee additional business for the operators already there. Many of the goods in question are actually manufactured in the UK, shipped to the Channel Islands and then moved back to the mainland through the mail. The sole purpose of that manoeuvre is tax avoidance. Like the Minister, I am a believer in the benefits that competition can bring to consumers, but that competition is unfair and in some cases illegal. It can have no public policy justification.⁴⁵

In response the then Financial Secretary, Stephen Timms, gave details of the action that had been taken to discourage companies from exploiting the relief:

⁴¹ HC Deb 1 November 2006 cc 145WH.

⁴² *Budget 2007* HC 342 March 2007 para 5.142

⁴³ For example, EDM 1767 of 2007-08, 11 June 2008: 25 Members signed this motion.

⁴⁴ HC Deb 18 June 2008 c992W

⁴⁵ HC Deb 27 January 2009 c272

Following discussions with UK officials in 2006, Jersey and Guernsey issued policy statements making it clear that they are opposed to the growth of so-called third-party facilitators on the islands. Those facilitators exist to provide logistical services to UK-based companies, enabling them to benefit from the relief by exporting UK-originating goods through the islands without making any investment in establishing wider real economic activity there. The islands' authorities recognised that that was damaging to their international reputation and credibility and undermined the UK tax base. The policy statement issued by the States of Jersey introduced a licensing regime for companies and facilitators supplying goods by post to UK consumers. Companies supplying CDs and DVDs were granted only a 12-month licence and, at the end of that period, the licences were not renewed, so a number of companies were required to leave the island: my hon. Friend mentioned a couple of them. She also said that one or two had come back in a different form; that is news to me, and I will investigate it tomorrow.

Since 2007, the Jersey authorities have refused to grant a licence to any new company operating in the CD and DVD market and wishing to relocate from the UK to Jersey. Equally, any new company wanting to relocate to Jersey is required to obtain an operating licence before it can start trading. The Jersey authorities have stated their strong presumption that licences will not be granted when there is no investment in the wider economic activity on the island. Following the withdrawal of licences, only one big company supplying CDs and DVDs from the island to the UK remains; it is a company that has been based in Jersey for quite a long time ...

As far as Guernsey is concerned, I understand that the authorities there cannot introduce a licensing system similar to the one in Jersey because of the constraints of the local constitution. However, the Guernsey authorities have adopted a policy statement quite similar to that of their Jersey counterparts and used other available powers, including planning controls and employment permits, to limit the growth of activity on the island that involves the exploitation of the relief by UK-based companies. Guernsey has made it clear to a number of UK companies involved in music retailing, including those that have been forced to close their Jersey operations, that it does not wish to see them establish activities on the island ...

As a consequence of the measures taken by the Channel Island authorities, we believe that the growth in the music sector there since 2006 has been curtailed. Of course the position might change, and my hon. Friend suggested developments that might lead to such a change, but that was the case at least until very recently. Certainly the exponential growth in the cost of the relief that some feared has not materialised, despite the rapid growth in internet shopping.⁴⁶

He went on to reiterate the disadvantages to cutting the LVCR ceiling to the €10 minimum:

If the Government decided to reform the low-value consignment relief, a number of options would be permitted under European Community law. We could reduce the threshold to the minimum level of €10 or seek a derogation from the European Commission to remove the relief from specific goods such as health products

⁴⁶ HC Deb 27 January 2009 cc 275-6

or CDs and DVDs, or from imports from certain countries. However, although some retailers might benefit from such a change, the knock-on effects on others would have to be considered. If the threshold of the relief were reduced to the lower limit, it is estimated that up to an extra 50 million small parcels a year would be subject to VAT. That would require substantially increased resources at Her Majesty's Revenue and Customs for calculation and enforcement of import taxes. ...

There would be an increase in the cost of goods, not only from the addition of the VAT, but from charges applied by the carriers for clearing packages through customs, and the associated need, in many cases, to travel to a mail delivery office to make payment. All that is on the assumption that goods would continue to come in from the Channel Islands.

We are also concerned that any restriction that we apply to the current threshold, or derogations against specific goods or exporting countries, could encourage businesses to reroute their low-value goods, quite legally, through other European Union countries that maintain the higher relief threshold. For example, it would be possible to send goods from the Channel Islands to France, from France to the UK and, because France still had the higher threshold, it would not be too difficult to reproduce the benefits of the current arrangements for companies that export directly from the Channel Islands to the UK. Once goods have been given customs clearance in the European Community, they can move between Community countries without restriction. A specific example would be goods sourced from Switzerland going through Italy or Germany to other member states.⁴⁷

2.3 The Coalition Government's approach

In July 2010 the new Coalition Government announced that it was 'actively reviewing' the operation of LVCR, and that in assessing the case for change it would "take into account the need to balance often conflicting considerations including the impact on consumers, UK businesses and Royal Mail and other parcel operators, as well as the overall fiscal position and the practicality and cost of enforcing any changes to the operation of the relief."⁴⁸ The Government gave no further details of this review in answers to PQs, though suggested if it concluded that changes should be made, it hoped to make an announcement by the time of the 2011 Budget.⁴⁹

In his Budget speech on 23 March 2011 the Chancellor George Osborne announced that the Government would "tackle the exploitation of low value consignment relief that has left our high street music stores fighting a losing battle with warehouses in the Channel Islands."⁵⁰ The Budget report gave more details:

The Government will reduce the LVCR threshold from £18 to £15 from November 2011. The Government will also explore options with the European Commission to limit the scope of the relief so that it can no longer be exploited for a purpose it was not intended for, and will revisit the level of the LVCR in Budget 2012

⁴⁷ HC Deb 27 January 2009 cc 276-7

⁴⁸ HC Deb 13 July 2010 c661W

⁴⁹ HC Deb 10 January 2011 c218W

⁵⁰ HC Deb 23 March 2011 c962

if discussions with the European Commission do not produce a workable solution to the problem of exploitation of the relief.⁵¹

At this time the Government published updated estimates of the cost of this practice, suggesting that the cost had risen to £140m by 2009/10.⁵²

The cut in the LVCR threshold was projected to raise £10m in a full year. Total sales to the UK from outside the EU under £18 were estimated to be worth about £395m in 2009/10, of which £95m was of goods worth £15 to £18.⁵³ HMRC's impact assessment suggested that the "number of people impacted by a £3 reduction in LVCR limit is likely to be small, and it will mostly affect some on-line shoppers." It went on to note that this would "reduce the attraction for UK businesses to locate outside the EU" and that non-UK companies would lose a certain price advantage over UK-based businesses, although it did not quantify these impacts. In HMRC's view any compliance costs for fast parcel operators involved in importing goods to the UK would be negligible, but that all of these effects "will be significantly magnified if the Government's discussions with the Commission are able to identify a practical mechanism to prevent LVCR from being exploited for tax management purposes in the future."⁵⁴

There was relatively little comment on this change following the Budget, though the *Times* quoted one VAT practitioner as noting that it would "still be possible for many items to be imported without customs duties or VAT being applied and there will be minimal impact to those companies currently utilizing LVCR."⁵⁵ Campaigners critical of LVCR were disappointed: the Forum for Private Business suggested the lower threshold would not prevent large companies exploiting the relief,⁵⁶ while Richard Murphy argued this would "vast amounts of abuse to continue - on almost all music for example."⁵⁷ The lobby group Retailers Against VAT Abuse (RAVAS) suggested that although the cut in the threshold was 'weak', it was significant that the Chancellor had suggested that companies using LVCR this way were, in essence, engaged in tax avoidance: "the real significance of George Osborne's statement is that it puts a shadow over the legality of the current practices and if further action is taken as promised, this industry may well be dead and buried within 12 months."⁵⁸

Provision to cut the LVCR threshold was made in s77 of the *Finance Act 2011*. There was a short debate on this measure at the Committee stage of the Finance Bill. Speaking for the Opposition David Hanson MP

⁵¹ HC 836 March 2011 para 2.158

⁵² HC Deb 28 March 2011 c39W. The standard rate of VAT was cut to 15% between 1.12.2008 and 31.12.2009, and increased to 20% on 4.1.2011.

⁵³ HM Treasury, *Budget 2011 policy costings*, March 2011 p43

⁵⁴ HM Revenue & Customs, [VAT: Low Value Consignment Relief – tax information & impact note](#), 23 March 2011

⁵⁵ "VAT dodge on CDs and DVDs is shut down – in part", *Times*, 24 March 2011

⁵⁶ Forum for Private Business press notice, *Budget's small business growth strategy is just a first step*, 23 March 2011

⁵⁷ "Channel Islands' VAT abuse - good news but not good enough", [Tax Research UK blog](#), 23 March 2011

⁵⁸ RAVGAS press notice, *The Message is in the Detail*, 24 March 2011. In their report the *Guardian* made a similar argument: "Tax loophole closed at last for VAT-free goods online", 24 March 2011.

argued that the Government should have cut the threshold to the lowest allowed under the EU rules: "I cannot understand ... why the Minister will not maximise the level of income by making level playing field ... we could raise a small ... but additional, amount of money by setting the exemption at £9."⁵⁹ In response Treasury Minister David Gauke said the following:

The Government recognise that there is a very difficult balance to be struck between delivering fairness in the tax system and ensuring that any new arrangements can be enforced effectively and efficiently, at a time when we are looking for savings in the cost of public administration. We will not, however, tolerate exploitation of the relief for a purpose, and on a scale, for which it was never intended.

We are therefore pursuing a twin-track strategy to stop such exploitation. First, [this clause] ... amends the *Value Added Tax (Imported Goods) Relief Order 1984* to reduce the threshold to £15 from 1 November this Year ...

Secondly, we are exploring options with the European Commission to limit the scope of the relief to prevent its exploitation, including the possibility of seeking a consignment relief. We will return to the issue of the appropriate level of the threshold in Budget 2012, if discussions with the European Commission do not produce a workable solution to the problem of exploitation of the relief, with a view to reducing the limit further ...

If we simply lower the limit to £9, we impose a significant additional administrative burden in relation to packages that come into the UK. There is likely to be a behavioural response which means that packages will still be below that £9 limit. The more effective approach is to take a first step by reducing the limit to £15. We think that that gets the balance right.⁶⁰

On 9 November the Minister announced that following discussions with the Commission, the UK would remove LVCR from goods imported from the Channel Islands from 1 April 2012; the relief – set at the new £15 threshold – would remain for commercial supplies from other non-EU jurisdictions. The Minister's statement is reproduced in full below:⁶¹

The Exchequer Secretary to the Treasury (Mr David Gauke): I

am today announcing further reforms to the relief from import VAT known as Low Value Consignment Relief (LVCR). These reforms will make a positive contribution to the UK economy as well as contributing towards the fairness of the tax system and reducing the deficit.

In Budget 2011, the Chancellor of the Exchequer announced that the Government intended to take action to end the exploitation of LVCR, which in recent years has been used on an increasingly large scale to sell low value goods free of VAT to UK consumers, a purpose for which it was never intended. Most of this trade originates from, or is routed through, the Channel Islands.

Our objectives in reforming LVCR are twofold. First, to ensure that UK companies, especially small and medium-sized enterprises, can compete on a level playing field with companies with operations

⁵⁹ Public Bill Committee (Finance (No 3) Bill), 9 June 2011 c509, c507

⁶⁰ *op.cit.* c508, c509

⁶¹ HC Deb 9 November 2011 cc15-16WS

in the Channel Islands. Secondly, to protect tax revenue for the Exchequer while taking into account the costs of collecting small amounts of VAT. As the first step towards reform of the way in which the UK applies the LVCR rules we legislated in Finance Act 2011 to reduce the LVCR value threshold, below which items are imported free of VAT, from £18 to £15. That change is being implemented from 1 November. In taking that legislation through the House I made it clear that it was only the first step towards preventing the exploitation of LVCR.

I can announce today that, as from 1 April 2012, LVCR will no longer apply to goods supplied commercially, as part of a distance selling transaction, from the Channel Islands. Legislation to enact this change will be published in draft on 6 December, for inclusion in Finance Bill 2012. This will mean that supplies from business in the Channel Islands bear the same VAT liability as supplies from VAT-registered businesses in the UK.

My decision to focus action on imports from the Channel Islands reflects:

- By far the greatest volume of all international parcel post to the UK from outside the EU is estimated to originate in the Channel Islands, and much of it appears to be linked to the exploitation of LVCR.
- Companies based in the Channel Islands can participate in HMRC's "Import VAT Accounting Scheme", which allows automatic collection of UK import VAT at source, thus avoiding delays at sorting offices and VAT collection surcharges. The ease of access of companies based in the Channel Islands to the UK consumer market is therefore very similar to that of domestic UK-based companies, in contrast to their non-EU counterparts.

This measure is expected to increase receipts by approximately £100 million per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at the autumn statement 2011.

LVCR will continue to apply with the lower £15 threshold to commercial supplies from other non-EU jurisdictions. I have no current plans for further changes to this threshold but will be watching its operation carefully and will take further action if necessary.

The existing import reliefs for gifts (non-commercial consignments) sent from outside the EU, including from the Channel Islands, also remains unchanged.

Alongside the statement HMRC published a number of FAQs on this measure, from which the following is taken:⁶²

Q. What types of goods are sold by the companies exploiting LVCR?

A. The most well-known are CDs and DVDs. However, there is an increasing array of other low value goods being sent from the Channel Islands including cosmetics, cut flowers, video games, health supplements, PC consumables (e.g. printer cartridges), stationary, greetings cards, clothing, toys, sports accessories and contact lens solutions.

⁶² HMRC, [Removal of Low Value Consignment Relief \(LVCR\) from all goods imported in to the UK from the Channel Islands](#), 9 November 2011

Q. Why are you removing the relief completely from the Channel Islands?

A. To protect small and medium sized businesses in particular from unfair competition and to protect the revenue.

Q. Why the Channel Islands and not other non-EU countries?

A. Most companies who have deliberately moved their operations to supply goods from outside the EU to UK consumers have set them up in the Channel Islands. 75 per cent of all international parcel post to the UK from outside the EU is estimated to originate in the Channel Islands.

Q. Will companies just move their operations to another non-EU country?

A. Probably not. Most companies based in the Channel Islands benefit from an HMRC trade facilitation measure, the 'Import VAT Accounting Scheme' which allows automatic collection of UK import VAT at source. Packages are not delayed at international postal sorting offices as an assessment is made of the VAT due and the end consumer avoids an £8 surcharge to cover Royal Mail's administrative costs. The ease of access of companies based in the Channel Islands to the UK consumer market via the postal system is therefore similar to that of domestic UK-based companies rather than to their non-EU counterparts.

There was limited reaction to the Government's announcement, though campaigners who had criticised the operation of LVCR strongly welcomed the change.⁶³

As indicated in the Minister's statement, the Government published much of the Finance Bill for 2012 in draft in December – and this included provision to restrict LVCR in this way. In a note accompanying these draft provisions, the department commented that the change would "raise revenue and is likely to have a modest but positive impact on the UK economy as businesses which have set up offshore supply arrangements in the Channel Islands return to the UK." On the impacts with regard to individuals, it noted that "the people mostly impacted [by this change] will be on-line shoppers ... [but] this change may not automatically lead to higher prices as the decision on how much of the increased cost to pass on to the customer is a commercial matter for those companies who have based their operations in the Channel Islands." The department also noted that "there are no figures available that indicate how many individual consumers import goods or how they will be affected financially."⁶⁴

Just prior to the 2012 Budget the Governments of Jersey and Guernsey challenged this measure in a judicial review – but on 15 March 2012 the High Court decided in the Government's favour. The judge ruled that the wording of the EU directive which allows for LVCR would not prohibit the UK from disapplying this exemption selectively. In addition the principle in EU law of fiscal neutrality – the prohibition of any

⁶³ eg, "Treasury to tackle Jersey's VAT relief", *Financial Times*, 9 November 2011; RAVGAS press notice, *Channel Island VAT Loophole Finally Closes*, 9 November 2011.

⁶⁴ HMRC, [VAT: Low Value Consignment Relief – tax information & impact note](#), 6 December 2011

national tax discriminating between domestic products and those from another State – did not apply to goods from countries outside the EU when they came into the EU (ie, before they entered free circulation within the Single Market).⁶⁵ Both Guernsey and Jersey announced they would not appeal against the judgement.⁶⁶

The Government confirmed in the Budget that LVCR would not apply to imports from the Channel Islands from 1 April 2012. It was estimated this would raise £90m in 2012/13, rising to £100m by 2014/15.⁶⁷ Legislation to this effect was included in the Finance Bill published after the Budget,⁶⁸ and was the subject of a short debate at the Committee stage of the Bill on 21 June. On this occasion the then Shadow Exchequer Secretary, Catherine McKinnell said that the Opposition supported this measure, but asked if the Government had considered withdrawing LVCR from all non-EU countries, as retailers might move their distribution facilities to other territories, such as Switzerland, Andorra and Gibraltar. In response Treasury Minister David Gauke said the following:

The overall effect [of the clause] will be to withdraw [LVCR] for all goods imported from the Channel Islands under a mail order arrangement from 1 April this year. The changes will lead to the alignment of the VAT treatment of Channel Islands based supplies with those of UK VAT registered companies. As a result of the change, there is already evidence that some companies based in the Channel Islands are relocating to the United Kingdom ...

The question was raised about whether other options are available to us. When considering the reform of [LVCR], we considered whether we should withdraw the relief altogether from selected other countries. We decided not to pursue those options for the time being as the exploitation of this relief primarily involves imports from the Channel Islands ... However, we will monitor carefully for evidence of the diversion of supplies from the Channel Islands to other non-EU countries, and if that happens on a large scale, we will remove [LVCR] from mail order imports from those countries as appropriate.⁶⁹

Following this change the issue does not appear to have been raised much in the House. In 2014 the Government introduced a minor change to the legislation to ensure that it operated as intended, and that only mail order transactions from the Channel Islands were excluded from the scope of LVCR.⁷⁰

⁶⁵ [2012] EWHC 718 (Admin). See also, "Channel Islands lose fight to save VAT loophole", *Financial Times*, 16 March 2012

⁶⁶ HC Deb 25 April 2012 cc 899-900W

⁶⁷ *Budget 2012* HC 1853 March 2012 para 2.194, Table 2.2 – item a

⁶⁸ No significant changes were made to the draft version as published in December 2011 (HM Treasury, *Overview of Tax Legislation*, March 2012 p14).

⁶⁹ Public Bill Committee (Finance Bill), *Fifteenth sitting*, 21 June 2012 c568. The clause was agreed without a vote, and forms s199 of the *Finance Act 2012*.

⁷⁰ [SI 2014/2364](#), which amended *Value Added Tax (Imported Goods) Relief Order* SI 1984/746 accordingly.

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