VAT registration threshold: members have their say

Indirect Tax

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A joint survey of members has provided valuable insight for the ATT and CIOT responses to the call for evidence on the design of the VAT threshold.

HM Treasury released a call for evidence on 13 March to explore whether the design of the VAT registration threshold could better incentivise growth.

As set out in the May edition of Technical Newsdesk, this call for evidence followed a report published by the Office of Tax Simplification (OTS) last year setting out concerns that the current level of the VAT threshold and its cliff edge nature distort taxpayer behaviour. In particular, small businesses may choose to keep their turnover below the threshold, either by legitimately limiting their expansion or illegally under-recording their takings.

To assist them in drafting their responses to the call for evidence, the ATT and CIOT published a detailed online survey for members. In total, over 420 responses were received to this survey; many thanks if you were one of those.

Key findings from the survey included:

- Members report it is fairly common for small businesses to manage their turnover to stay below the VAT threshold, with 45% saying this was fairly common, and 21% that it was very common.
- The most important reason for wanting to stay below the VAT threshold was concern over being able to compete with VAT registered businesses.
- There is little support amongst members for lowering the VAT threshold, with 29% disagreeing and 22% strongly disagreeing that decreasing the threshold would reduce the cliff edge nature of the VAT threshold

- There is not much faith that Making Tax Digital (MTD) will lessen the administrative burdens of VAT. In fact, 74% of those responding felt that MTD was a further reason for small businesses to want to stay below the VAT threshold!
- Support was limited for the EU's proposals to simplify the administration of VAT for SMEs, and the other administrative and financial smoothing mechanisms proposed in the call for evidence. Respondents were concerned that these would either have a limited effect on the number of businesses managing their turnover, and/or be overly complex.

The ATT and CIOT submissions in respect of the call for evidence, as summarised below, were based upon the results of this survey as well as wider discussions with members.

The ATT response

The ATT response notes that, whilst some small businesses may manage their turnover to stay below the VAT threshold, it should not be assumed that in the absence of this behaviour those businesses would grow significantly. Many small businesses have no intention of growing into large companies, and are merely set up to provide their owners with sufficient income to support them and their families. There are also many other reasons beyond VAT why a business may seek to limit its size, key amongst which are the tax and wider concerns associated with taking on employees.

The ATT therefore does not believe that VAT should be considered in isolation when it comes to business growth and productivity in the UK. Instead, the broader tax and regulatory landscape should be considered.

The ATT suggests that, rather than changing the level of the VAT threshold, the most appropriate way to address concerns that the current threshold distorts taxpayer behaviour is to smooth the impact on businesses crossing the threshold for the first time.

However, any potential smoothing mechanisms need to be kept as simple as possible to avoid introducing extra complexity into the VAT system. Whilst some of the proposed smoothing mechanisms in the call for evidence may sound appealing, the ATT is concerned that these would be overly complex both for small businesses

to apply and for HMRC to monitor.

Instead, the ATT would prefer to see a simple solution considered. This could include extending the flat rate scheme (FRS), and in particular revisiting the limited cost trader rules introduced in April 2017.

The CIOT response

The UK has a high VAT registration threshold as a simplification measure for small businesses to avoid the financial and administrative burdens of accounting for VAT.

The CIOT would like this simplification to remain available to small businesses.

The CIOT also noted that the reasons for remaining under the VAT registration threshold are not solely VAT related, but include other factors such as the costs and complexities involved in taking on an employee for the first time, moving into new premises, incorporating a business and so on. The CIOT recommends that wider research is undertaken into the barriers to growth that businesses perceive to exist, and for the government to consider how they might be overcome.

Throughout the survey results, respondees set out that the primary reason that businesses manage turnover to remain under the VAT registration threshold is the financial burden experienced by those businesses that bear the cost of charging output VAT when they have limited costs bearing input VAT, and the barrier to competition with similar unregistered businesses. Having a financial smoothing mechanism that addresses the ‘cliff edge’, whilst also remaining administratively simple, is key to addressing this issue.

The European Commission’s proposal for a council directive to amend the Principal Directive sets out changes to make VAT simpler for smaller businesses and member states from 1 July 2022. Although the UK will not be a member of the EU in 2022, the CIOT would recommend that the UK government considers what simplifications are made available to small enterprises in the EU and whether similar simplifications should be made available to similar sized businesses in the UK so that they may remain competitive internationally.

Once the call of evidence responses have been considered, the CIOT would urge further consultation with business prior to the introduction of any new measures.

The ATT response can be found on the ATT website and the CIOT response on the CIOT website.