VAT: Alternative method of VAT collection – split payments

Indirect Tax

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Whilst split payment might accelerate and secure the payment of an amount representing VAT to HMRC, it will inevitably bring complexity for businesses, payment handlers, advisers and HMRC. It is vital that these complexities and costs are fully understood before split payment is progressed, to ensure that the benefits sufficiently outweigh the costs.

The CIOT has responded to HMRC's second consultation on Alternative method of VAT collection – split payments. See www.tax.org.uk/ref445.

Initially launched alongside a package of measures to combat VAT loss from online sales, HMRC explores how it can use card payment technology to collect VAT on online sales and transfer it directly to HMRC. The aim of this would be to significantly reduce the challenge of enforcing online seller compliance and, say HMRC, offer a simplification for businesses.

The CIOT supports measures to combat tax fraud and loss, be that because of a lack of understanding, complexity of legislation or deliberate non-compliance. However, the extent of current levels of non-compliance are unclear, especially taking into account the impact of recent Budget measures to deal with VAT loss from online marketplaces. We would welcome further analysis to establish a more accurate picture of the risk that needs to be addressed, which would in turn better inform the policy aims.

What are the three options under consideration?

Option 1 – standard rate split: this assumes that every transaction is liable to standard rate VAT and does not take into account any input tax deduction. This would involve withholding 20% of each sale, regardless of its actual liability. **We do**

not support Option 1 as it does not meet the design principles of a fair and proportionate response.

Option 2 – Flat rate scheme: HMRC suggests mandating overseas sellers to use the flat rate scheme using one of a small number of new flat rates for this purpose. This could include allowing overseas businesses to participate in the flat rate scheme over the existing turnover threshold (£150,000 a year excluding VAT or the in-scheme eligibility cap of £230,000). This approach may be difficult to justify if overseas businesses are allowed a competitive advantage that UK businesses are not. **We do not support Option 2 as it legislates to put UK companies at a competitive disadvantage.**

Option 3 – net effective rate: HMRC's preferred option involves each individual overseas business calculating its own specific net-effective rate, based on the previous year's outputs and inputs; using this rate to make advance instalments with an annual reconciliation. This rate would be applied to all sales by that business, carried out by the party effecting the split payment. If this information is not forthcoming, then option 1 would be invoked. **We have a number of questions about HMRC's preferred Option 3.**

Our questions and concerns

A fundamental principle to establish at the outset is whether the split payment reflects an amount of VAT (paid in advance/ on account) or it is the actual payment of VAT. Any proposals to change the underlying VAT rules concerning the supply could create significant complexity, which, in our view, would not be necessary to tackle the non-compliance targeted by this measure.

The cash flow impact on business of options 1 and 2 needs much greater analysis. If output tax is to be paid on a real time basis but any input tax recovered in arrears through the quarterly VAT return, then businesses will become effectively repayment traders on a cash flow basis. Free cash flow is a key business metric and split invoicing could have an impact on business valuation and credit worthiness. Some businesses may struggle to fund the new requirements.

Concerns remain about how errors, refunds and disputes are dealt with. There are cash flow issues as well as compliance and commercial risks from having to rely on third party information in order to fulfil VAT obligations.

Split payments done in this way are a departure from the basic principles of HMRC seeking to collect the right amount of tax from the right person at the right time.

What happens next?

Greater clarity is still needed on the scope of this proposal. We have received very few comments from our members on this consultation and, anecdotally, it seems there is a still a vagueness around precisely who and what type of transactions these new rules are aimed at. This is, we feel, detrimental to the effectiveness of the consultation process.

To keep in line with the policy objective of combatting fraud and ensure a fair and proportionate response, we think that split payment should only be introduced for overseas sellers at this stage. This will enable the model to be targeted at the population with the (assumed) greatest risk of non-compliance and ensure that largely compliant UK businesses (who represent the majority of sales to UK customers) will be unaffected.

The CIOT has indicated to HMRC that we would like to attend HMRC’s stakeholder meeting to explore the issues raised in further detail.