Changes to the VAT Flat Rate Scheme

Indirect Tax

01 March 2017

We have continued our engagement with HMRC regarding the proposed changes to the Flat Rate Scheme and submitted our comments and concerns to HMRC.

Background

HMRC explained the nature and scale of the abuse of the Flat Rate Scheme (FRS) at meetings attended by representatives of the CIOT and other stakeholders, although much of this had already been reported in the media. However, the CIOT is of the view that the proposed measures may not curtail the abuse and will almost certainly result in a high degree of ‘collateral damage’.

Existing legislation

We are surprised that HMRC has concluded that it cannot effectively challenge the abuse using the existing legislation and legal principles, and encouraged them to revisit those conclusions before implementing this proposal. It should be remembered that using existing legislation allows past underpayments of tax to be collected; relying on new legislation does not.

We are concerned that the proposals will not prevent the abuse, and a number of mechanisms to continue to take advantage of the changed system have already been mooted in articles and on social media. HMRC are aware of some of these ideas and will be devising anti-avoidance legislation accordingly. This is understandable, but we are concerned that it will also add further complexity to what is becoming an increasingly complicated ‘simplification’ measure.

‘Collateral damage’

HMRC’s explanatory notes provided estimates of the impact of the proposed changes, such as the number of businesses who might become ‘limited cost traders’, how many FRS traders will revert to normal VAT accounting etc. We think that HMRC has underestimated the extent of the impact on the ‘innocent’, particularly for the service sector and mobile businesses.

The measure is also extremely complex so, even with an effective online tool, it will be difficult for many businesses to understand the detail of the new rules. For example, understanding what are supplies of goods and what are supplies of services for VAT purposes is often unclear (software, gas and electricity, subscriptions etc.), and therefore basing the definition of a ‘limited cost trader’ on the value of goods purchased is not straightforward.

Are there alternatives?

HMRC explained that they have considered numerous alternative measures to prevent the abuse, but we think some of these should be explored further, such as restricting the FRS to businesses required to be registered for VAT, or tightening up the associated business rule (if it is believed to be less effective than intended). We also question the long term prospects for the FRS in the light of Making Tax Digital, particularly if records of income and expenditure will need reporting to HMRC on a quarterly basis.

Direct tax issues

HMRC have not indicated whether they will also seek to prevent abuse of the Employment Allowance, which is a feature of many of these arrangements. We suggest that HMRC takes a joined up approach to challenging these schemes, rather than acting in silos.

Our full submission can be found on the CIOT website.