Focusing the picture

Indirect Tax



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Nigel Mellor outlines the current OTS project on VAT and invites input from readers on their experiences

Key Points

What is the issue?

The OTS has been asked by Ministers to review the UK VAT system to see how it fits the modern context and to make proposals for simplification.

What does it mean to me?

The review provides an opportunity for you to highlight any areas where you consider the VAT system can be simplified, improved or is outdated.

What can I take away?

After reading the article, are there any areas which you think should be included in the review? Can you offer examples of complexities? If so, contact the OTS review team via ots@ots.gsi.gov.uk.

As all will be aware, VAT was introduced into the UK more than 40 years ago in 1973 and it is often referred to as being (or intended to be) a simple tax. In principle it should be. However, as with most forms of taxation, it has been subject to a process of evolution and change and it is now widely recognised as being complex to administer. That in turn creates compliance challenges for all types of businesses, ranging from micro businesses to large global corporations with activities in the UK.

Recognising these issues, it was announced in the Autumn Statement that the Chancellor and Financial Secretary have asked the Office of Tax Simplification (OTS) to carry out a VAT General Simplification Review of a range of aspects of the UK VAT system. The Terms of Reference were published at the same time on the OTS web pages on GOV.UK.

The overall aim of the review is for the OTS to consider whether the VAT system is working appropriately in today's economy and to identify any simplification opportunities. The OTS has been asked to develop recommendations for the Chancellor and the Financial Secretary as to how to reform and simplify aspects of the VAT system from both a tax technical and administrative perspective. It is intended that the OTS will provide a report which will be laid before the House of Commons in the autumn of 2017 at around the time of the Autumn Budget and that the Chancellor will subsequently make a formal response to the proposals. The OTS has recently published an update on its work to date and a call for evidence.

The review is the first wide-ranging review of the VAT system in more than 40 years to focus on simplification and as a consequence the scope includes consideration of some fundamental aspects in order to test whether long established policy positions or practical approaches are still valid in today's economy. After all, life has moved on

greatly since VAT was designed and although it has developed to deal with the changing economy, can we do better? How should it be modernised?

Registration

A good example of this is the compulsory VAT registration limit which currently stands at £83,000. Successive administrations have increased the limit on the basis that this reduces the administrative burden on UK businesses, and it is interesting to note that some countries which introduced a VAT or similar system in more recent times have gone for a far higher limit so that only the largest businesses are registered which reduces the administration costs for both businesses and the tax authorities.

However, the majority of countries which operate a VAT system have deliberately adopted a lower or minimal registration threshold which as a consequence requires any business to register for VAT as soon as it is created or develops some commercial substance. The main advantage of this approach is that it removes the distortion created in the economy when small or new businesses such as hairdressers, catteries and bed and breakfast hotels amongst others find it makes sense to close for a few weeks each year purely for VAT purposes so as to avoid falling off what is frequently referred to as the VAT cliff. This arises because the fixed registration threshold requires that a business with a turnover £1000 over the limit has to account for VAT at 20% on all its revenue, in contrast to a competitor who is £1000 below the limit who stays outside the VAT net. The effect on the business which is over the limit by only £1,000 is a VAT cost of £14,000.

Consideration is therefore going to be given to whether the registration limit should be increased, decreased, remain the same or if an alternative approach may be appropriate such as a more graduated registration threshold. How would these work in practice? Which routes would most help – or damage – small businesses?

Partial exemption and capital goods

Another area being reviewed is the potential for simplifying the operation of the Capital Goods Scheme (CGS), partial exemption methodologies and the option to tax, with a particular focus on the impact on smaller businesses. These areas of VAT now seem to be having an impact (with an exposure to financial penalties) on

businesses which when the tax was first introduced would not have been affected by them.

One obvious factor is that the CGS threshold was set at £250,000 26 years ago and has never been updated. If this was to be increased then the threshold is likely to be closer to £1,000,000. Similarly, in industries such as farming, in recent years there has been market pressure for diversification and one additional source of income is the rental of space for semi industrial units. This frequently will bring the business into partial exemption which adds complexity and compliance costs to farms' VAT accounting. Should such businesses really be in partial exemption? If not, how should the system be reformed to exclude them? Or are there ways of simplifying the operation of partial exemption generally that would do the job?

Rates, zero rates, exemptions and schemes

The review will not consider changes to the rates of VAT but it will explore the extent to which the types of supply which are currently exempt from VAT, subject to a reduced rate or are zero-rated, fit the modern context and create complexity for both businesses and tax administration. What specific examples of difficulties do practitioners see? We won't be looking at the financial sector exemptions as they will be very much on the Brexit agenda, but what other exemptions cause problems? Are there ways to improve things?

Since the VAT system was introduced in 1973, a number of special accounting schemes have been introduced such as the Flat Rate Scheme, Retail Schemes, the Tour Operators Margin Scheme, Cash Accounting and Annual Accounting Schemes. The review will give consideration to the level of take up and usefulness of these schemes given the more widespread use of technology and changes in business models. Are they still needed, particularly with Making Tax Digital on the horizon? Would it be better to recast them to focus them on particular areas?

Running the system

One issue raised regularly with the OTS in the past is a rulings system for VAT. Many request it but what would be the level of demand and practical challenges (not just for HMRC)? Where and why would it provide most benefit? Is it all about uncertainties for businesses in relation to Transfers of a Going Concern or when a

new product line is introduced? This issue has been raised by businesses on a number of occasions and it is interesting to note that a number of countries which also operate a common law system have successfully introduced such ruling systems which are either free or on a pay as you go basis.

Further areas to be considered by the OTS are the general administration of VAT and this will include the penalty regime and the appeals processes. Similarly, the opportunities to align VAT more with other taxes (or vice versa) as part of the Making Tax Digital plans are in scope.

We will also need to consider the revenue implications of the ideas that we develop. What would it cost (or yield) for the Treasury? Very importantly, what would be the implications for the administrative costs of businesses, agents and HMRC?
As can be seen from the areas outlined above, the scope of the review is very wide and as noted it will not focus on issues which are likely to be significant in the context of the Government's consideration of Brexit, such as the treatment of financial services, statistical reporting and EU cross border issues such as MOSS. However, as the review is forward looking, so it will bear the Brexit context in mind when considering and making recommendations.

Contributing to the work

The review team at the OTS mainly consists of VAT specialists from the Tax Profession. Oversight of the review is provided by the Board of the OTS and, as has been the practice for similar reviews, a Consultative Committee has been formed which will meet on a regular basis in order to provide comment and guidance to the review team. This committee is formed of representatives from industry, the tax and accountancy professions, trade associations, the public sector and representatives from HM Treasury and HMRC.

The OTS has already held around 20 meetings in developing our interim report, including with the CIOT Indirect Taxes subcommittee and VAT practitioner groups. We are now setting up a fuller series of meetings during April-July to gather evidence and help formulate recommendations. Anyone who wants to comment either personally or on behalf of an organisation is invited to contact ots@ots.gsi.gov.uk. In particular, specific examples of where it is considered that the VAT system is not working efficiently and suggestions for simplification changes are particularly welcomed – and of course ideas for how things could be improved!