

The Office of Tax Simplification

Review of Value Added Tax

Progress report and call for evidence

February 2017

Contents

Foreword	2
Executive Summary	3
1. Identifying the implications of the level of the registration threshold	4
2. Multiple VAT rates: causes of complexity?	6
3. Partial exemption methodologies, option to tax and capital goods scheme simplification	8
4. Special Accounting Schemes.....	11
5. VAT admin, penalties and appeals processes	15
6. Formal ruling system	19
7. VAT and Making Tax Digital Alignment Opportunities	20
8. Further areas for investigation	21
Annex 1: Comparison of EU VAT registration thresholds (April 2016)	23
Annex 2. Full list of Questions.....	25
Annex 3: List of Contributors	29

Foreword

Next year VAT will be 45 years old. In that time the business environment has changed dramatically and with it VAT has grown in size, complexity and importance, raising some £116bn in 2015-16. VAT (or GST) has become a near-worldwide tax, in use in over 150 countries.

We have moved from completing spreadsheets by hand to a world where accounting software can deal with many complex calculations in a fraction of a second and even the smallest shops now have bar code scanners. Business practices have also evolved. It is now very common to find diversified businesses that operate primarily in one sector but conduct a small side operation in another: a farmer who converts a barn to a holiday let for example, or a plumber who sells a few boilers as well as installing them. Products and services evolve rapidly, pushing the boundaries of VAT classifications.

These seem to be the sort of areas where the VAT regime most shows its age and which raise questions about how well it is working in today's environment – or whether it is ready for tomorrow with all its digital possibilities. This is the basis of the current OTS project.

There are instances where the UK regime is more complex than in some other EU states (for example, the extent of zero-rating). Some non-EU states have made specific design choices to avoid the complexity we face in the UK, including a much broader tax base, a single rate, fewer exemptions and formal rulings. On the other hand, some aspects are simpler (for example, the UK VAT return).

In initial research we identified a number of areas of complexity¹ and set out to test these with a sample of businesses and advisers. These stakeholders confirmed that the areas of complexity we had identified were broadly correct and gave us more information on where the complexity lay in those areas. They also provided several examples of complexity that we hadn't identified.

This progress report presents the areas of complexity identified during *phase 1* of this review. We briefly discuss the issues and pose some questions in each section, though these will not be comprehensive. We'll use these in our meetings and research, aiming to develop recommendations for simplification during the *phase 2* of the review that will report in the autumn.

Contributing to the review

We now need help in three ways, to help develop ideas on how we can get a sustainable VAT system for the future that imposes minimal burdens on business:

- (1) Evidence of how these areas cause difficulties and complexities (quantified if possible)
- (2) Ideas for how to improve matters
- (3) Identify any areas for simplification that we've missed

As always, we welcome all submissions and comments, however short or long and whether they answer some or all of the questions we pose. Please write to us at ots@ots.gsi.gov.uk; contributions would, as always be welcome at any time but will be most useful to us if received before 30 June.

Similarly, businesses or organisations who would like to meet with the project team should get in touch with us at ots@ots.gsi.gov.uk. Please bear in mind that we want to carry out most of our visits and meetings in the period 1 April – 30 June.

¹ The terms of reference for our project are at <https://www.gov.uk/government/collections/ots-review-of-value-added-tax>. Note that some areas of the VAT system have been specifically excluded from the scope of the review because of the way they will be impacted significantly by Brexit discussions – for example the VAT status of financial services. It must also be borne in mind that until the UK exits the EU, it will continue to be bound by the same requirements in relation to VAT as any other EU member state.

Executive Summary

At the 2016 Autumn Statement, the Chancellor of the Exchequer and the Financial Secretary to the Treasury asked the OTS to conduct a review of VAT to see whether the system is working appropriately in today's economy and to identify simplification opportunities. We are now providing an update on our work and calling for further evidence in this progress report. The eight areas we're particularly looking at are:

1. **Identifying the implications of a high registration threshold** | The UK VAT registration threshold, at £83,000, is much higher than most other countries' (generally closer to £20,000 across all countries with a VAT system or equivalent). This influences and distorts business behaviour. Would it be less distortive if the UK's threshold were lowered to bring in more businesses? If so, how would those small businesses cope? What would be the impact of raising the limit to remove more businesses from VAT? Or could the 'cliff edge' of registration be managed better?
2. **Multiple rates: Causes of complexity** | The UK currently has in effect four different VAT rates: the standard 20% rate, the 5% reduced rate, a zero-rating, and exempt goods and services. The definitions—and practical application of definitions—of items within each rate cause a lot of complexity. How might this be simplified?
3. **Partial exemption, option to tax and capital goods scheme** | These have been raised as some of the most complicated areas of VAT. Many more businesses now seem to be affected. Can they be simplified? Or are there ways to amend them to reduce their range and impact?
4. **Special Accounting Schemes** | There are several schemes, including the flat rate scheme, retail schemes, tour operators margin scheme and annual accounting scheme, generally designed to simplify the VAT regime. Business practices and technology have changed significantly since they were designed, so are these schemes working appropriately today? Do they need improving – or are any in fact no longer needed?
5. **VAT admin, penalty and appeals processes** | Many have reported complications ranging from unclear guidance to opaque penalty regimes and resource-consuming appeals processes. We've begun identifying specific complexities in the VAT machine and are open to any suggestions on how this might be simplified, increasing certainty for businesses.
6. **Formal ruling system** | We've already had suggestions that uncertainties around VAT treatment can delay or prevent many business decisions, especially when bringing a new product to market. A rulings system sounds a possible route but how would it work? Would it provide enough simplification to justify its introduction, given the demands it would place on HMRC?
7. **VAT and Making Tax Digital (MTD)** | HMRC's MTD plans encompass VAT so that brings opportunities and risks. Which areas of the VAT regime need to be simplified to better fit into MTD? And what simplification could MTD bring to the VAT regime – how would the special accounting schemes be affected?
8. **Further areas for investigation** | We have also identified some further issues including sector specific considerations. What other complexities are out there that we need to address?

Next steps | We are keen to hear from *you*. We want to know how these issues affect you, your business or your clients and what changes would bring simplification. Input is welcome in writing or in meetings and will help us develop recommendations for simplification that we will publish in autumn 2017.

1. Identifying the implications of the level of the registration threshold

We have been specifically asked to look at the issues and impacts which would be involved if the VAT registration threshold were either higher or lower than at present.

The current VAT registration threshold of £83,000 (approx. €97,000 following recent falls in Sterling) is significantly higher than the EU average of around €30,000. Furthermore, HMRC data indicates that 44% of businesses registered for VAT actually operate below the threshold². Some of the reasons that we've been told drive this:

- start-ups in transition:
 - those expected to grow quickly so for simplicity register for VAT alongside all other initial company formation registrations
 - those claiming a high amount of input VAT, on high capital expenditure for example, and the cash-flow benefits outweigh any administrative burden. This especially applies to those that incur VAT on services as this can only be reclaimed if the business registers for VAT within six months
- B2B businesses that will be at a financial advantage
- businesses that want to appear larger than they actually are
- businesses that simply do not know that VAT registration is optional below the threshold
- businesses that receive advice from non-qualified advisers to register (for example traders in umbrella companies that are given a generic set of advisory materials upon joining)
- businesses that previously traded above the threshold but are now trading under and choose not to (or do not know that they can) deregister

We expect there are others and we do not yet know how the 44% is distributed, but it implies:

- for many traders VAT is simple enough so they elect to use it; and/or
- the additional complexity and burden is outweighed by the advantages of registration (for example, making a net gain from VAT repayments and perceived improvements in the business's reputation)³

Countries adopting a VAT or goods and services tax (GST) more recently generally set lower a registration threshold than the UK. But Singapore has a GST⁴ registration of S\$1million (approx. £500,000) and so totally excludes all small businesses⁵.

The £83,000 threshold seems to be having a distortionary impact on business population with an unusual number of businesses reporting turnover at levels just below the threshold. It is possible for some businesses, especially self-employed service workers⁶ to live a relatively comfortable life off profits made on turnover below the threshold.

² HMRC VAT Factsheet 2015-16, sheet 2.7

³ We have also received submissions and comments from small businesses that refer to VAT as straightforward and the simplest of all the taxes they deal with. One showed us their very simple spreadsheet method that seemed to consume minimal time, something we will return to in the Making Tax Digital section.

⁴ Singapore's GST system has some other differences compared to UK VAT. It applies a rate of 7% to all goods and services excluding only the provision of financial services, sale and lease of residential properties, and the import and local supply of investment precious metals. Non-domestic supplies are out of scope.

⁵ We note that the UK could not increase the threshold above inflation under EU law.

⁶ Likely to have little input VAT to reclaim.

Several stakeholders we spoke with cited examples of businesses actively managing their businesses to stay below the threshold through:

- refusing to take on another contract until the year end
- physically closing their store, restaurant or B&B for a month or two each year
- deciding against taking on a part time employee or apprentice

There is also the risk of traders simply declaring a false, lower turnover through suppressing sales or business splitting, something HMRC have experience of.

Invariably these are 'B2C' businesses and so entering the VAT system is seen as bringing a 'VAT penalty', through having to charge VAT and so increase prices or absorb it. While traders are entitled to take as much time off as they wish, would fewer do so to such an extent, if they didn't face a large VAT penalty for continuing to trade? Alternatively would this be solved by a much lower threshold like most EU and many non-EU states, so that any established business would be subject to VAT and the competitive disadvantage removed?

Against this, how would the small businesses drawn into VAT through a lower registration threshold manage? Would the admin burdens and general complexity of being in the VAT 'net' outweigh any levelling of the playing field?

It may be thought that this is not strictly a simplification issue. But if changing the threshold would make for an easier businesses environment and remove a 'cliff edge' that would clearly be a simplification.⁷ Taking that a bit further, we also have to consider the implications of a higher threshold (though as we have already noted, at present the UK can only raise the threshold in line with inflation). Potentially that would exclude more businesses – so would the simplification gain be worth the risk of more distortion in the marketplace?

We have already had a number of alternative routes suggested to us. Would there be simplification benefits in having, for example, a tiered regime, or offering tax reliefs to reduce the cliff edge impact as many EU states have done?⁸

A key part of our assessment will be whether changing the threshold would have an economic impact, tackle any disincentive to grow and potentially create more jobs. And, of course, we will be assessing the exchequer impact of changes.

Questions

- Why are businesses below the VAT threshold registering – how does that 44% break down?⁹
- What would be the impact of raising the threshold significantly? With and without the option for voluntary registration?
- What would be the impact of reducing the threshold significantly? How would HMRC and businesses who were brought into the VAT net manage?
- In both cases what would be the impact on economic activity?
- Are there any other approaches that could simplify the regime? Does Making Tax Digital (see below) have an impact?

⁷ It is beginning to emerge from initial discussions that, unless the change is significant, any increase or decrease might only shift where the threshold impacts are felt, rather than really mitigating problems.

⁸ The French system allows a business above the minimum threshold, but below a certain further threshold for up to two consecutive years, to avoid charging VAT.

⁹ HMRC VAT Factsheet 2015-16, sheet 2.7.

2. Multiple VAT rates: causes of complexity?

The UK currently has, in effect four different VAT treatments:¹⁰ the standard 20% rate, the 5% reduced rate, a zero-rate and exemption.¹¹ It is quite possible for an input to be subject to multiple VAT rates as it moves through the supply cycle and forms a part of different products.

The application of the different rates seems to be heavily influenced by historical accident or legacy decisions rather than a conscious current policy. For example, the zero-rating around cakes and bread was designed so that everything sold by the local baker would be zero rated. That was a simple solution in the 1970s but in 2017 the vast majority of people purchase their cakes, bread and even Jaffa cakes from a supermarket or convenience store with the rest of their groceries. At the same time, if one still has a local baker, there's a good chance that that baker has also diversified and is likely to also sell, for example, chocolate covered gingerbread men.¹²

A similar issue occurs with zero-rating of some goods for disabled people. Not only do people find the definitions extremely complicated, it's also very difficult to apply precisely, especially for new products and services.

Stakeholders often raised the example of the zero-rating for young children's clothing. Young children are far bigger today than they were 40 years ago, with many more clothes purchased for children now subject to VAT.¹³ The rules are complex to apply.¹⁴ It would be possible to fill this entire report with similar examples across the VAT system but some immediate ones will suffice:

- food for dogs vs food for working dogs
- the recent decision on children's colouring and dot-to-dot books vs adult colouring and dot-to-dot books¹⁵
- corn chips v potato crisps (very little practical difference to the consumer, but the ingredients achieve a different tax liability)
- the multiplicity of cases on cereal bars and similar products

Many noted that there was a social objective or at least a political motive behind some VAT schedules. For example, zero-rates on young children's clothing and some basic foods can benefit the poorest or influence behaviour. However, as one stakeholder stated, VAT can only influence behaviour if it influences prices and there is little evidence to suggest it does. It is quite easy to find children's clothing cheaper in other countries that charge VAT than in the UK where it is VAT free.^{16 17}

Are there simpler ways of achieving objectives here? Our remit in this respect, of course, is tax simplification, rather than broader policy matters.

¹⁰ Excluding the 4% rate in the agricultural flat rate scheme

¹¹ Being outside the scope is arguably a fifth category.

¹² Gingerbread men decorated with chocolate unless this amounts to no more than a couple of dots for eyes must charge VAT at the standard rate.

¹³ The actual sizes of clothing are not specified in the regulation so this is something that could be addressed by HMRC updating guidance.

¹⁴ One stakeholder shared an example of an inspector having to take a tape measure on an inspection to measure the lengths of a box of children's vests.

¹⁵ This was raised on more than one occasion as a typical example where a new rule has been introduced that actually causes a great deal of complexity for minimal gain and it is difficult to see the real world rationale.

¹⁶ There is also the strong point that VAT-free clothing benefits most those who can afford to buy their children lots of clothes – so the better off – rather than the poorest.

¹⁷ We note that VAT will not be the only factor determining the overall cost of a good or service.

What could be done?

It is not surprising that some have already suggested radical options to us, such as simply applying a standard rate to everything. If there were concerns about revenue neutrality, doing so could coincide with a significant rate reduction as the tax base would be much broader. Such a radical proposition is outside our scope so we just note it for completeness. A less radical approach would be to scrap the exemption schedule and make everything taxable at either a standard, reduced or zero rate, though again we have to note that a key aspect – VAT and financial services – is outside our terms of reference.

However, we must at least note that the simplification benefits of such moves could be vast. A broad standard rate could significantly reduce the complexity caused by different schedules including removing partial exemption rules and the Capital Goods Scheme altogether. It would also remove the need for much of the anti-avoidance provisions and would create a system simple enough that one could probably do away with many of the special accounting schemes.

What we will be concentrating on in this review is looking at the number of definitions and boundaries and seeing if complexities caused can be reduced or better managed. Again, what can be done while within the EU is limited.¹⁸ Perhaps one could be less prescriptive with certain categories that cause the most pain?¹⁹ Another area of complexity that has been raised involves transfers of going concerns, which we discuss in more detail in the formal rulings section.

Questions

- Where are the categories that most give rise to boundary issues and so complexity for traders?
- Why have these difficulties arisen? Is it product development/technological advance or other reasons?
- Would it be possible to simplify some of the definitions to allow more leeway for reasonable trade decisions?
- If part of the problem is commerce developing faster than the VAT law, how might VAT law best keep up?
- What would be the impact of introducing much broader definitions in areas such as food? Would this help or cause more difficulties in practice?
- Could Making Tax Digital (see below) be used to resolve complexities associated with types of supply, either on its own or in conjunction with other changes?

¹⁸ There is limited scope to apply a zero or reduced rate to items that are currently standard rated, although one can move goods from zero to reduced or standard and reduced to standard.

¹⁹ Any changes in this area could require the Government to reconsider its tax lock.

3. Partial exemption methodologies, option to tax and capital goods scheme simplification

Partial Exemption

Issue

A business can only recover input tax which relates to taxable supplies. Taxable supplies means supplies of goods or services which are taxed at the standard, reduced or zero-rate. Partial exemption is the situation when a business incurs input VAT on costs which relates to exempt supplies as well as taxable supplies.

Over time the number of partially exempt businesses has grown, and in particular beyond the traditional sectors of financial services and businesses engaged in land and property supplies. However, its remit has become much wider as businesses diversify their activities, often through land and property. An example would be a farmer who diversifies his business by renting out former barns as industrial units. The rental income will generally be exempt and he will therefore be required to calculate the input tax costs that relate to the farming activities, which will be recoverable in full. The input tax relating to the rental income stream will be irrecoverable as it relates to an exempt activity. Any VAT on overheads will need to be apportioned. We would like to know more and in particular why those affected do not opt to tax.

In a similar vein, businesses that make supplies that are outside the scope of VAT, or are non-business related have become more involved in such calculation. Charities, for example, are often affected here.

Complications

Calculation of the amount of input tax which can be recovered by the business is widely seen as complex, with difficulties for businesses. Even the Standard Method seems to cause problems; agreeing other methods can take a lot of time. Our discussions with stakeholders have provided us with evidence from a number of different sectors that the de minimis limits and rules around 'incidental' exempt activities don't help enough in practice.

We have received a considerable amount of feedback that negotiating a bespoke partial exemption methodology with HMRC can take many months and indeed years to agree. We would like to hear more about such examples and, in particular, where the complexity lies, what takes all the time and how agreements can be achieved more quickly.

Further research/suggestions

We will examine this area more extensively in phase two in order to identify how more businesses which make only incidental exempt supplies can be removed from the partial exemption regime, over and above existing mechanisms. Could there be a simple, standard calculation that businesses would find easier to use to test whether they are in partial exemption's ambit?

Alternative methods will be considered such as trade sector specific methods so as to reduce the number of bespoke schemes. We will also explore flat rate recoveries based on different business categories with no requirement for agreement with HMRC unless the result is materially different.

We also want to consider how bespoke methods can be more quickly agreed, if more sector based methods would bring simplicity, and if an improved system of self-assessment would be more appropriate.

Questions

Partial exemption is a complex subject and we would be grateful for comments under a number of areas:

- Where does partial exemption arise in practice unexpectedly? What is the impact on the businesses concerned?
- Would it be practical to exclude more of these 'accidental' partially exempt businesses in some way? Would that just mean raising the de minimis amounts and changing incidentals guidelines?
- What alternative methods would you recommend – or recommend avoiding?
- What alternatives or improvements could be put in place to make the process of agreeing a partial exemption special method with HMRC simpler, easier and quicker? Would a flat rate or sector-specific methodology for PE calculations be better than the flexibility of agreeing a bespoke method?

Option to Tax

Issue

The option to tax (OTT) is a process whereby a business can decide to charge VAT on any supplies relating to land on which it has exercised an option to tax. The main reason for doing this is so that the business can recover any input VAT which it incurs relating to those supplies of land.

Complications

The process of opting is a two stage process. A decision needs to be taken (and evidenced) and this has to be notified to HMRC. There is no central record or database to enable a business to check whether someone has opted to tax an interest in a piece of land. Many have said to us that this would be a very useful reference tool.²⁰ In addition, there are some supplies of land and buildings where, even if the business has opted to tax, the option will not apply and supplies remain exempt.

Further work

We want to gather evidence of any difficulties caused by the current OTT system, including how it affects or distorts the property market (if at all).

Questions

- Could the process of Opting to Tax be simplified? How?
- Could a system where, say, all commercial property is considered as opted by default work? Would this cause complexities with awareness?
- Could a central database be created? What value would this provide and would that outweigh privacy considerations? Would you be willing to incur the burden of providing data to HMRC to allow such a database to be accurate and up-to-date?
- Can the notification process be improved? Does this require confirmation from HMRC?

Capital Goods Scheme (CGS)

Issue

A business which acquires land and property, or undertakes civil engineering works, refurbishments and certain other activities, with a value in excess of £250,000, is required to undertake an annual calculation if the item is not used wholly in the making of taxable supplies. This provides a mechanism

²⁰ This raises issues over taxpayer confidentiality, which we will try and research.

so that any variation in the making of taxable supplies leads to an adjustment on a yearly basis over a ten year period of the input tax recovery. The scheme also applies to computer equipment, ships and aircraft worth over £50,000 (over a five year period).

Complications

The £250,000 limit has been in place since 1990. This low threshold means that many more businesses are required to do this annual adjustment than when the scheme was originally introduced. The £50,000 limit for computers has also been in place since 1990. But computer prices have fallen rapidly since 1990 and servers are now sold as a series of distinct components, so it is unlikely that there are many or any computers that now fall into this scheme. Nobody to date has cited any application of the CGS in relation to computers.

CGS means extra record keeping and calculations are required. We have been told many times that it is little understood by businesses and non-specialist advisers. Those that have experience of it mostly say that it leads to few adjustments of any significance and rarely outweighs the costs of the administration involved. Against that, some clearly value the possibility of making adjustments when business activities change significantly.

Further work

We will examine this area in more detail and make suggestions as to how the scheme can be reformed so as to reduce the costs associated with businesses having to comply with this scheme. This will include reviewing whether the abuse which the scheme prevents/tackles can be addressed using other more targeted powers.

The inclusion of computers in the scheme would appear to be otiose but we will review this in more detail.

Questions

- What burdens does the CGS create in practice?
- Are there examples in practice of the application of the computer strand of CGS? What of ships and aircraft?
- Can the aims of CGS be achieved in simpler – possibly more targeted – ways? As far as land and property is concerned, does the option to tax make a difference or have a part to play?

4. Special Accounting Schemes

Several special accounting schemes (SASs) have been introduced into the VAT regime, ranging from various flat rate schemes to cash accounting and annual accounting. Some of these date from the tax's introduction. What they almost all have in common is that they were intended to provide simplification. It is clearly sensible to test whether they are actually delivering simplification today.

Once a business has decided upon the scheme they wish to use and is operating within it, the tax arrangements are simpler. However, businesses and advisers have raised a number of complication issues with these schemes including: boundary issues caused by the number of different schemes; difficulties for agents to identify the scheme someone is using when they have transferred from a previous agent; and complexities around entering and exiting schemes (for example how to complete a VAT return if moving from an invoicing to payment scheme). Also, some people are simply not aware of all the schemes, so not necessarily in the scheme that works best for them—especially for businesses without an adviser.

Flat Rate Accounting Schemes

Flat rate schemes were designed to provide simplicity for small businesses that registered for VAT but were not large enough to engage dedicated expertise to deal with some of the more complicated aspects of 'the simple tax'. These schemes allow businesses to simply pay a fixed percentage of their turnover²¹ as VAT, with deductions only permissible on capital purchases over £2,000.

Arguably the greatest *simplification* benefit of the flat rate schemes is not the simplification of the general VAT calculation, but to escape some of the tax's complexities—partial exemption for example.

If a business continues to grow beyond the upper threshold of the flat rate schemes they'll find themselves subject to normal VAT rules and its complexities. As such the flat rate schemes only act as a sticking plaster and do not solve any of the underlying complexity in the VAT regime.

The simplification benefit of flat rate schemes has also diminished as modern accounting packages and technology make the general VAT scheme simpler to administer. Recent anti-avoidance measures may have made them more complicated, following the schemes being looked at as tax *saving* opportunities rather than *simplifying*. Perhaps unsurprisingly, many commented on the new limited cost trader tests and cited complexity within its quarterly calculations²².

Questions

- Is it possible to reduce the number of different FRS rates?
- Will there be a sufficient simplification benefit to require traders to state what scheme they are using on their VAT return?
- Is it possible to further increase knowledge of schemes up front when traders first register?
- Can measures directed at abuses of the schemes be better targeted? Perhaps by framing eligibility differently?

²¹ See <https://www.gov.uk/vat-flat-rate-scheme/how-much-you-pay> for the list of rates.

²² While many are likely to leave the scheme because it no longer offers a tax advantage, some have suggested that traders will leave the flat rate scheme because of complexity. We have also been told that the test is easily avoidable. Could, then, the policy aims be achieved more simply? We also note the new online calculator developed by HMRC to assist taxpayers using this rate.

- Overall, do these schemes still work? Is there still a sufficient simplification benefit to justify their retention or would it be simpler just to simplify particular aspects of the general VAT system? Will MTD make them less relevant?

Retail schemes

Retail schemes were introduced as it would have been burdensome for some retailers (especially smaller businesses) to account for the different rates of VAT on multiple small items on each purchase. This would certainly have been the case when VAT was first introduced but we now live in a world where many of the smallest retailers appear to have barcoding and digital accounting packages that can automatically calculate the correct VAT due on each transaction.

The removal of these retail schemes would simplify the VAT system as a whole but it could cause a significant amount of complication for businesses. We spoke with some major retailers that still very much relied on the retail schemes as while they had long upgraded their tills to show full VAT breakdowns for customers, this information wasn't being sent to and could not be processed by their much older accounting systems. We would be interested in your views on whether the use of retail schemes are being driven by genuine underlying accounting simplicity.

One issue that many retailers did raise with the retail schemes was that the process for amending bespoke schemes does not seem to be functioning as it should. We were given many examples of simple changes taking over a year to be agreed.

Questions

- Do any complexities arise in operating retail schemes?
- How common is modern accounting software in the retail sector?
- What specific complexities with VAT accounting do the retail schemes help manage?
- Would there be a simplification benefit in moving to systems that send information to HMRC straight from the till, as is now in use in some other countries? And would the simplification outweigh any implementation and running costs?

Tour Operators Margin Scheme (TOMS)

TOMS was introduced as a *simplification* measure so that travel companies purchasing items from multiple EU states, typically as components of holiday packages would not have to register in multiple member states. However, it is widely seen as in effect some form of additional control or even anti-avoidance.

The complexity of the arrangements, and the fact that it is compulsory, means that most of the businesses we spoke with raised this as a cause of confusion and additional administrative burden. Some told us that they or businesses they work with have decided to no longer engage in any business activity that could be in scope of TOMS, even though those activities would likely lead to business growth, including new export opportunities.

Interestingly, we were also told that many travel companies have structured their activities so they no longer fall within TOMS – including by basing some operations outside the EU.

Given this simplification measure seems to be generally capturing businesses it was not meant to capture and causing complexity rather than simplification, can it be simplified? Should, for example, the

UK follow the example of other EU states like Ireland that allow most businesses that are not travel agents to simply ignore TOMS?²³

Questions

- What arrangements and transactions are caught in TOMS nowadays? Are these 'tours' as envisaged?
- Does TOMS still help the sort of tour operators originally targeted?
- Can TOMS be simplified to still target the original arrangements but excluding things that should not be in its ambit?
- Should TOMS apply to supplies that solely occur in the UK?
- What should be done to maintain or increase alignment with international regimes where this offers greater simplicity?

Agricultural flat rate scheme (AFRS)

The AFRS is a scheme that allows farmers to levy an optional 4% VAT on defined agricultural supplies to VAT registered traders. The farmers' customers can reclaim this back as input VAT but the AFRS registered farmer keeps the 4% VAT collected. This is offered as an alternative to VAT registration and the 4% retained is in lieu of any input tax the business could reclaim under standard accounting, but cannot reclaim under AFRS. This is in essence a Government reimbursement that is delivered through other private businesses that must then claim it back from Government.

The scheme was designed as a simple way for very small farmers to deal with VAT, but again we must ask, 40+ years into the VAT regime, with the advance of technology, is this still necessary? Take up of the scheme appears to be low and few of the advisers we spoke with, including those that worked with farmers, knew much about it.

Questions

- How widely used is the AFRS and is it still necessary?
- What would be the impact of removing this scheme: what sort of businesses would lose out? How much would they lose, bearing in mind administrative costs?

Cash Accounting

Cash accounting was generally regarded as a good simplification for the smallest businesses. In addition, many people that had used it themselves or had clients that used it saw it as an essential lifeline. Cash flow is critical for many small businesses; many do not receive payment until many months after issuing an invoice. The risk is they wouldn't have the cash flow to pay the VAT at the time the invoice was raised.

²³ Under Irish law, any business, other than a travel agent's business, that supplies only incidental or one-off supplies of margin scheme services can account for the VAT on those supplies under the normal VAT rules and is not obliged to apply the margin scheme to them. However some businesses, such as organisers of sporting events, training courses and conferences are subject to the scheme when they package travel and accommodation with their supplies. <http://www.revenue.ie/en/tax/vat/leaflets/travel-agent-margin-scheme.html>.

Questions

- Are there any problems with the current VAT cash accounting system?
- Does the impact of wider direct tax cash accounting with MTD, with its differing thresholds, cause any difficulties?

Annual Accounting Scheme (AAS)

Views on the Annual Accounting Scheme were much more mixed. For those that had a good general grasp of their tax affairs, the AAS was a useful simplification, resulting in one return annually rather than four.

However, those without a good grasp of their accounts found that overall, the scheme didn't offer any simplification. A common scenario cited was a trader, or adviser to a trader, using the scheme and then finding that it led to poorer record keeping and an unanticipated VAT liability. Many moved back to quarterly returns, preferring the good record keeping encouraged by the frequency of returns, and the smaller, more regular payments. One agent we spoke with referred to quarterly VAT returns as having the single biggest impact on the quality of small business record keeping of any Government policy to date.

Questions

- How much simplification does the AAS provide in practice? Since its presence adds yet one more scheme for a business to consider, should this be retained at all?
- Will the AAS be compatible with Making Tax Digital plans, given quarterly reporting?

5. VAT admin, penalties and appeals processes

Administration

HMRC guidance

VAT is a self-assessed tax and, as such, it is for the business to ensure that it has calculated its VAT correctly. To do this the business or its advisers need clear guidance upon which they can rely. Issues with HMRC guidance were raised in almost all the meetings we attended. The issue which caused most frustration concerned advisers, generally specialists in their field, writing to HMRC for clarification when they considered guidance was contradictory or incorrect. Often that resulted in a response to the effect that HMRC could or would not provide further clarification because there was already guidance in place; there would be no willingness to address the specific matter raised.

People also expressed difficulty in finding guidance or where one piece of guidance relied on an interpretation from another. We would be interested in your experience in relation to VAT guidance. Are there particular types of guidance that cause issues? Or are complexities caused by the administration of guidance? For example, being notified of new guidance, identifying changes to guidance, navigating Gov.uk, locating guidance and understanding the legal status of any newly issued guidance.

While HMRC clearly need to guard against avoidance or manipulation, advisers insisted that they were often simply finding it very difficult to secure the certainty of treatment their clients need. Some also raised instances of where they could not present HMRC guidance as evidence at a Tribunal and would instead require an expensive Judicial Review for the guidance to be considered. The status of guidance at a Tribunal is a Ministry of Justice (MoJ) competence but we note it here as an issue raised with us. Might there be a way to provide simplicity here directly via the guidance?

VAT Overpayments

A point that was raised by some stakeholders was the difficulty and complexity of the process of receiving a VAT refund if VAT was incorrectly charged. Typically the purchaser has no right to deduct; instead the seller has to issue a refund to the buyer and then seek to reclaim the money from HMRC. It was suggested that it could be simpler if the buyer could just seek the refund directly from HMRC. This would also help the buyer in situations where the seller had ceased to trade. How else could this operate fairly to ensure that only one repayment of the overpaid VAT is made and that it is made to the right person (the person who bore the economic burden)? And how could this operate without exposing HMRC to multiple claims from the same supply chain or risks of fraud?

Questions

- We would be interested in your experience in relation to VAT guidance. Are there particular types of guidance that cause issues? Or issues about accessing guidance?
- Would it help if there was a search function or site map for guidance?
- Would it be simpler if there was an automatic notification feature for all new and amended guidance that also told you precisely what the amendments were?
- What other areas of VAT administration cause complexity? Are VAT repayments a problem in practice?
- How could the VAT overpayments regime operate fairly to ensure that only one repayment of the overpaid VAT is made and that it is made to the right person (the person who bore the economic burden)?

Penalties

Balancing simplicity and fairness in the penalties regime is a difficult task. A great deal of the complexity stems from the huge variation in the nature of businesses and operating practices, which leads to equally large variations in the nature of disputes. This can be further complicated by non-compliance or where there has been a deliberate attempt to evade tax.

We have received broad feedback that the penalties regime feels too subjective and did not always appear to be consistent. Examples were given of voluntary disclosures where companies thought they had taken all reasonable care but made an error. They expected to not be penalised but were penalised. On the other hand, we've also been told of situations where businesses thought they really should have been penalised and were not. The result for some was that when they spotted a mistake, they had to think twice before reporting it to HMRC. This is an important issue to solve as the penalties regime exists to encourage good behaviour. Is there anything that could increase certainty and encourage good behaviour, including voluntary disclosures?

Some have suggested that the system worked better when it was an objective test, before the reforms following the creation of HMRC. It was felt that subjectivity, while designed to ensure the regime was fair, actually led to a lack of consistency between decisions. On more than one occasion stakeholders proposed a drastically simplified system; for example, a system with no fine for a voluntarily disclosed genuine mistake but a penalty (perhaps a fixed percentage of the VAT due) for all other instances. Their argument was that since a penalty is supposed to encourage good behaviour, all it needs to do is penalise bad behaviour while not discouraging good.

Another issue raised was the amount of time taken for penalties linked to errors to crystallise for big businesses because of the four year period for error correction. This causes uncertainty for businesses as they could have a fine hanging over them of a magnitude that hadn't yet been fully defined. A proposed solution was to have a flat penalty for a late return rather than relating it to the amount of tax due. Again this appears to be a question about simplicity vs. fairness/proportionality.

Default surcharge

The default surcharge for late filing and payments is a subject on its own and attracted mixed views. While many appreciated its simplicity, many also felt it was often too unfair and disproportionate. Because of this, there are a high number of statutory reviews (of which 53% are successful²⁴) and the process of also having to go through the appeal procedure made the whole experience complicated. It is also worth noting the 2016 Consultation "Making Tax Digital: Tax administration" that HMRCs expectations are new sanctions for late submission and late payment will, in due course, replace VAT default surcharge.

The government will consult on specific proposals to charge penalty interest taking into account rate levels and the interaction with the current interest provisions. A further consultation is also intended on specific proposals later in 2017.

The OTS responded to the MTD: tax administration consultation and, in general, welcomed the proposal to modernise penalties for late submission and late payment²⁵. We will continue to be involved in the debate on the proposals. As we do not want to duplicate MTD discussions, we pose only limited questions here.

²⁴ Tax Assurance Commissioner's Annual Report 2015-16 (TAC). The number of VAT penalty decisions cancelled on review represents a small proportion, just over 1%, of the total number of VAT penalties issued

²⁵ This was in line with the OTS's recommendations in the Penalties Review (Nov 2014)

Questions

- What are the major concerns with the penalties regime?
- How could we provide more clarity regarding the voluntary disclosure regime to encourage more compliance?
- Could the penalties system be more like speeding fines, with only exceptional excuses?

Appeals processes

The grounds for making an appeal depend on the nature of the dispute and the circumstances. A penalty for late filing or late payment may be appealed on the grounds that the taxpayer has a 'reasonable excuse'. Penalties for errors in returns or documents causing an understatement of tax may be appealed on the basis that the taxpayer took 'reasonable care'. This type of penalty can be removed, reduced or suspended. When a taxpayer disagrees with a tax penalty they can request a Statutory Review or take the case to the tribunal (or both).

Statutory Review

Most of the comments received so far suggest that people often see the process as a rubber-stamping exercise so businesses didn't bother to use it or just used it to buy time.²⁶ It was also suggested that a lot of unrepresented taxpayers either didn't know about the statutory review procedure and so didn't use it, despite this being explained in every decision letter; or would in any case simply take an appeal straight to Tribunal. This picture somewhat contradicts the findings of the Tax Assurance Commissioner's Annual report, which suggests a greater level of engagement by taxpayers with statutory reviews. However, we would be interested in finding out more about people's views of the statutory review procedure. It could offer a simpler route to dispute resolution, but that requires users to trust it. What could be done to increase that trust?

Alternative Dispute Resolution (ADR)

The Litigation Settlement Strategy (LSS) makes it clear that HMRC should, where possible, work collaboratively with the taxpayer to resolve the dispute within the boundaries of the law. On the occasions when this approach does not lead to a resolution, it may be appropriate to consider Alternative Dispute Resolution (ADR). There were 148 active ADR cases in 2015-16 including those carried over from the previous period. This is a very small proportion of the 16,284 VAT reviews against HMRC decisions during that year.²⁷ There were 15 cases that proceeded to litigation beyond ADR but, the success rate of ADR overall was 95%.

The ADR process aims to help the taxpayer and HMRC resolve disputes without the need to go to the tribunal. It usually involves an HMRC specialist trained officer who will act as a neutral facilitator, but exceptionally HMRC might agree with the taxpayer to jointly pay for a professional independent mediator. ADR tends to work well where there are differences of opinion or disputes on facts or misunderstandings; rather than on technical issues, interpretation of the law and specifically, fixed penalties. Therefore it has been raised by a number of people, including those very supportive of ADR generally, that it has limited use where VAT is concerned. We would be interested in views on making more use of ADR in VAT, if that was deemed appropriate, because it can offer a simpler dispute resolution.

²⁶ We have been informed that 57% of VAT decisions were overturned at review stage. However this might be skewed by the fact that the majority of reviews are related to the default surcharge that is automatically administered by a system. It is only seen by a human at the review stage.

²⁷ Tax Assurance Commissioner's Annual Report 2015-16

Tribunal

Many of the larger businesses we spoke with made it clear that taking a case to the Tribunal was not an easy decision, with a significant consideration seeming to be reputational risk. Few established businesses want to make the headlines for challenging HMRC over tax issues. It also appears as though unrepresented taxpayers are more likely to go to the first tier tribunal.

In addition to this, some businesses said that they found it unattractive because of time and cost. We've also had suggestions that the process of getting to the tribunal can be unnecessarily tortuous.

However, what we are interested in here is complexity. If you have experience with taking cases to the Tribunal we would like to hear whether you found any aspects complicated as well as suggestions for simplification, though it's important to bear in mind that the procedures will generally be governed by the Ministry of Justice.

Questions

- Would improvements to decision letters help improve understanding about the statutory review process?
- Are there areas of complexity with the statutory review process that need addressing? If you don't use statutory review, why not? Is your experience different in the context of other taxes?
- Should anything be done to encourage greater use of ADR in VAT?
- In general, are there any simple routes to making the dispute resolution process, including the Tribunal stage, less time consuming and costly? Would lowering barriers risk encouraging too many appeals? Could anything be done to make a tribunal less time consuming and costly? And would lowering these barriers help or simply result in more appeals that could congest the system?

6. Formal ruling system

The issue is fundamentally one of certainty. Businesses want certainty in two main areas:

- The first is where they want a binary ruling, for example when they are introducing a new product and they want confirmation as to the VAT treatment.
- The second area is where they are undertaking a one-off unusual business event such as selling a business.

We have been told that this is an area which is very important to business because they feel that in too many cases the VAT treatment is unclear. Often this is because a new product or service has been developed and it is felt that current VAT law or HMRC guidance does not apply precisely to it.

Commentators have said HMRC often appears unable or unwilling to provide confirmation of a proposed VAT treatment of a transaction and are as a matter of course referring the business to their published guidance. However, frequently the business or their adviser has written in to ask for a ruling precisely because the guidance is perceived to be incomplete or outdated.

Businesses are concerned as to whether they have to charge tax or not but the main motivating factor we have heard is that if they take the wrong decision, then they can suffer penalties. The nature of VAT, being on a per transaction basis, means that large penalties can quickly accrue and give businesses exposure over a lengthy period.

A number of countries offer rulings so as to provide certainty to businesses. These rulings can be free of charge or on a pay as you go basis. It appears that there is a lot of demand for HMRC to offer this service so it should be considered in more detail. HMRC do offer their 'Clearance' service so we need to understand why this is not meeting business' needs. The possible publication of anonymised rulings should also be explored.

In addition, it has been suggested that if HMRC guidance were improved, perhaps with more examples outlining HMRC's interpretation of the law then the need for rulings would be reduced. We would be interested in any examples of the sorts of amendments to guidance that would result in you not requiring a ruling.

Questions

- What are the areas of the VAT system that most need rulings? Why are these needed – and how many would arise in a year?
- Could an agreed certification procedure between a buyer and seller work for issues such as compliance with TOGC liability rules? How could HMRC be protected against abuse?
- Are there examples of practices in other countries that are particularly worth investigating – or emulating?
- What other routes could be used to achieve the needs of businesses for rulings without setting up a formal system?

7. VAT and Making Tax Digital Alignment Opportunities

We have noted in previous sections a number of areas where HMRC's Making Tax Digital (MTD) plans have implications for VAT, and may also bring opportunities to simplify. This is partly through the requirement for quarterly reporting for businesses, which may mean it is appropriate to re-examine some VAT rules and procedures. HMRC has already shown how the system will allow it to move to a simple interest related surcharge regime.²⁸

The OTS has regular discussions with the MTD project team and MTD is a subject that is regularly raised with us by businesses and advisers, but exactly how it may influence our VAT review will only be clearer as the project evolves and the MTD pilots progress.

There are also other interesting opportunities that we could explore in the context of the infrastructure offered by MTD. Some of the ideas suggested to us are:

- A simple online track-and-trace facility for businesses and agents to see the status of queries without having to call an HMRC official, potentially saving both businesses and HMRC a significant amount of time;
- Allowing for real time VAT returns and payments directly from tills;
- Being able to use a single submission to cover both VAT and the quarterly updates;
- Using an approach similar to the Brazilian system where the tax authority embeds real time reporting software within businesses' accounting software, so that this regular monitoring could offer the potential to do away with some anti-avoidance measures²⁹;
- Removing some paper/postal reporting processes, e.g. documentation relating to importations.

In addition to the simplification that MTD can bring, there are aspects of the existing VAT system that might need simplification in order to be compatible with MTD. For example, would the system cope with partial exemptions, special methods and business/non-business separation? Perhaps more controversially, if MTD reporting is well established, does that call into question some or all of the VAT special accounting schemes?

Questions

We'll be asking four broad questions regarding MTD, expanding on some of the comments mentioned during the first phase of this review:

- What are the areas of the VAT regime that require simplification to be compatible with MTD?
- Does MTD mean that VAT annual accounting and other simplified schemes are redundant?
- What opportunities does MTD offer to further simplify VAT for businesses?
- What can we learn from other countries that have a more digitised VAT system?

²⁸ The current automatic surcharge system, while simple, was seen as unfair and led many to appeal (often successfully). The need for appeal made the process far more complicated than it should have been for many. See HMRC, Making Tax Digital: Tax administration, Summary or responses, 31 January 2017

²⁹ We note that different countries have introduced this sort of system to deal with specific local issues. We are only considering this from the view of providing simplicity for businesses.

8. Further areas for investigation

In addition to the areas outlined above, we invited stakeholders to comment on anything that they thought we had not explicitly mentioned in the terms of reference for this review. In response to their comments we will also consider scope for simplification in the following areas. Both are in many ways cross-cutting in nature.

Sector specific issues

In addition to the complexities outlined in the above chapters, it was also made clear to us that there were a number of sectors that had either changed significantly from when VAT was introduced or simply weren't envisaged at the time. These included:

- **Agriculture** | Many modern farmers now operate a significantly more diversified business than was the case in the 1970s. Much of the reason for this is due to encouragement from national and EU governments. Farmers now come into contact with aspects of the VAT regime that they never came across in the past. The National Farmers' Union (NFU) informed us that partial exemption was the issue raised most often with their specialist tax help centre.
- **Higher education and research** | Universities are now incredibly diverse institutions, often involved in joint research projects with private companies and multinational ventures. Education is in principle exempt from VAT but diversification and modern methods mean it is quite common to find the higher education institution having to deal with TOMS, business/non-business separation, partial exemption, capital goods scheme and more. These issues have an impact on investment decisions within the organisations, with an impact on the quality of research and education produced.
- **Charities** | There is no general relief for charities as the normal VAT rules apply to business supplies made by charities. However, since VAT was introduced into the UK, the legislation has provided a range of special reliefs which do cover many supplies to charities. This includes zero-rating for some supplies to charities and there are some exemptions, zero-rating and other concessions for business supplies made by charities. In addition to our discussions with charities, we have received representations from diverse industries who have said that they find the rules regarding supplies to and by charities to be overly complex to administer. These include, inter alia, motor dealers, construction companies, educational bodies and retailers.
- **Property and construction** | The property market is acutely impacted by issues around the capital goods scheme, option to tax and the time it takes for HMRC to decide whether something is subject to VAT or not (and at what rate). Because each property transaction is unique (rather than a product line of multiple items being created) and the market moves quickly, firms simply are not able to wait for HMRC to make a decision on whether a property should be liable to VAT or not. The construction industry also faces complexity when trying to register for and operate VAT as a joint venture.

There are likely to be several other sectors in a similar situation. We will look to see whether sector specific simplifications may be required, weighing the need carefully against the fact that the introduction of any sector specific solution in itself causes complexity.

HMRC communications

The most common concern in this regard was when HMRC did not appear to be acting reasonably or exercising proportionality in its demands. For example, requiring businesses to go through complicated processes, or not allowing a simple workaround, when it is clear that it would make no difference to

the tax due. Some commenters reflected on their experiences working with other nations that were much more flexible: Belgium, which operates within the same EU parameters as the UK, was most often cited as a country that allowed for time-saving workarounds where it would make no difference to the tax paid. Exercising a sensible amount of flexibility was seen as a useful way to make a complicated system simpler to deal with on the ground.

Another example was when the fines and penalties regime seemed to be heavy handed, requiring an appeal (with all its associated complexity) to reach a more reasonable amount. An example was given where a company miscalculated one column on a spreadsheet of several hundred columns that was produced by an external specialist data contractor. The mistake was raised with HMRC by the client so they could pay any VAT owed but they are now facing a penalty for carelessness. A further example was given of HMRC requesting examples where other companies in a similar position were given a different VAT treatment. The examples were duly supplied but HMRC then responded by saying that they couldn't comment on individual cases, despite having asked for the examples. Several of the stakeholders we met gave examples of when they experienced this behaviour.

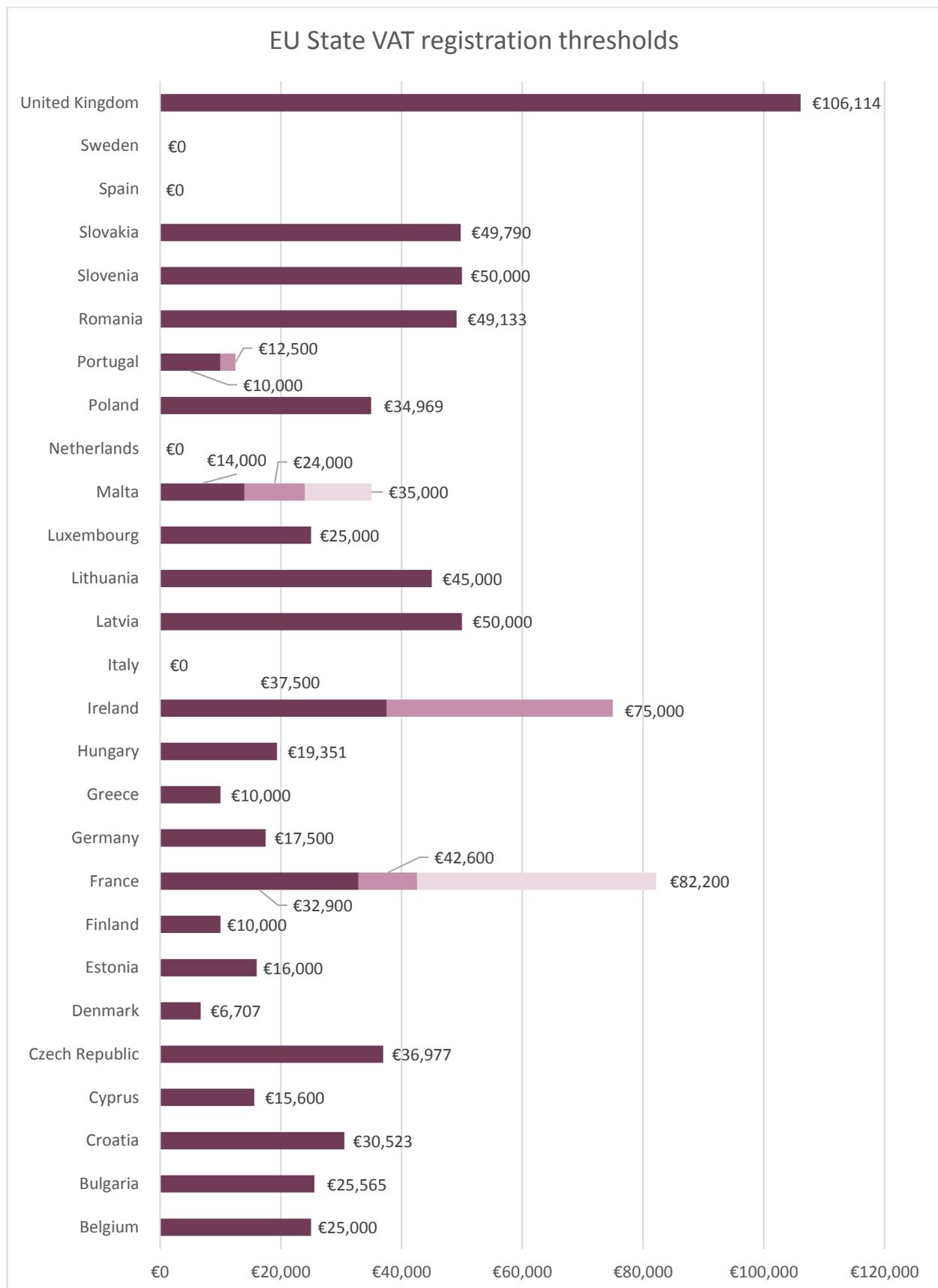
On the other hand, people identified HMRC practices that made VAT much simpler to deal with. For example, people universally spoke positively of the benefits that a good Customer Relationship Manager brought. However, smaller companies were seen to be at a disadvantage because only larger businesses had CRMs. A suggestion was made that large accountancy firms should also be given CRMs, which would provide more consistency when dealing with customers across the board. However this could cause a significant distortionary problem as regards smaller agents.

A suggestion was made that HMRC could look at introducing agent dedicated lines for VAT, as these appear to have worked reasonably well for other taxes. HMRC also attracts praise for the format of the UK VAT return, widely seen as much better and simpler than other countries' returns.

Questions

- Are there other business sectors that have particular VAT issues beyond those we have noted?
- Do you have examples to contribute of good and less good communications issues? Are there ways to improve matters easily?
- Bearing in mind our terms of reference, are there other areas of VAT that we should be investigating?

Annex 1: Comparison of EU VAT registration thresholds (April 2016)



Source: European Commission

Member State	Exemption for small enterprises	
	National currency	Euro equivalent ³⁰
Belgium	€25 000	
Bulgaria	BGN 50 000	€25 565
Croatia	HRK 230 000	€30 523
Czech Republic	CZK 1 000 000	€36 977
Denmark	DKK 50 000	€6 707
Germany	€17 500	
Estonia	€16 000	
Ireland ³¹	€75 000 €37 500	
Greece	€10 000	
Spain	None	
France ³²	€82 200 €42 600 €32 900	
Italy ³³	None	
Cyprus	€15 600	
Latvia	€50 000	
Lithuania	€45 000	
Luxembourg	€25 000	
Hungary	HUF 6 000 000	€19 351
Malta ³⁴	€35 000 €24 000 €14 000	
Netherlands	None	
Austria	€30 000	
Poland	PLN 150 000	€34 969
Portugal	€10 000 €12 500	
Romania ³⁵	RON 220 000	€49 133
Slovenia	€50 000	
Slovakia	€49 790	
Finland	€10 000	
Sweden	None	
United Kingdom ³⁶	GBP 83 000	€106 114

Source: European Commission

³⁰ Equivalent as of April 2016

³¹ €75,000 for goods, €35,000 for services.

³² €82,200 for commercial sales and furnished accommodation, €42,000 for lawyers, writers and artists, and €32,900 for services.

³³ The European commission shows the Italian thresholds to be €25,000, €30,000, €40,000, €45,000 and €50,000, however our research shows that Italy has a €0 threshold.

³⁴ €35,000 for goods, €24,000 for low value services, and €14,000 for all other economic activities.

³⁵ The thresholds are expressed in national currency calculated from the EUR values at the exchange rate on the date of accession, i.e. 1st January 2007.

³⁶ Equates to approximately €97,000 in February 2017 following recent falls in Sterling.

Annex 2. Full list of Questions

We are eager to hear from you about areas where you have a simplification concern. Below is a summary of all the questions asked in the paper. Feel free to comment on as few or as many as you would like.

1. Identifying the implications of the level of the registration threshold

- 1.1. Why are businesses below the VAT threshold registering – how does that 44% break down?
- 1.2. What would be the impact of raising the threshold significantly? With and without the option for voluntary registration?
- 1.3. What would be the impact of reducing the threshold significantly? How would HMRC and businesses who were brought into the VAT net manage?
- 1.4. In both cases what would be the impact on economic activity?
- 1.5. Are there any other approaches that could simplify the regime? Does Making Tax Digital (see below) have an impact?

2. Multiple rates: Causes of complexity?

- 2.1. Where are the categories that most give rise to boundary issues and so complexity for traders?
- 2.2. Why have these difficulties arisen? Is it product development/technological advance or other reasons?
- 2.3. Would it be possible to simplify some of the definitions to allow more leeway for reasonable trade decisions?
- 2.4. If part of the problem is commerce developing faster than the VAT law, how might VAT law best keep up?
- 2.5. What would be the impact of introducing much broader definitions in areas such as food? Would this help or cause more difficulties in practice?
- 2.6. Could Making Tax Digital (see below) be used to resolve complexities associated with types of supply, either on its own or in conjunction with other changes?

3. Partial exemption methodologies, options to tax and capital goods scheme simplification

Partial Exemption

- 3.1. Where does partial exemption arise in practice unexpectedly? What is the impact on the businesses concerned?
- 3.2. Would it be practical to exclude more of these 'accidental' partially exempt businesses in some way? Would that just mean raising the de minimis amounts and changing incidentals guidelines?
- 3.3. What alternative methods would you recommend – or recommend avoiding?
- 3.4. What alternatives or improvements could be put in place to make the process of agreeing a partial exemption special method with HMRC simpler, easier and quicker? Would a flat rate or sector-specific methodology for PE calculations be better than the flexibility of agreeing a bespoke method?

Option to Tax

- 3.5. Could the process of Opting to Tax be simplified? How?
- 3.6. Could a system where, say, all commercial property is considered as opted by default work? Would this cause complexities with awareness?

- 3.7. Could a central database be created? What value would this provide and would that outweigh privacy considerations? Would you be willing to incur the burden of providing data to HMRC to allow such a database to be accurate and up-to-date?
- 3.8. Can the notification process be improved? Does this require confirmation from HMRC?

Capital Goods Scheme (CGS)

- 3.9. What burdens does the CGS create in practice?
- 3.10. Are there examples in practice of the application of the computer strand of CGS? What of ships and aircraft?
- 3.11. Can the aims of CGS be achieved in simpler – possibly more targeted – ways?
- 3.12. As far as land and property is concerned, does the option to tax make a difference or have a part to play?

4. Special Accounting Schemes

Flat Rate Accounting Schemes

- 4.1. Is it possible to reduce the number of different FRS rates?
- 4.2. Will there be a sufficient simplification benefit to require traders to state what scheme they are using on their VAT return?
- 4.3. Is it possible to further increase knowledge of schemes up front when traders first register?
- 4.4. Can measures directed at abuses of the schemes be better targeted? Perhaps by framing eligibility differently?
- 4.5. Overall, do these schemes still work? Is there still a sufficient simplification benefit to justify their retention or would it be simpler just to simplify particular aspects of the general VAT system? Will MTD make them less relevant?

Retail schemes

- 4.6. Do any complexities arise in operating retail schemes?
- 4.7. How common is modern accounting software in the retail sector?
- 4.8. What specific complexities with VAT accounting do the retail schemes help manage?
- 4.9. Would there be a simplification benefit in moving to systems that send information to HMRC straight from the till, as is now in use in some other countries? And would the simplification outweigh any implementation and running costs?

Tour Operators Margin Scheme (TOMS)

- 4.10. What arrangements and transactions are caught in TOMS nowadays? Are these ‘tours’ as envisaged?
- 4.11. Does TOMS still help the sort of tour operators originally targeted?
- 4.12. Can TOMS be simplified to still target the original arrangements but excluding things that should not be in its ambit?
- 4.13. Should TOMS apply to supplies that solely occur in the UK?
- 4.14. What should be done to maintain or increase alignment with international regimes where this offers greater simplicity?

Agricultural flat rate scheme (AFRS)

- 4.15. How widely used is the AFRS and is it still necessary?
- 4.16. What would be the impact of removing this scheme: what sort of businesses would lose out? How much would they lose, bearing in mind administrative costs?

Cash Accounting

- 4.17. Are there any problems with the current VAT cash accounting system?
- 4.18. Does the impact of wider direct tax cash accounting with MTD, with its differing thresholds, cause any difficulties?

Annual Accounting Scheme

- 4.19. How much simplification does the AAS provide in practice? Since its presence adds yet one more scheme for a business to consider, should this be retained at all?
- 4.20. Will the AAS be compatible with Making Tax Digital plans, given quarterly reporting?

5. VAT admin, penalty and appeals processes

Administration

- 5.1. We would be interested in your experience in relation to VAT guidance. Are there particular types of guidance that cause issues? Or issues about accessing guidance?
- 5.2. Would it help if there was a search function or site map for guidance?
- 5.3. Would it be simpler if there was an automatic notification feature for all new and amended guidance that also told you precisely what the amendments were?
- 5.4. What other areas of VAT administration cause complexity? Are VAT repayments a problem in practice?
- 5.5. How could the VAT overpayments regime operate fairly to ensure that only one repayment of the overpaid VAT is made and that it is made to the right person (the person who bore the economic burden)?

Penalties

- 5.6. What are the major concerns with the penalties regime?
- 5.7. How could we provide more clarity regarding the voluntary disclosure regime to encourage more compliance?
- 5.8. Could the penalties system be more like speeding fines, with only exceptional excuses?

Appeals procedure

- 5.9. Would improvements to decision letters help improve understanding about the statutory review process?
- 5.10. Are there areas of complexity with the statutory review process that need addressing? If you don't use statutory review, why not? Is your experience different in the context of other taxes?
- 5.11. Should anything be done to encourage greater use of ADR in VAT?
- 5.12. In general, are there any simple routes to making the dispute resolution process, including the Tribunal stage, less time consuming and costly? Would lowering barriers risk encouraging too many appeals? Could anything be done to make a tribunal less time consuming and costly? And would lowering these barriers help or simply result in more appeals that could congest the system?

6. Formal ruling system

- 6.1. What are the areas of the VAT system that most need rulings? Why are these needed – and how many would arise in a year?
- 6.2. Could an agreed certification procedure between a buyer and seller work for issues such as compliance with TOGC liability rules? How could HMRC be protected against abuse?

- 6.3. Are there examples of practices in other countries that are particularly worth investigating – or emulating?
- 6.4. What other routes could be used to achieve the needs of businesses for rulings without setting up a formal system?

7. VAT and Making Tax Digital Alignment Opportunities

- 7.1. What are the areas of the VAT regime that require simplification to be compatible with MTD?
- 7.2. Does MTD mean that VAT annual accounting and other simplified schemes are redundant?
- 7.3. What opportunities does MTD offer to further simplify VAT for businesses?
- 7.4. What can we learn from other countries that have a more digitised VAT system?

8. Further areas for investigation

- 8.1. Are there other business sectors that have particular VAT issues beyond those we have noted?
- 8.2. Do you have examples to contribute of good and less good communications issues? Are there ways to improve matters easily?
- 8.3. Bearing in mind our terms of reference, are there other areas of VAT that we should be investigating?

Annex 3: List of Contributors

Consultative Committee

It has been the OTS's practice on our previous projects to form small, informal Consultative Committees (CCs), comprising up to 10 members. The role of the CC is to assist us with the direction of the project concerned: to suggest avenues for exploration (including people/groups to meet), to critique our plans, provide practical insights, to debate our findings and to review our ideas and recommendations. The VAT CC has already provided invaluable help and will continue to provide assistance as the project progresses.

We have met with the CC on two occasions during this phase of the review and have received a number of further comments in writing.

Members

- Ian Carpenter
 - Martin Blanche
 - Martin Scammell
 - Neil Gaskell
 - Neil Owen
 - Nick March
 - Roger Bennett
-
- Joanne Cheetham – HMRC
 - Mike Cunningham – HM Treasury

Stakeholder meetings

We conducted 30 meetings with businesses, business groups and tax advisers from around the country. We met with some on more than one occasion and many of these were round table discussions or forum events where views from several organisations were heard. In addition to the meetings we received several written submissions from businesses and individuals. Below is a list of meeting hosts (we apologise to any that we have inadvertently omitted from the list):

Industry

- Association of Accounting Technicians
- British Property Federation
- British Universities Finance Directors Group
- Chartered Institute of Taxation (Indirect Tax Sub-Committee)
- Crunch
- Federation of Small Businesses
- FreeAgent
- FTI Consulting
- Home Builders Federation
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- John Lewis
- KPMG
- National Farmers Union
- Neil Warren
- North West VAT Group
- PFK Littlejohn
- Retail VAT Group
- The Investment Association
- UK 200 Accountants Group
- VAT in Industry Group
- VPG East Anglia
- VPG East Midlands
- VPG Finsbury
- VPG North of England
- VPG Policy
- VPG Scotland
- VPG Severn
- VPG South Coast
- VPG Southern
- VPG West End

Government Departments

In addition to our meetings with industry experts, we have also met with several teams from Government departments:

- Department for Business Energy and Industrial Strategy
- HM Treasury
- HM Revenue and Customs