

# OTS evaluation update on its Value added tax report

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## Introduction

- 1.1 The Office of Tax Simplification (OTS) is the independent adviser to government on simplifying the UK tax system. The work of the OTS is rooted in improving the experience of all who interact with tax. The OTS aims to improve the administrative process – which is what people actually encounter in practice – as well as simplifying the rules. These are often of equal importance to taxpayers and HM Revenue & Customs.
- 1.2 The 2018-19 OTS Annual Report<sup>1</sup> noted that ‘the impact of our work is felt in a variety of ways, both through formal responses to our work, action taken on our recommendations, an enhanced (we hope) quality of informed public debate and a more pervading influence in government.’ That report also committed the OTS to ‘review the impact of our more significant recent reports’.
- 1.3 This evaluation update is the first of what is envisaged as an occasional series of publications issued by the OTS to help do that, which will:
  - keep stakeholders and the wider public up to date, highlight progress made and the OTS’s contribution to it
  - continue to raise the profile of tax simplification, enabling more informed public debate
  - provide an opportunity to flag up specific recommendations for refreshed consideration or more focused action, where appropriate, and to indicate areas in which the OTS could potentially do further work in the future
- 1.4 This paper outlines and evaluates responses by the government, HM Treasury (HMT) and HM Revenue & Customs (HMRC) to the OTS’s VAT review: *Value added tax: routes to simplification*.<sup>2</sup>

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<sup>1</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/817692/OTS\\_Annual\\_Report\\_2018-19\\_-\\_web\\_copy.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/817692/OTS_Annual_Report_2018-19_-_web_copy.pdf)

<sup>2</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/657213/Value\\_added\\_tax\\_routes\\_to\\_simplification\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/657213/Value_added_tax_routes_to_simplification_web.pdf)

## The original recommendations

- 1.5 The OTS's VAT review was requested by the Chancellor at the 2016 Autumn Statement,<sup>3</sup> following discussions between HMT and the OTS to help focus the review on those areas where the OTS could most improve the experience of people interacting with this tax.
- 1.6 The report was published in November 2017 and contained eight main and fifteen additional recommendations, across three main areas. The Chancellor responded later in the month.<sup>4</sup>
- 1.7 The first area concerned the level of turnover above which a business is required to register for VAT, known as the VAT threshold.
- 1.8 At £85,000 the UK has the highest threshold in the EU and the data and anecdotal evidence in the report showed that the threshold distorts behaviour by creating a significant cliff edge. This results in a bunching effect just below the £85,000 turnover level, rather than the smoother pattern one would otherwise expect.
- 1.9 Secondly, the report looked at administration of VAT, and proposed a range of measures which could be implemented in the short term to ease friction points in the system.
- 1.10 Thirdly, a variety of technical areas were considered which had been long standing irritants to users of the system and where there was a significant potential for simplification in either the short, medium or longer term. These included multiple rates; partial exemption; the capital goods scheme; the option to tax land and buildings and special accounting schemes.

## Actions to date

- 1.11 Since the report was published, the OTS has kept in touch with HMT and HMRC in relation to their work on considering and, where appropriate, implementing the recommendations. The OTS would like to thank HMT and HMRC for their ongoing engagement.
- 1.12 The OTS is pleased to note substantial progress on guidance and communication, partial exemption and the capital goods scheme, and penalties, alongside wider ongoing consideration of the approach to the VAT threshold.
- 1.13 The OTS will continue to monitor future developments and may provide a further review on progress at a later date. The OTS recognises that government will need to consider a range of factors such as exchequer and distributional impacts, alongside simplicity in considering policy change.

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<sup>3</sup> <https://www.gov.uk/government/publications/autumn-statement-2016-documents/autumn-statement-2016>

<sup>4</sup> <https://www.gov.uk/government/publications/letter-from-the-chancellor-to-the-office-of-tax-simplification-ots>

## Changes under way

### Partial Exemption and Capital Goods Scheme (recommendations 5, 6, 7, 19 and 20)

- 1.14 The OTS highlighted that the time and administration required to operate the Partial Exemption and Capital Goods Scheme processes can be disproportionate to what are often relatively small adjustments, and that the Partial Exemption de minimis had not been increased in decades.
- 1.15 Accordingly, the OTS recommended that the government should consider increasing the de minimis limits and simplify the complex calculations and categories.
- 1.16 The OTS was pleased that in July 2019 the government published a formal consultation, *Call for evidence: simplification of partial exemption and the Capital Goods Scheme*<sup>5</sup> and look forward to seeing how this may enable the challenges the OTS identified to be tackled.

### Penalties (recommendations 3 and 11)

- 1.17 Businesses and their advisers told the OTS that they were concerned about the administrative costs and uncertainty relating to penalties for inaccuracies, even when they are voluntarily disclosed. The OTS recommended that HMRC should review these penalties, and those relating to the suspended penalty regime.
- 1.18 The OTS is pleased that in the short term HMRC has committed to look for ways to streamline operational processes to help reduce administrative costs and uncertainty, although we understand that legislative change would have to be a longer-term objective.
- 1.19 The government is committed to reforming late submission and late payment penalties and has consulted extensively on this. Further penalty review including inaccuracy penalties is for the longer term and will be considered alongside HMRC's ongoing commitment to consider options for reviewing and updating the tax administration framework, to ensure that it is effective in underpinning modern tax administration.
- 1.20 The OTS understands that its work is also informing work within HMRC on potential proposals relating to penalties when voluntary disclosures are made, and penalties suspended.

### HMRC processes (recommendations 12, 13, 14, 15, 22 and 23)

- 1.21 The OTS identified several areas of VAT where the administration could be significantly improved at relatively little cost to HMRC. These included
- HMRC considering ways in which statutory review teams can deepen engagement with business and adviser groups
  - HMRC introducing electronic C79 import certificates
  - the VAT recovery process by overseas businesses being digitised

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<sup>5</sup> <https://www.gov.uk/government/consultations/call-for-evidence-simplification-of-partial-exemption-and-the-capital-goods-scheme>

- 1.22 The OTS is pleased that HMRC have reformed their processes by increasing the range of circumstances in which Alternative Dispute Resolution may be offered and changing the functionality of the Customs Declaration Service computer system to ensure that all importers will receive Digital C79s.
- 1.23 Similarly, the development of a more accessible interactive claim form for the DIY House Builder Scheme is understood to be nearing completion, though consideration of the wider recommendation on VAT recovery of professional fees is not understood to be a government priority at present.
- 1.24 HMRC considered Making Tax Digital as a possible solution for digitising VAT recoveries for overseas businesses, and while it could still offer a digital avenue to achieve this objective in the future, existing priorities means that it is not currently in scope.

### Guidance and communication (recommendations 2, 9, 10 and 17)

- 1.25 The OTS recommended that HMRC should maintain a programme for improving the clarity of its VAT guidance, covering a range of areas including HMRC's:
- responsiveness to requests for rulings in areas of uncertainty
  - targets for updating guidance promptly when it becomes out of date
  - approach to tracking online guidance
  - provision of support to other parts of government
- 1.26 The OTS reported on guidance issues more widely in its separate review on HMRC guidance, *Guidance for taxpayers: a vision for the future*, published in October 2018.<sup>6</sup>
- 1.27 The OTS is pleased to be able to report that HMRC has responded proactively and constructively to its VAT guidance and communications recommendations.
- 1.28 In particular, HMRC is undertaking a review of all of its published notices and manuals to ensure that they are clear and up to date, starting with VAT. HMRC have also made some improvements relating to circular loops in the guidance to help improve its quality.

## Ongoing work

### VAT registration threshold (recommendation 1)

- 1.29 The most significant of the main recommendations was for the government to examine the level and design of the VAT registration threshold, with a view to setting out the future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism. This could address the distortionary impact of a relatively high threshold on business growth and activity.

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<sup>6</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/746076/OTS\\_Guidance\\_for\\_taxpayers\\_041018.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/746076/OTS_Guidance_for_taxpayers_041018.pdf)

- 1.30 The OTS was encouraged that the government gave these issues serious consideration in HMT's VAT registration threshold consultation of 2018.<sup>7</sup> Following this, the government committed to monitor and evaluate the design of the threshold and simplification schemes, and look again at the possibility of introducing a smoothing mechanism once the terms of EU exit are clear.
- 1.31 The OTS looks forward to this issue being considered further in due course, while recognising that making material changes in this area would have fiscal implications, and that a smoothing mechanism would carry risk of additional complexity and administrative implications.

#### VAT and the Public Sector (recommendation 16)

- 1.32 The OTS notes that in the Spring Statement 2019, the government announced that a policy paper on VAT Simplification and the public sector would be published.

#### Reduced rates (recommendations 4 and 18)

- 1.33 The OTS also recommended that HM Treasury and HMRC undertake a comprehensive review of the reduced rate, zero-rate exemption schedules, including the possibility of listing zero-rated goods by reference to their customs code.
- 1.34 It has now become clear that EU Member States may in future be given greater flexibility about using different rates of VAT. The OTS understands that any changes will need to be considered once the terms of EU Exit are clear.
- 1.35 The OTS looks forward to this issue being considered further in due course, while recognising that making changes to the VAT base would have fiscal, distributional, and administrative implications.

#### Tour Operators Margin Scheme (recommendation 21)

- 1.36 The recommendation made by the OTS for increasing the Tour Operators Margin Scheme (TOMS) de minimis limit, and removing meetings, incentives, conferences and exhibitions (MICE) businesses from TOMS, is considered by HMRC to be a post EU Exit issue.

#### Options to tax (recommendation 8)

- 1.37 The OTS recommended that HMRC review the current record keeping and audit trail requirements for options to tax, and the extent to which they could be made on-line.
- 1.38 The OTS understands that there is potential to facilitate this through HMRC's work on Making Tax Digital and the Enterprise Tax Management Platform. However, it is not yet known whether or when this will be possible given the range of HMRC's other commitments.

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<sup>7</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752042/VAT\\_Threshold\\_Call\\_for\\_Evidence\\_Summary\\_of\\_Responses\\_digicomms.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752042/VAT_Threshold_Call_for_Evidence_Summary_of_Responses_digicomms.pdf)