Office of
Tax Simplification

Value added tax: routes to simplification

November 2017

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Foreword

VAT is the third largest source of tax revenue collected by HMRC, after income tax and National Insurance Contributions. £120bn of VAT was collected in 2016-17, which was 22.5% of all taxes.

This is the first Office of Tax Simplification review to focus specifically on VAT. It takes a high-level look at areas where simplification of either law or administration would be worthwhile.

Unlike income taxes, the VAT system is largely prescribed by European Union rules, so Brexit may present an opportunity to consider areas which could be clarified, simplified, or just made easier. It is not clear at present how Brexit will unfold so this review does not embrace aspects of the VAT system which are part of the Brexit negotiations, such as financial services, or focus specifically on cross-border trade.

The dominant issue that has come out of this review is the level of turnover above which a business is required to pay VAT, known as the VAT threshold. At £85,000, the UK has the highest VAT threshold in the EU, where the average is £20,000, and the highest general threshold in the OECD.

The data and anecdotal evidence considered in this review clearly shows that the threshold distorts behaviour by creating a significant cliff-edge, resulting in a bunching effect just below the £85,000 turnover level, rather than the smoother pattern one would otherwise expect.

The threshold is therefore presenting a significant disincentive to maximising the potential growth of some businesses and, considering the numbers involved, this is likely to adversely impact economic growth.

This problem appears more acute in the UK than in other EU countries because of the high level of the UK registration threshold. Indeed, the OTS has often been told that some businesses take steps to reduce the level of their business activity to avoid crossing the threshold.

In this context, this report considers a broad range of options for reform, in particular setting out the impact of either raising or lowering the threshold. For example, lowering the threshold might create less drag on economic growth but would bring a larger number of businesses into the VAT system. On the other hand, a higher threshold could also result in less distortion but it would clearly raise less tax. Importantly, however, this report also explores other ways to address the bunching issue, whatever the level of the threshold, including smoothing the cliff-edge.

The VAT threshold though, is not the only issue covered in this report. The OTS has also taken a thorough look at the administration of VAT, and proposes a range of measures which could be implemented in the relatively short term to ease friction points in the system.

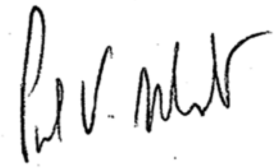
Finally, a number of technical areas are considered which have been long-standing irritants to users of the system and where there is significant potential for simplification in either the short or longer term. These areas include: multiple rates; partial exemption; the capital goods scheme; the option to tax land and buildings; and special accounting schemes.

In undertaking this work the OTS has encountered a range of the extraordinary anomalies in VAT. For example, many will remember the debates involved in determining that a Jaffa Cake is a cake (zero-rated for VAT) rather than a chocolate-covered biscuit (taxable). Every day when using a fast food outlet, you will be asked if you are ‘eating in’(liable to the standard rate of

VAT) or 'out' (when no VAT is due), on exactly the same sandwich. Even more mystifying, a gingerbread man with chocolate-covered trousers is subject to VAT, but not if it has chocolate eyes. This report highlights more examples from the curious list of what is VAT-able and what is not.

The OTS would like to thank the diverse and experienced team who have worked on this review, led by Nigel Mellor and Eileen Rafferty. We've benefitted greatly from the contributions of Ruth Corkin and Richard Dowling (seconded to us by Grant Thornton and HMRC respectively). The work has been guided by Head of Office David Halsey and, until the publication of the interim report in February 2017, by Aaron Yamoah and former OTS Tax Director John Whiting. We are also particularly grateful to HMT and HMRC colleagues, our Consultative Committee members and many others who have willingly given ideas, challenge and support.

Angela Knight CBE



Paul Morton

Executive summary

Overview

Value Added Tax (VAT) was introduced to the United Kingdom on 1 April 1973 in conjunction with the UK's entry into what is now the European Union.

Almost exactly a year before, the then Chancellor of the Exchequer, Anthony Barber, told the House of Commons that "One of the great benefits of VAT is that it is a broadly-based tax which will avoid some of the ridiculous anomalies that were part of the purchase tax system" (which pre-dated VAT) and that he was determined to have "the simplest VAT in Europe".

Over the last 45 years, the relevant legislation has grown so that it is now spread across 42 Acts of Parliament and 132 statutory instruments,[1] while still retaining some of the complexities of the pre-1973 UK purchase tax system.

This review by the OTS, of a tax which annually raises around £120bn, is the first wide-ranging simplification review of the VAT system conducted in the UK[2] and considers in particular:

- The issues and impacts involved if the VAT registration threshold were either higher or lower than at present
- Administrative changes which could help businesses, advisers and HMRC better achieve their common aim of easing friction points in the system
- The extent to which the definitions of the types of supply which are currently relieved from VAT create complexity for businesses and administration

In carrying out this work the OTS has borne in mind the OECD principles for a good VAT system of neutrality, efficiency, simplicity and certainty, effectiveness and fairness, and flexibility. Although these broad principles were designed to apply to the taxation of electronic commerce, they are generally accepted as applying to consumption taxes as well. In fact, the OECD has very recently re-published these principles as being the benchmark for good practice. [3]

Main Findings

The OTS makes 23 recommendations in this report across key areas of VAT, which are set out in the tables at the end of this Executive Summary:

- 8 core recommendations, which are the most significant and are set out in the Executive Summary
- 15 additional administrative and technical recommendations, included in the chapters which follow, which could also make a useful contribution to users

[1] As at October 2016, per the 2016-17 edition of the Tolley's Orange Tax Handbook.
[2] The Mirrlees Review (Mirrlees et al, Tax By Design: Oxford University Press, Oxford, 2011) considered the VAT system as part of a comprehensive review of taxation in the UK.
[3] OECD (2017) International VAT/GST Guidelines, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en page 20, originally the Ottawa Taxation Framework Conditions of 1998

The report also indicates which recommendations could be progressed in the short term (1 year), medium term (2 to 5 years) or long term (5+ years). Where appropriate, those recommendations which could not be implemented under present EU law are identified.

In the short term, there are opportunities to bring about some highly desirable simplifications in the administration of the system (chapter 2). Many of these should be relatively easy to progress, with some requiring no legislation while others might require only relatively minor legislation. It is reasonable therefore to expect that they could be achievable in the relatively short term.

For the medium term, areas where more substantial primary or secondary legislation may be necessary, or where further work by HMT or HMRC is required, are identified. For the longer-term recommendations, it is difficult to judge the legislative requirements at this stage.

The VAT Registration Threshold

The UK's £85,000 VAT registration threshold is the highest threshold in both the EU,[4] where the average is £20,000, and the highest general threshold in the OECD.[5]

The UK's high threshold is often itself seen as a tax simplification measure, as most businesses can operate without needing to be registered for VAT – for example many largely labour-based business owners are content to operate on the basis of a turnover below the threshold.

However, there is clear evidence, from academic analysis of HMRC data and from submissions to this review, that the high level of the threshold is having a distortionary impact on business growth and activity.

Bunching

There is currently significant 'bunching' of businesses whose turnover is just below the threshold (see Chart 1), particularly businesses with lower levels of inputs relative to supplies to consumers - such as labour-intensive businesses, and businesses operated by sole proprietors - for whom this bunching effect has the appearance of a cliff edge.[6]

The bunching in front of the threshold and the very significant fall-off in business numbers immediately after it, reflects the significance to a business of crossing the threshold, as when this happens all a businesses' supplies to customers potentially increase in sale price by up to 20%.

For example, compare a business with a turnover of £84,000 which is not registered for VAT with a VAT-registered business having a turnover of £85,000. If VAT applied to the whole of the turnover, the VAT-registered business would be liable for an additional £17,000[7]).

Evidently, many businesses will not be able to pass this increase on to customers, especially when competing with unregistered businesses. Meanwhile, others fear the administrative impact of VAT registration.

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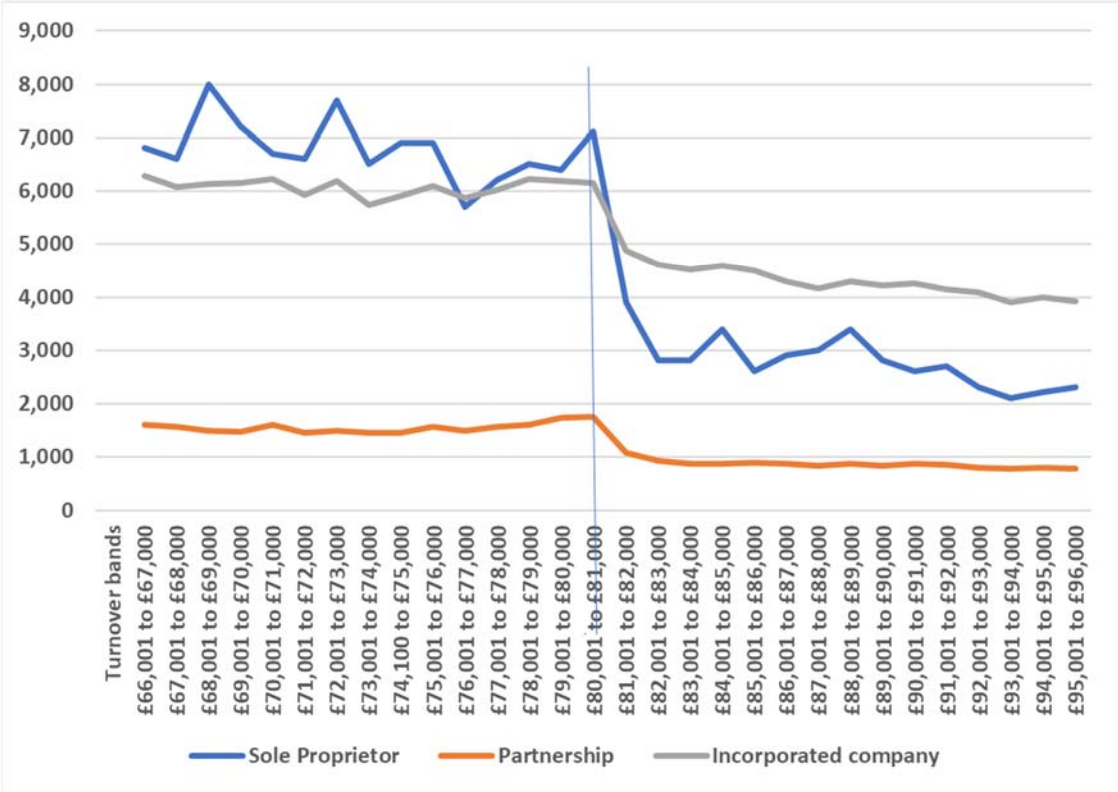
[4] Where the UK threshold is twice the level of that in any other EU country – except for some types of business in France (commercial sales and furnished accommodation) and Ireland (goods) – see Annex D

[5] http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/consumption-tax-trends-2016_ctt-2016-en#page91

[6] The term 'sole proprietor', in this context, refers to unincorporated businesses other than partnerships. These may have one or more employees.

[7] (85,000 x 20% = 17,000). In practice the net figure is likely to be less (in some cases significantly less) as the newly-registered business will be able to recover VAT on its purchases, which it was unable to do before registration.

Chart 1: Numbers of entities by turnover band around the registration threshold



Source: HMRC data from 2014/15, when the threshold was £81,000[8]

Bunching arises from two main factors. Firstly, some businesses limit expansion – for example by not taking on an extra employee, or an extra contract, or closing their doors for a period, to keep their turnover below the threshold. This is an entirely legal practice. Second, some businesses deliberately suppress their recorded takings and then report a turnover below the threshold. This practice is illegal.

More broadly, the fact that many taxpayers are spending time considering these issues and the impact on their business, and adapting their behaviour to avoid either the economic or administrative consequences of entering the VAT system, is itself an undesirable complexity in terms of the 'user experience' of VAT as well as being potentially economically distortive.

Increasing or reducing the threshold

In this report, the OTS has considered the impact of either raising or lowering the threshold, both by small or larger amounts.[9]

[8] The partnership and incorporated figures are an analysis of 100% of relevant data. The sole proprietors figure is based on a sample of taxpayers from the survey of personal incomes (SPI), grossed to represent the full Self-Assessment population. This means that unlike the other two series in the chart, the Sole Proprietor series is affected by sampling variability. A consequence of this is that it is not as smooth across the income bands as it would be if it were based on 100% data.

[9] Our understanding is that EU law might permit a lowered threshold but may not currently allow for a significant increase or the introduction of a new graduated tax relief.

Smaller changes to the threshold

Freezing the threshold is one option. If the government had maintained the existing threshold in 2017/18 (rather than increasing it in line with inflation as has become the norm) 4,000 extra business would potentially have been required to register in that year, with an increase in revenue to the public purse of approximately £10m and a consequent increase in the administrative costs of those businesses. (If the freeze were continued into future years the numbers brought into VAT and the revenues involved would continue to grow.)

Reducing the threshold a little would mean that a few thousand additional businesses would be required to register, increasing their tax compliance costs.

Either freezing or slightly reducing the threshold would have limited impact on competitive distortions however, because only a small number of businesses would be affected relative to the overall UK business population, and the behavioural consequence might only be to shift the point at which bunching occurs.

Increasing the threshold by a small amount – say £2,000 - would mean that approximately 12-15,000 fewer businesses would be required to register. This would produce some administrative savings for those businesses, but again have limited impact on competitive distortions. Tax revenue would be reduced by between £30-50 million in the first year, increasing over time.[10] As with small reductions, the behavioural consequence might only be to shift the point where bunching occurs.

However, the revenue and administrative impacts would, clearly, be greater if the threshold were raised or lowered by a more substantial amount.

Significant changes to the threshold

Raising the threshold significantly, for example to £500,000,[11] would potentially impact around 800,000 businesses. Of those, between 400,000 and 600,000 businesses might choose to deregister, while 200,000-400,000 might choose to remain voluntarily registered.[12] This would simplify the tax obligations for businesses that chose to deregister, reduce VAT-related competitive distortions between registered and unregistered small businesses, and reduce the administrative burden on those businesses.

However, raising the threshold to such a high level would cut the funds available for public services by between £3bn and £6bn a year. It would also have potential behavioural consequences. For example, the presence of many more unregistered businesses in the marketplace could well encourage some of them to operate in the hidden economy, reducing their compliance with - and payment of - other taxes. Competitive distortions would also be shifted upwards so medium-sized businesses would be in competition with many more unregistered businesses in total, some of which would be of substantial size.

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[10] Note that these figures reflect the current bunching effect which might be expected to shift as the threshold moved.

[11] This is approximately the registration threshold in Singapore (1 million Singapore $). Singapore is an example of one of the highest VAT registration limits globally. This figure is used for illustrative purposes only.

[12] These numbers are based on an analysis of VAT returns between the threshold and £500,000, and include assumptions about the percentage of businesses within each trade sector making supplies to other businesses or otherwise likely to benefit from being registered. The calculation assumes that such businesses would wish to remain voluntarily registered.

Reducing the threshold from £85,000 to £43,000 (for example) would impact between 400,000 and 600,000 businesses.[13] This would reduce the unregistered business population and competitive distortions, and make it harder for businesses seeking to evade VAT to remain undiscovered. It would also raise between £1bn and £1.5bn a year.

However, it would increase compliance costs for a large number of businesses and involve additional costs for HMRC in managing this increased population of registered businesses.

It should be noted that significant changes to the VAT threshold would have implications going much wider than the simplification of VAT, including impacts on economic growth and productivity, on pricing, and the impact of VAT on those in different income brackets.

Potential smoothing mechanisms

Given that any threshold creates an incentive to operate below it, the OTS has also considered ways in which the distortive effect of a threshold might be reduced by introducing some form of smoothing mechanism.

Options considered included:[14]

- smoothing the cash impact of becoming registered
- smoothing the administrative impact
- smoothing both cash and administration
- a time-limited reduction in the VAT Flat Rate Scheme rate for newly-registered businesses and a financial taper

Any such mechanism could be considered to increase the overall complexity of the system, but it could also offer businesses a way to pass more easily across the threshold and as a result have a positive impact on economic growth and productivity.

Developing a workable mechanism that balances the risk of fraud, revenue loss and potential complexity against the benefits of smoothing entry to the VAT system and reducing business burdens is challenging, but the OTS considers there is merit in examining this for the future.

Recommendation 1: The government should examine the current approach to the level and design of the VAT registration threshold, with a view to setting out a future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism.

VAT administration including guidance, rulings, penalties and appeals

Practical administrative issues are often the most important to users of the tax system and many contributors identified areas where improvements could make life easier for businesses.

Guidance and rulings

Businesses benefit from certainty when making decisions about the VAT treatment of goods and services they supply, and/or when dealing with one-off events such as a complex restructuring. If

[13] £43,000 was the starting point for higher rate income tax when this report was prepared – it is used here for illustrative purposes only.
[14] Our understanding is that many of these would not be possible under present EU law.

they get the VAT treatment wrong, then they and their customers may be exposed to additional costs.

A range of concerns were raised about the comprehensiveness of parts of HMRC guidance and its response to requests for rulings. In particular, this includes cases where HMRC has referred taxpayers back to the guidance that they have already found to be insufficient.

Recommendation 2: HMRC should maintain a programme for further improving the clarity of its guidance and its responsiveness to requests for rulings in areas of uncertainty.

Penalties

Errors can occur even in the best-managed businesses. HMRC recognises this and encourages businesses to voluntarily disclose errors found. The current voluntary disclosure procedures allow for small inaccuracies to be adjusted on a subsequent return by the business.

Although small inaccuracies can be adjusted in this way, businesses are still required to notify HMRC about the inaccuracy for penalty consideration purposes even though very few such voluntary disclosures lead to a penalty in practice. This was identified by many businesses as creating uncertainty.

Recommendation 3: HMRC should consider ways of reducing the uncertainty and administrative costs for business relating to potential penalties when inaccuracies are voluntarily disclosed.

Multiple rates

Goods or services are standard rated by default. The law then provides various exceptions under which goods and services may be subject to a reduced rate or zero-rated, or may be exempt from VAT. Certain sectors, for example charities, may also have non-business income which is outside the scope of the tax.

These VAT rates, their scope and any changes to them, are limited to an extent by the framework of EU law, at least for as long as the UK remains within the EU. Although the UK can replace reduced or zero rates with the standard rate, it is not able to enlarge the scope of those lower rates outside of EU law, and if any supplies are removed from the scope of zero rates this treatment could not then be reinstated.

The boundaries between these treatments are often a cause of complexity, and are administratively burdensome. The scale of this is now such that the OTS considers that it is time for a comprehensive review of these issues. This should be aimed at simplifying the rates structure, and considering ways to frame them so they can better adapt to changes in government objectives, the market and technology. Such work will also provide a useful basis for the consideration of potential approaches in this area post Brexit.

Recommendation 4: HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS.

Partial exemption

VAT on expenses used in making taxable supplies can be recovered, while VAT used in making exempt supplies generally cannot. Businesses that are partially exempt, that is, which make both taxable and exempt supplies, need to calculate how much tax they can recover.

The partial exemption regime has evolved over 40 years and is now capturing many businesses that would not originally have been affected by it. This is mainly because de minimis limits, intended to ensure smaller businesses did not find themselves with small amounts of irrecoverable input tax, have not been increased for decades.[15]

In addition, businesses that need HMRC approval for a method for calculating how much tax they can recover have expressed significant concerns about the time required – sometimes up to two years – to obtain approval of proposed methods.

Recommendation 5: The government should consider increasing the partial exemption de minimis limits in line with inflation, and explore alternative ways of removing the need for businesses incurring insignificant amounts of input tax to carry out partial exemption calculations.

Recommendation 6: HMRC should consider further ways to simplify partial exemption calculations and to improve the process of making and agreeing special method applications.

Capital Goods Scheme

Input tax recovery is generally determined by the use to which the expenditure is to be put at the time it is incurred. The Capital Goods Scheme (CGS) aims to ensure that input tax recovery on major items of expenditure reflects the use of an asset for taxable or exempt purposes over time, by calculating a recovery percentage once a year.

The assets that fall within the CGS are:

- land, buildings and civil engineering work costing £250,000 or more
- computers and computer equipment costing £50,000 or more
- aircraft, ships, boats or other vessels costing £50,000 or more

Each year after the purchase or first use of the asset, the business must consider whether the proportions of its taxable and exempt use have changed.

Take, for example, a business that purchases a building and intends to use it for the purposes of its fully taxable activities. On this basis, the business is entitled to fully recover the input tax that it has incurred. After a few years, the business changes and it decides to lease part of the building to another business. In the absence of an option to tax, the leasing activity would give rise to an exempt supply. At this point, the business has potentially over-claimed the input tax that it has incurred.

The CGS acts as a means of remedying this. It operates over a period of 5 years (for computers, boats and aircraft) or 10 years (for land and property).

However, there are several issues with the scheme. The first is that the threshold for land and buildings has not been raised since the introduction of the CGS in 1990, with the result that many more transactions are now in the scheme than was originally anticipated. In addition, the scheme also includes extensions and refurbishment of existing buildings, so some taxpayers have multiple CGS calculations running for varying amounts of time. The time and administration required for relatively small adjustments is significant for business.

[15] Currently, input tax attributable to exempt supplies is fully recoverable when it is less than £625 per month on average and less than 50% of the total input tax incurred in the period.

Another issue is that the threshold for computers was introduced at a time when single items of computer equipment were of high value. Changes in technology and the value of computer systems means that it is now rare for a single piece of equipment to breach the threshold.

Recommendation 7: **The government should consider whether capital goods scheme categories other than for land and property are needed, and review the land and property threshold.**

Option to tax

Supplies of commercial land and buildings (other than of those less than three years old) are by default exempt from VAT. The option to tax provides businesses with the ability to change what would otherwise be an exempt supply of commercial land or buildings to a taxable supply, thus enabling input tax recovery on costs associated with that supply.

Opting to tax is a relatively simple process, but it can take some time for HMRC to acknowledge receipt of the option. Businesses sometimes believe an option is automatically in place if the owner or previous owner has opted, not realising that each person has to make their own decision to opt their interest in the land or buildings. As there is no universal record of who has opted in relation to what property interests, uncertainty about whether a piece of land or a building has been opted[16] can cause difficulties when the land or building is being sold.

Recommendation 8: **HMRC should review the current requirements for record keeping and the audit trail for options to tax, and the extent to which this might be handled on-line.**

Brexit

The terms of reference for this review stated that it would not:

"…focus on issues 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 VAT rules. However, it will actively bear the Brexit context in mind in looking at opportunities to simplify VAT for the future."

It is too early at this stage of the Brexit process to gauge the extent or timing of its impact on VAT. However, in the longer term, Brexit may offer opportunities to consider areas that might otherwise have been difficult to simplify.

Some respondents made the case for including VAT on financial services within the scope of this report. However, the OTS considers the simplification of this important part of the VAT system would be better dealt with once the shape of Brexit negotiations and the legislative implications of Brexit become clearer, and the resulting pressure on parliamentary time eases.

Consultation process

This report is based on work carried out by the OTS from October 2016 to August 2017. It includes feedback from an extensive set of meetings with businesses and advisers, both individually and in groups. The OTS has also spoken to a wide range of policy teams in both HMRC and HM Treasury (HMT), and front-line staff in HMRC.

[16] Land or buildings which are subject to an option to tax are customarily described as "opted".

The OTS has found real enthusiasm both from business and advisers for the review, and from officials in HMRC and HMT, who all shared a real awareness of the burdens on business the VAT system can impose as well as the challenges for HMRC.

The report has been informed by views we've heard and the OTS's own research into tax legislation, tax policy and administrative processes. It also draws upon the knowledge of OTS staff, who collectively have many years' experience in government, business and tax advisory work. The work has also benefitted greatly from the knowledge, experience and wisdom of our Consultative Committee members (listed in Annex B).

Table A: Core recommendations

	Recommendation	Short	Medium	Long term
	Threshold			
1	The government should examine the current approach to the level and design of the VAT registration threshold, with a view to setting out a future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism.	✓	✓	
	Administration			
2	HMRC should maintain a programme for further improving the clarity of its guidance and its responsiveness to requests for rulings in areas of uncertainty.	✓		
3	HMRC should consider ways of reducing the uncertainty and administrative costs for business relating to potential penalties when inaccuracies are voluntarily disclosed.		✓	
	Multiple rates			
4	HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS.		✓	✓
	Partial exemption, capital goods and option to tax			
5	The government should consider increasing the partial exemption de minimis limits in line with inflation, and explore alternative ways of removing the need for businesses incurring insignificant amounts of input tax to carry out partial exemption calculations.	✓		
6	HMRC should consider further ways to simplify partial exemption calculations and to improve the process of making and agreeing special method applications.	✓		
7	The government should consider whether capital goods scheme categories other than for land and property are needed, and review the land and property threshold.	✓		
8	HMRC should review the current requirements for record keeping and the audit trail for options to tax, and the extent to which this might be handled on-line.		✓	

Table B: Additional recommendations

	Recommendation	Short	Medium	Long term
	Administration			
9	HMRC should establish a target to update guidance within a short, defined, period after a legal change or new policy takes effect.	✓		
10	HMRC should explore ways to improve online guidance, making all current information accessible, and to gauge how often queries are answered by online guidance.	✓		
11	HMRC should review options to reduce the uncertainty caused by the suspended penalty rules.	✓		
12	HMRC should draw greater attention to the facility for extending statutory review and appeal time limits to enable local discussions to take place where appropriate.	✓		
13	HMRC should consider ways in which statutory review teams can deepen engagement with business and adviser groups to increase confidence in the process, and for providing greater clarity about the availability and costs of alternative dispute resolution.	✓		
14	HMRC should consider introducing electronic C79 import certificates.		✓	
15	HMRC should consider options to streamline communications with businesses, including the process for making payments to non-established taxable persons.	✓		
16	HMRC should looks at ways of enhancing its support to other parts of government (for example, in guidance) on VAT issues affecting their operations.	✓		
17	HMRC should review its process for engaging with business and VAT practitioner groups to see if representation and effectiveness can be enhanced.	✓		
	Multiple rates			
18	HMRC should explore the possibility of listing zero-rated and reduced rate goods by reference to their customs code, drawing on the experience of other countries.		✓	✓
	Partial Exemption			
19	HMRC should consider ways of ensuring partial exemption special methods are kept up to date, such as giving them a limited lifespan.	✓		
	Capital Goods Scheme			
20	The government should consider introducing a de minimis level for capital goods scheme adjustments to minimise administrative burdens.		✓	
	Special Accounting Schemes			
21	The government should consider the potential for increasing the TOMS de minimis limit and removing MICE businesses from TOMS.		✓	

22	HMRC should consider updating the DIY House builder scheme to include clearer and more accessible guidance, increased time limits and recovery of VAT on professional services.	✓
23	HMRC should consider digitising the process for the recovery of VAT by overseas businesses not registered in the UK.	✓

1 The VAT registration threshold

1.1 In this review, the OTS was asked to look particularly closely at the issues that would arise if the VAT registration threshold were to be either higher or lower than it is at present.

1.2 At £85,000, the UK has the highest general VAT registration threshold in the EU[1] and the OECD[2] and far above the global average of around £15,000.

1.3 The VAT registration threshold has typically been increased on an annual basis in line with inflation. Maintaining such a high threshold means that it has often been seen as a simplification measure, since most businesses do not need to be registered for VAT, keep VAT accounting records or file VAT returns.[3]

1.4 Many small businesses, especially labour-only businesses, are felt to deliver sufficient income from a turnover below the threshold, and for some this is built into their business model.

1.5 However, the threshold is costly (the annual cost of VAT foregone compared with the EU minimum threshold of €10,000 being over £2bn).[4] There is also evidence it has a distortionary impact on business growth and activity. The OTS has accordingly considered ways in which the effects of the current threshold might be reduced.

1.6 This chapter

- sets out evidence of the distortionary impacts the threshold has on business growth
- describes the economic effects of the current threshold – the constraints on growth of small businesses and the impact on the informal economy
- introduces two broad approaches – to raise or lower the threshold, or to develop mechanisms to smooth the financial impact of the threshold wherever it lies
- describes the positive and negative impacts of raising or lowering the threshold
- outlines some potential smoothing mechanisms
- considers administrative options which could help ease businesses' entry into the VAT system

Background and evidence

1.7 Once a business reaches the VAT threshold of £85,000 it must register for VAT. Businesses with taxable turnover below the threshold can choose to register voluntarily.

1.8 A registered business can reclaim VAT on purchases and must account for VAT on sales.

[1] See Annex D.
[2] http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/consumption-tax-trends-2016_ctt-2016-en#page91 page 82
[3] Approximately 55% of small businesses in the UK were not registered for VAT or PAYE in 2015. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf
[4] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs

1.9 Registered businesses, especially those selling direct to consumers, or those which have very little expenditure that is liable to VAT,[5] will either absorb the VAT incurred on their inputs (for example, where there is strong price competition from unregistered businesses below the threshold) or pass this cost onto consumers by reflecting it in their retail prices. In addition, registered businesses must comply with VAT regulations – HMRC's standard estimate is that the administrative costs for an average small business are around £675 per year.[6]

1.10 Businesses can and do register before they reach the threshold. 44% of all businesses registered for VAT in the UK are voluntarily registered in this way. Businesses may do this for a variety of reasons

- the ability to recover VAT on purchases is beneficial to businesses with high levels of costs which have borne VAT
- similarly, businesses that primarily make supplies to businesses can pass VAT costs on to their customers (and benefit from VAT recovery) without reducing profits
- businesses that are expecting to grow quickly may find it convenient to register early
- some businesses may see VAT registration as creating an impression of substance and credibility

1.11 For those that do not voluntarily register for VAT, the available evidence shows a clear bunching of businesses with turnovers just below the registration threshold.

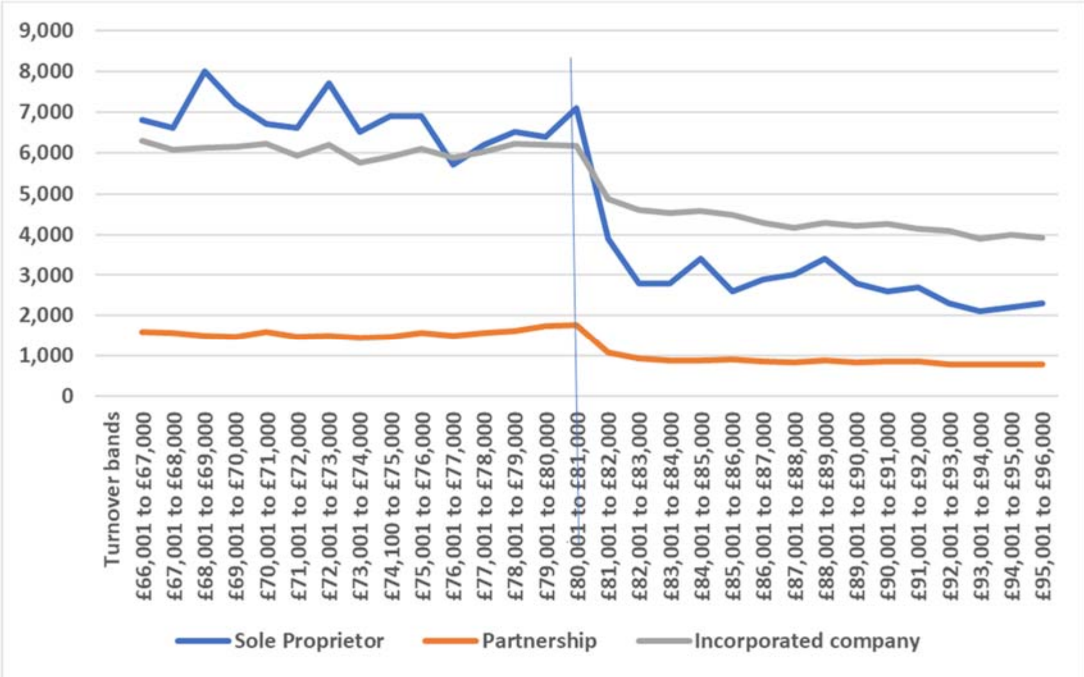
1.12 For example, in 2014/2015, when the threshold was £81,000, there were approximately 7,100 sole proprietorships, 1,765 partnerships and 6,160 companies declaring trading income between £80,000 and £81,000. However, in the turnover band from £81,000 to £82,000 there were only 3,900 sole proprietorships, 1,080 partnerships and 4,870 companies, falls of 45%, 39% and 21% respectively. See Chart 1.A.[7]

1.13 Recent academic research on the threshold has explored this trend. In their paper 'VAT Notches, Voluntary registration and Bunching: Theory & UK Evidence' Li Liu (formerly of Oxford University) and Ben Lockwood (Warwick University) provide evidence that bunching occurs among businesses which are most likely to suffer competitive distortions and least likely to make financial gains by registering (either because they sell to the general public who cannot reclaim the VAT, or have limited expenses, the VAT on which can be recovered).[8]

1.14 The bunching pattern for sole proprietors appears particularly strong, relative to corporates. This could be a result of the relatively small sample or reflect differences in behaviour. Liu and Lockwood suggest a plausible explanation, that corporates have less control over their turnover than those sole proprietors who are effectively one-person businesses. The bunching pattern is not replicated for VAT-registered businesses, see Chart 1.B.

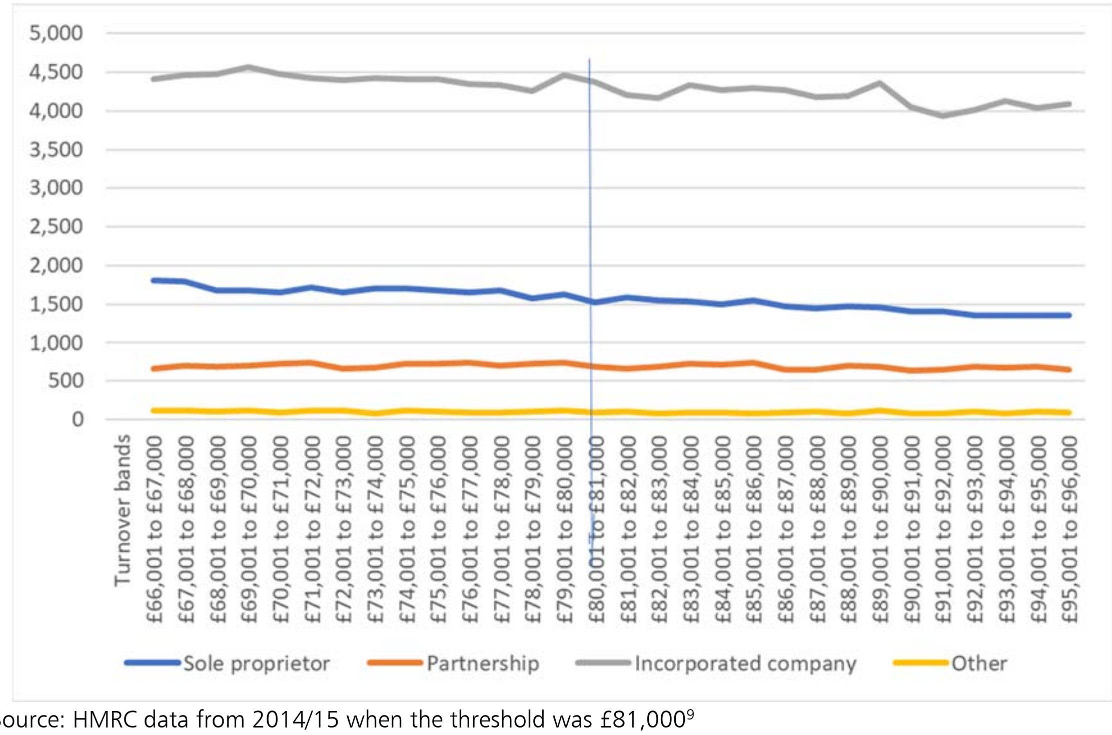
[5] For example, because it has few costs other than labour or financing.
[6] HMRC estimate the cost of VAT registration to be a one-off cost of registering of about £40 plus an ongoing cost £675 (for very small businesses around the threshold). The ongoing cost is the sum of the obligation to keep a VAT account, submission of VAT returns, issuing VAT invoices, paying VAT and making bad debt relief claims.
[7] The partnership and incorporated figures are an analysis of 100% of relevant data. The sole proprietors figure is based on a sample of taxpayers from the survey of personal incomes (SPI), grossed to represent the full Self Assessment population. This means that unlike the other two series in the chart, the Sole Proprietor series is affected by sampling variability. A consequence of this is that it is not as smooth across the income bands as it would be if it were based on 100% data.
[8] https://www2.warwick.ac.uk/fac/soc/economics/staff/blockwood/vat_bunching_restuds__11_7_16.pdf

Chart 1.A: Numbers of entities by turnover band around the registration threshold



Source: HMRC data from 2014/15, when the threshold was £81,000

Chart 1.B: Turnover of VAT-registered entities around the VAT registration threshold



Source: HMRC data from 2014/15 when the threshold was £81,000[9]

[9] Data source: VAT Annual Extract for 2014/15, which is a summary of VAT returns made throughout 2014/15; all figures given refer to the live VAT population at financial year end or any trader who was not live at the year end, but submitted a non-nil return throughout the year. Turnover here refers to the annual turnover declared on traders' returns, excluding VAT (absolute turnover figures are used, hence for traders only registered for part of the year returns are not scaled and values will only cover part of the year). This is taken to correspond to the financial year equivalent of Box 6 of the VAT Return (includes supplies to other EC member states).

Distortions caused by the registration threshold

1.15 Having noted the statistical evidence of bunching around the threshold, further analysis by Liu and Lockwood (also supported by what people have said to us) suggests it is caused by businesses consciously taking steps to remain below the threshold and therefore outside of VAT. Businesses whose sales are mainly to consumers and which can operate below the threshold without needing to register have not only an administrative advantage[10] but also a significant economic advantage over VAT-registered competitors.

1.16 The UK VAT threshold of £85,000 is sufficiently high that many very small businesses, especially labour-only businesses, can make a profit that their owners regard as sufficient while remaining under the threshold.

1.17 For businesses close to the threshold, two types of behaviour have been highlighted during this review which enable the business to remain unregistered.

1.18 Firstly, several stakeholders cited examples of steps businesses take to actively manage their activities and stay below the threshold. For example, many businesses close to the threshold

- decide not to take on an additional contract until the end of the year
- cease trading for a period to reduce their turnover
- decide not to take on an additional member of staff to grow their businesses

1.19 All of these behaviours suggest that the current threshold is acting as a disincentive to economic growth. Liu and Lockwood note that when turnover gets close to the threshold, annual growth in turnover slows, and it accelerates once the turnover is exceeded and firms have become VAT-registered.

1.20 The second type of behaviour seen is declaration of a false, lower, turnover or attempts to artificially split a business.

1.21 This bunching reflects the fact that crossing the threshold is a significant financial and administrative cliff edge: all a business's supplies to customers potentially increase in price by up to 20% (worth the equivalent of £17,000 if applying to the whole of a VAT-exclusive turnover of £85,000). If a business were to pass all of this on to its customers it might compromise its competitiveness, as there would be an uneven playing field as compared with the position of unregistered businesses. For other businesses bunching may be explained by an unwillingness to bear the administrative burden of registering for VAT.

1.22 Academic studies from other countries show that some economic distortions arise when registration thresholds are set at any positive amount.[11] The economic distortions in the UK appear more pronounced due to its comparatively high threshold.

1.23 In addition, and importantly from a simplification perspective, the fact that taxpayers approaching the registration threshold appear to be spending time considering whether to register or to manage their business affairs to avoid registering is an undesirable administrative complexity in terms of a taxpayer's interaction with the VAT system.

[10] VAT-registered businesses are required to issue VAT invoices for their supplies, keep a VAT account, and make regular returns and payments.

[11] Experience from Japan: http://www.sciencedirect.com/science/article/pii/S0047272708001953 and Finland: https://www.cesifo-group.de/dms/ifodoc/docs/Akad_Conf/CFP_CONF/CFP_CONF_2015/pse15-van-der-Ploeg/Papers/Harju.pdf

Approaches to addressing distortion and bunching

1.24 There are two possible approaches to addressing the competitive distortions caused by the current VAT threshold and bunching.

1.25 The first would be to raise or lower the threshold to either exclude a larger number of smaller businesses altogether or to include all but the very smallest businesses. The second would be to develop options to smooth the financial or administrative costs of crossing the threshold.

1.26 These options are not mutually exclusive and could be combined. However, there are constraints on what is possible while the UK remains subject to EU law in this area.

Implications of relatively small changes to the threshold

1.27 Looking initially at the implications of small changes to the registration threshold, Table 1.A shows estimates of the fiscal impact and the number of business directly affected by relatively small reductions or increases in the threshold in the first year after any change.

Table 1.A: Fiscal impacts and number of businesses affected by small changes in threshold

	Yield/Cost (£m)		Businesses affected	
	Lower end of range	Upper end of range	Lower end of range	Upper end of range
£5000 reduction	70	195	17,000	51,000
£1000 reduction	15	40	3,000	9,000
£2000 increase	-30	-50	12,000	15,000
£5000 increase	-60	-100	25,000	30,000

Source: HMRC internal estimate. These figures are uncertain have not been certified by the Office for Budget Responsibility.

1.28 If the government had maintained the existing threshold in 2017/18 (rather than increasing it in line with inflation) approximately 4,000 more business would have been required to register in that year, with an increase in revenue for the public purse of approximately £10m. If the freeze was maintained in future years, the numbers of businesses and sums would continue to grow steadily.

1.29 Keeping the threshold at the same level or reducing it by a small amount would mean that a few thousand additional businesses would be required to register, increasing their tax compliance costs. This would have limited impact on competitive distortions because only a small number of businesses would be affected, relative to the overall UK business population.

1.30 Under current EU law, it is not likely that the UK would be able to increase the level of the threshold above inflation.

1.31 Although relatively small adjustments would not have a major impact on distortion or bunching, they might give the government an opportunity to set an intended direction of travel, and evaluate the impact of changes without committing to an immediate major change.

Implications if the threshold were to be raised significantly

1.32 A higher VAT threshold would mean that fewer businesses would have to register for VAT or make returns. Raising the threshold significantly, for example to £500,000, would potentially impact around 800,000 businesses. Of those, between 400,000 and 600,000 businesses might choose to deregister, while 200,000-400,000 might choose to remain voluntarily registered.[12] This would reduce tax obligations for those businesses and also reduce revenue by £3bn-6bn. This would lead to the UK's VAT efficiency ratio, as measured by the OECD, reducing further. The UK is already considered to be significantly below the OECD average[13] due to a combination of a high threshold and extensive exemptions.

1.33 Many businesses, particularly those supplying other businesses, choose to register while trading below the threshold. Where this is advantageous, it is likely that this would continue as long as voluntary registration remained possible. An increase in the threshold would not in itself remove the complexity that results from needing to consider whether to register or not. For the smallest business to consumer (B2C) businesses below the new threshold the competitive distortion would be reduced – they would have to grow very significantly to approach the threshold. There would still be some distortion, in that medium-sized businesses would be in competition with more unregistered smaller businesses.

1.34 HMRC's costs in administering VAT would fall because resources could be targeted at a smaller number of large businesses. These businesses are likely in general to be more compliant with their VAT and accounting obligations as they will have more sophisticated accounting controls and will be subject to more external scrutiny.

1.35 VAT as a largely "self-policing" tax requires businesses to comply with its accounting arrangements and be a visible part of the formal economy, but this would no longer apply to a significant number of businesses. Removing the disciplines of VAT from a significant sector of the economy could potentially risk increasing the hidden economy in the UK.

1.36 Under current EU law, it is unlikely to be possible to increase the level of the threshold in real terms.

Implications if the threshold were to be reduced significantly

1.37 The UK's exceptionally high VAT registration threshold is set at a level that enables around 55% of small businesses, particularly those where labour is the major cost, to comfortably stay out of VAT.[14] Because so many of the smallest businesses can legitimately remain under the threshold, it is relatively easy for businesses which illegally evade VAT to feel that they can stay under the radar without fear of detection.[15]

1.38 A revised threshold that was still high enough for many small businesses to operate under it would enable many to remain unregistered. The fact that a significant percentage of the B2C business population were not VAT-registered and in direct competition with businesses who are

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[12] These numbers are based on an analysis of VAT returns between the threshold and £500,000, and include assumptions about the percentage of businesses within each trade sector making supplies to other businesses or otherwise likely to benefit from being registered. The calculation assumes that such businesses would want to remain voluntarily registered.

[13] http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/consumption-tax-trends-2016_ctt-2016-en#page107 The VAT efficiency ratio measures the difference between the VAT actually collected and what would theoretically be collected in a pure VAT regime in which the standard rate applied to all potentially taxable transactions, and all the tax due was collected.

[14] Approximately 55% of small businesses in the UK were not registered for VAT or PAYE in 2015.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf

[15] In practice, HMRC has many ways of targeting hidden economy activity and continues to innovate in this area: however it represents a significant sector of the UK economy.
http://www.telegraph.co.uk/finance/personalfinance/tax/11941248/HMRC-taskforces-raked-in-an-extra-109m-this-year-heres-how.html
https://www.nao.org.uk/wp-content/uploads/2015/12/Tackling-tax-fraud-how-HMRC-responds-to-tax-evasion-the-hidden-economy-and-criminal-attacks-Summary.pdf

registered would continue to cause competitive distortions for a large percentage of the business population.

1.39 Lowering the threshold significantly to address this - for example, to a level that was close to, or below the national average wage (£26,000) - would significantly reduce the extent of the unregistered business population, reducing competitive distortions, and make it harder for businesses that wish to illegally evade VAT to remain undiscovered.

1.40 Clearly such a significant reduction would bring many more businesses into the system (1-1.5 million, if the threshold were set at £25,000; 400,000 to 600,000 for a threshold of £43,000) and would raise significant additional revenue (£1.5-2bn and £1-1.5bn respectively).

1.41 With a significantly reduced threshold, the impact on the economy of businesses choosing to close for a period, or not to take on additional contracts, would probably be reduced as it would no longer be practical for most businesses to operate at that level. On the other hand, some might opt to cease trading or to structure themselves differently.

1.42 A significant increase in the number of VAT registered businesses would also inevitably increase HMRC's administrative overheads. Many small businesses would also face increased administrative costs. The government has announced that only businesses with a turnover above the registration threshold of £85,000 will be required to meet the IT requirements of Making Tax Digital[16]: a lower threshold would result in a greater number of businesses being mandated and required to obtain relevant software to submit returns to HMRC.

Core recommendation 1: The government should examine the current approach to the level and design of the VAT registration threshold, with a view to setting out a future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism.

Ways of smoothing the impact of the registration threshold

1.43 The OTS has considered a wide range of options to smooth the impact of the registration threshold. Although such mechanisms are likely to be incompatible with EU law at the current time, the OTS believe there is merit in considering this for the future.

1.44 Every possibility has pros and cons, which are set out below. Each option identified has some potential to add complexity to the administration of the tax, which must be set against the potential benefits to relevant businesses, and impacts on yield and competition. Two options appear worth further consideration and are explored in some depth.

1.45 Reflecting the OECD principles referred to above, the OTS has developed some additional considerations to inform work on potential smoothing mechanisms:

- it would be inequitable (and not fiscally neutral) if such a mechanism provided an advantage to businesses with a turnover above the registration threshold and not to smaller businesses which are registered voluntarily below the threshold
- any mechanisms should be effectively targeted, as far as practical, to businesses making B2C supplies
- if some VAT registered businesses could reclaim all of their input tax and pay no tax over to HMRC (or pay only a limited proportion of it) this could encourage businesses to manage their affairs so as to stay within that band, or prompt fraudulent activity[17]

[16] https://www.gov.uk/government/publications/making-tax-digital-for-business/making-tax-digital-for-business
[17] For example, the creation of artificial supplies between connected persons.

- a starting rate of payment at or near to zero would also have very significant revenue costs, with the costs greater at lower rates

VAT Flat Rate Scheme

1.46 Any consideration of mechanisms to reduce the burden of VAT for small and newly registered businesses must include consideration of the current VAT Flat Rate Scheme (FRS).

1.47 The FRS is designed to simplify accounting for small VAT registered businesses and smooth their transition into the VAT system. Businesses with a turnover below £150,000 are entitled to join the scheme. The amount of VAT they pay is a fixed percentage of their turnover, calculated to reflect the average net VAT position for businesses in their sector. They cannot normally reclaim VAT on purchases and do not have to keep purchase listings for VAT purposes. In the first year of registration, businesses benefit from a reduction of 1% in the rate they would otherwise be required to use.

1.48 Approximately 31% of all eligible businesses use the Flat Rate Scheme.[18] Users report that the benefits experienced are generally in line with their expectations, with around 60% finding that the scheme saves time and administrative burdens and 41% reporting a financial benefit. Of those which didn't use the scheme, approximately 30% were unaware of it or didn't understand it, while 20% were advised not to use it by an accountant: the remainder either thought it was not relevant or gave no particular reason for not using it.

1.49 The FRS is expected to continue to be available under Making Tax Digital (MTD), with accounting software facilitating simplified record-keeping. The FRS helps those who are registered by simplifying accounting for VAT but does not reduce the financial impact of having to charge VAT to customers who are not able to recover it.

1.50 It is clear that businesses value this administrative simplification. HMRC may be able to further increase usage of the scheme by publicising its benefits, to help potential users understand how it might ease the administrative burden that they fear from VAT registration.

1.51 A larger reduction in the first year of registration or a continuation of it into the second or third year of registration might encourage more businesses to grow above the threshold. This would need to be at a level that was attractive but not so high that it encouraged abuse of the scheme or had a significant revenue cost.

1.52 For example, using the current FRS thresholds, one possibility would be for a newly registered business with taxable income below £150,000 to benefit from a reduction of 5% in the rate of VAT they would otherwise be required to pay under the scheme in the first year of registration, 3% in the second, and 1% in the third. This would clearly have a revenue cost: it has not been practical to estimate the potential cost at this time.

1.53 In the UK, just over 40% of businesses survive their first five years, with the highest drop-off rates occurring in the first three years. [19] Support for businesses in their first three years would be targeted at their most vulnerable period.

1.54 A major advantage of using the FRS to reduce the financial impact of registration is that it is an existing scheme that is popular with businesses and generally well-understood.

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[18] There are more than 410,000 current users known to HMRC.
https://www.uktradeinfo.com/Statistics/Statistical%20Factsheets/VAT_Factsheet_16.xls

[19] https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/2015

1.55 Any reduction applied to existing FRS rates would benefit all businesses, not just those making B2C supplies. However, the reduction would apply to established rates for business sectors, which take account of the proportion of business to business (B2B) supplies in the sectors concerned. Attempting to apply the reduction only to individual businesses making mostly B2C supplies would be administratively difficult and resource intensive for both HMRC and businesses. The percentage reduction for businesses with limited taxable inputs might need to be lower than for other businesses, to reduce the risk of abuse.

Possible financial smoothing mechanism

1.56 The FRS focuses on reducing administrative costs for small VAT-registered businesses but is not intended to smooth the major financial costs of becoming registered for VAT.

1.57 There is also an option for a financial smoothing mechanism that may be worth further consideration. This would operate within a turnover band above the registration threshold[20] and would involve the business retaining a proportion of the VAT that would otherwise have been paid to HMRC.

1.58 The business would be required to register once its turnover exceeded the threshold, and to charge VAT on all sales, as is the case now. If a net VAT repayment was due this could be claimed in full, also as now. However, if a net amount of VAT was due to HMRC, then if the business's total turnover lay within the band, it would need to account for only a proportion of that net VAT and the remainder would be retained.

1.59 Consideration would need to be given to a starting percentage (the amount of VAT to be paid to HMRC) that would represent a sufficient reduction to smooth a businesses' introduction to the VAT system without raising major fraud or revenue risks. The scheme would apply for a limited period of time following registration – see the discussion of timeframes under the FRS section above.

1.60 The following example assumes a registration threshold of £85,000, a top figure for the smoothing band of £115,000 and a starting percentage of the tax to be paid over of 70%.

Example

For three years from first registration, a business with a VAT-exclusive turnover of up to £95,000 would pay over 70% of the net VAT. A business with a turnover above £95,000 and below £105,000 would pay over 80%, and a business below £115,000 would pay over 90%. Once turnover exceeded the top of the band, all the net VAT would be due, as now. Banding would be based on turnover for the preceding year. A rule would be needed to protect against fraud.

1.61 These figures are illustrative only: further work would be required to establish optimal rates, which would ease the financial impact of registration without giving rise to opportunities for fraud or manipulation. If this proposal were taken forward, the top of the band should be revalorised in proportion to changes in the registration threshold.

1.62 Introducing this without altering the level of the threshold would, of course, result in a reduced yield from those businesses whose turnover lies within the band. This could be addressed by reducing the threshold at the same time, so that the band straddled the existing

[20] This option owes something both to the formula approach used in Finland, an approach developed in Japan and an idea put to us by the Institute of Chartered Accountants of England & Wales (ICAEW).

threshold and more yield was obtained from businesses whose turnover lies just below the existing threshold.

1.63 The smoothing mechanism could exist alongside the FRS, with taxpayers able to decide whether they wished to adopt the FRS instead. This would introduce further complexity to the system by increasing choice and related decision-making and this would have to be weighed against the benefits. The smoothing mechanism does not include the administrative simplifications of the FRS.

Options considered but not recommended for further development

1.64 Other potential approaches which were considered, which would be quite radical or would be highly likely to lead to unattractive impacts, either in terms of administration, in relation to competition or in terms of the impact on yield included:

- introducing an exempt slice of turnover for all businesses and adjusting the threshold to compensate for this (increased administration, merely changing the nature of the distortion)
- adjusting the amount of VAT charged to customers on individual transactions depending on the overall turnover of the business concerned (complex administration, competition impacts); an example would be only charging VAT on transactions above the threshold (though it is unclear how a business would determine which transactions were caught)
- reducing the threshold and compensating smaller businesses, whether by grants, allowing the business to retain the VAT in the first year or two it is above the threshold or reducing other taxes (increased administration, uneven incidence of any such compensation – producing significant numbers of gainers and losers)

Administrative options to help ease businesses' entry into the VAT system

1.65 No significant concerns with the process of registration itself have been put to us during this review, suggesting it works reasonably well and is simple to operate.

1.66 Our own suggestions below are focused on ways of smoothing the transition to registration.

1 An option to choose a longer first VAT period (up to six months) for a businesses' first VAT return, with the ability to apply to HMRC for a first period of up to a year – and a facility to pay on account during that first period.

1.67 Under this approach, the business would still have to register for VAT at the time it does now but could delay accounting for and making its first VAT payment. Any significant reduction in the threshold would draw many businesses into the VAT system for the first time. A longer first VAT period could help ease their entry, although they would still need to plan ahead for the level of VAT payment that would be due at the end of the first period.

2 Apply the threshold test over two years of turnover rather than just one.

1.68 This would have the effect of postponing entry into the VAT system. As an example, a business with a steady monthly turnover of £8,000 starting in January 2017 crosses the £85,000 VAT threshold in November 2017 so must register for VAT from 1 January 2018. If the threshold test were £170,000 over two years, the same business wouldn't pass the threshold until October 2018 and would register for VAT from 1 December 2018. Such a change in approach would, of course, involve a revenue cost. This provision would also help businesses with significant variations in turnover from year to year.

2 VAT administration

2.1 The OTS has found in many reviews that practical administrative issues are often among the most important concerns of users of the tax system.

2.2 That has certainly been borne out in conversations during the work on this review as well as in written submissions. This is partly because, as VAT is a transaction tax, it is important to know how to treat individual transactions in real time. In any event, it is important to explore ways in which the friction points in the system could be eased.

2.3 Doing this will depend on integrating

- improvements in the customer experience in specific areas – such as guidance, rulings, voluntary disclosures, penalties and appeals
- enhancements in the relationship between HMRC and businesses – to enable and help embed such improvements

Guidance

2.4 Many people offered comments on HMRC's VAT guidance as summarised below, along with an outline of what HMRC is doing and planning to do in this area. It is evident that considerable progress is being made. However, there is still some way to go and this report offers some ideas to feed into the process.

2.5 Almost everyone who contributed to the review said HMRC's guidance could be considerably improved.[1] The OTS was told it was frequently out of date, difficult to search and not all in one place (when one includes public notices and Revenue & Customs Briefs). In particular, there have been cases where HMRC has referred taxpayers back to the guidance that they have already found to be insufficient.

2.6 Businesses with simple queries are generally positive about HMRC's online guidance.[2] However, particular difficulties arise when one needs to do more than find a form or find out how to pay tax. There was also concern about not being able to get automatic notifications when guidance has been updated.

2.7 HMRC's approach to updating its guidance when tax policy changes, is set out in paragraph 7 of the Tax Consultation Framework.[3]

"Guidance on tax policy changes will normally be written in consultation with interested parties and published alongside the legislation: it will always be published in good time for orderly implementation. New or revised forms relating to the tax policy change will normally be published in draft for comment before or alongside the draft guidance or draft legislation."

2.8 The statement that the guidance will, where possible, always be published in time for orderly implementation is perhaps difficult to track or measure. HMRC's Budget teams are rightly proud that all information relating to the Budget will be online within one minute of the Chancellor finishing his speech. But there is no target for HMRC, for example, to update guidance within a set period of a legal or other significant change taking effect.

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[1] This finding is a common theme across our work on a variety of taxes.

[2] https://www.gov.uk/government/publications/hm-revenue-and-customs-individuals-small-businesses-and-agents-customer-survey-2015

[3] https://www.gov.uk/government/publications/tax-consultation-framework

Recommendation 9: HMRC should establish a target to update guidance within a short, defined, period after a legal change or new policy takes effect.

2.9 Where this is not possible, then at least a link to the Budget Notice or Revenue & Customs Brief should be inserted into the relevant page by that time. This would minimise the risk of taxpayers being confused or misled by outdated guidance. It may be that HMRC will not be able to meet this target in every case – especially where changes may be outside their direct control - but HMRC's aim should be that most businesses and advisers can readily find an accurate answer to their question online most of the time.

2.10 More widely, the public notices can be difficult for lay users to find, as the Business tax/VAT web page[4] has a quick link to VAT notices in numerical rather than alphabetical order.

2.11 HMRC has a customer experience team working in this area, which liaises with policy teams to improve guidance and ensure that it is checked every six months and updated as required. HMRC also recognises that the VAT manuals need review, for example because some of the process information aimed at HMRC staff can get in the way of non-HMRC readers finding what they need. HMRC have improved internal processes to minimise the chances of mistakes in published guidance. However, these processes have not prevented gaps persisting.

2.12 HMRC is also keen to receive feedback from customers about their experiences of using the VAT guidance, and there is a dedicated email address for this.[5] The Chartered Institute of Taxation reports that initial experience of this is positive, with HMRC responding within 24 hours confirming their position and setting out a timeline for fixes to be published.

2.13 It is unclear, however, how widely publicised the email feedback facility has been and it is not mentioned on the individual VAT guidance pages themselves. There is on each page a link entitled 'Is there anything wrong with this page?' but when clicked this seems to be concerned with technical issues, asking 'What were you doing?' and 'What went wrong?'

2.14 Whether the answers are found in guidance, by calling the helpline or by writing to the Written Enquiries Team, we'd encourage HMRC to continue to develop an integrated view of the customer journey of a person seeking to resolve a query, to improve the user experience.

2.15 HMRC is also working on using analytics technology to improve the user experience, through personalisation of its customer service. It has recently become possible to see whether a person who rang in with a query then carried out the task concerned online, so HMRC can gauge where problems lie. Work looking at customer journeys is being undertaken (for example, to see whether there is a web page where customers come to a halt) and HMRC analyses the outcomes of online customer satisfaction surveys.

2.16 This is very encouraging, as measuring the success or otherwise of people's interactions with HMRC is the first step towards effecting improvements which will make them easier.

Rulings

2.17 In the first instance, businesses should be able to answer most tax queries by looking at published guidance or calling HMRC's advice line. However, there is also an important place for formal rulings from HMRC in a range of circumstances.

2.18 In VAT, rulings are written confirmation of HMRC's view of how tax law is applied to a specific transaction or event. The business must show that there is uncertainty as to how

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[4] https://www.gov.uk/topic/business-tax/vat
[5] customerexperience.indirecttaxes@hmrc.gsi.gov.uk

legislation will affect transactions that it is involved with. If the information supplied is accurate and complete, and the business carries out the proposed transactions exactly as described, it 'will generally be able to rely on HMRC's advice.'[6] Such rulings are non-statutory.

2.19 This is an area in which recommendations for change made by the OTS in October 2014[7] were accepted by the government. Encouragingly, there have been some noticeable improvements in this area since that time.

2.20 For example, changes implemented in 2016 have led to an improvement in the quality of written responses being provided to people who contact the enquiries team. Even where replies did not constitute advice or a ruling, they more often adopt a helpful tone, for example by giving a clear steer to specific parts of HMRC guidance that was likely to answer the enquirer's question. However, as noted in our interim report, this is an area which was frequently commented on and where further improvements could make a significant difference.

2.21 The underlying issue is fundamentally one of certainty. Businesses need certainty in two main areas.

2.22 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. Often this is because a new product or service has been developed and businesses and their advisers are uncertain as to the VAT treatment and there is no clear guidance.

2.23 A number of other countries publish rulings (for example Canada and Australia) issued by the revenue authority. These rulings, which are generally binding on the revenue authority, express an interpretation of the law in relation to a specific set of facts: perhaps about the tax treatment of particular types of business restructuring or the application of an anti-avoidance provision in specified circumstances.

2.24 HMRC have considered publication of rulings previously, but have not felt it possible to anonymise them in a way which will sufficiently protect taxpayer confidentiality while still being useful to others. However, considerable feedback from many stakeholders suggests that the publication of such potentially generic rulings would be welcomed, and it seems that other countries which do publish rulings and have a common-law system have been able to address these concerns.

2.25 As noted above, the key thing businesses desire in such cases is earlier certainty about the application of the law in particular instances. Published rulings are seen as a good way to achieve early certainty, especially if guidance may take a while to be updated. They may also cover cases that apply to a limited number of businesses and might be considered too narrow in application to be incorporated into general guidance.

2.26 A fully effective and timely process for updating guidance, as recommended above, would significantly reduce the need for published rulings. One downside of giving guidance via published rulings is that it would mean that businesses would have to look at more than one source of guidance. Businesses that looked only at the published guidance or notices might not find the answer they were looking for.

2.27 The second area where certainty is very important is in relation to a one-off event that applies only to the businesses involved, such as a sale of an entire business.

[6] https://www.gov.uk/guidance/non-statutory-clearance-service-guidance

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf

2.28 One of the subjects most commonly raised by businesses was the VAT treatment of Transfers of a Going Concern (TOGC). Where these provisions apply, no VAT is charged on the sale or transfer of a business. However, in certain circumstances standard rate VAT can be applicable, in which case output tax will be due on the full value of the sale. Uncertainty or errors in this area can give rise to significant unexpected VAT charges, or to penalties for incorrect returns.

2.29 Clearly one concern is whether businesses have to charge VAT or not, but the main motivations for seeking a ruling are to guard against the risk of what can be substantial financial penalties if a mistake is made, and because lawyers often ask for assurance on the tax treatment as part of their due diligence work on such transactions.

2.30 In relation to requests for confirmation of TOGC status and other matters, one general observation from a number of stakeholders was that responses to written enquiries are currently taking months rather than days which creates unnecessary uncertainty for businesses.[8]

2.31 Another observation from advisers was that HMRC was quite often unwilling to provide a view on the correct VAT treatment of a transaction, in particular referring the business to their published guidance, even when the enquiry states that it has been made precisely because the guidance was perceived to be incomplete or outdated (though it is likely some of these comments refer to instances pre-dating the 2016 changes noted above).

2.32 HMRC's policy on rulings is that HMRC will not give rulings in circumstances where it considers the matter to be covered in guidance.[9] While this is understandable, particular issues arise where guidance is unclear, out-of-date, or hard to find. It is helpful that teams are looking at ways to point questioners to relevant parts of the guidance where possible.

2.33 From our meetings with the HMRC written enquiries teams, it seems HMRC deals with requests for written rulings on a first come first served basis. This means that a routine request for explanation of an amount owing is given the same priority as a request from someone who has a deadline - for example a sale of a business or a VAT return which needs to be submitted - where there is uncertainty over a VAT liability of a new product.

Core Recommendation 2: HMRC should maintain a programme for further improving the clarity of its guidance and its responsiveness to requests for rulings in areas of uncertainty.

2.34 This should include consideration of publishing generic rulings (suitably anonymised) ensuring that enquirers are not simply referred back to guidance they have already looked at, and seeking to prioritise ruling requests which are more time sensitive. It is recognised that an enhanced rulings service would require additional resources on HMRC's part. However, enhancing this area will help businesses comply with their tax obligations and avoid costly mistakes and related resource costs on both sides.

Recommendation 10: HMRC should explore ways to improve online guidance, making all current information accessible, and to gauge how often queries are answered by online guidance.

2.35 Some contributors to the review also stated that the toolkits for agents that are published by HMRC are very useful and that it could be worthwhile to adapt some for use by business.

[8] HMRC's records, seen by OTS, showed that more than 75% of cases were answered within 28 days in the year ended March 2017. The figure has fallen in recent months to 46%. The team is undergoing some reorganisation, which may affect throughput temporarily.

[9] General guidance: https://www.gov.uk/guidance/non-statutory-clearance-service-guidance
VAT-specific annex:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/423806/Annex_D_final_150416-5.pdf

Voluntary disclosures and penalties

2.36 Errors, or inaccuracies, can occur even in the best-managed businesses. HMRC recognises this and encourages businesses to voluntarily disclose errors.

2.37 The current procedures allow businesses to correct errors under £10,000 on a subsequent return. Those under £50,000 may also be adjusted in this way if they equate to less than 1% of the net outputs of the business for the period in question. Larger amounts need to be the subject of a specific voluntary disclosure, to draw HMRC's attention to the issue.

2.38 Larger businesses pointed out that in their context errors over £50,000 are more likely than in medium-sized businesses, and that making regular voluntary disclosures was a burden. It may be appropriate to consider whether errors that are not material, relative to a business's net tax liability, need not be the subject of a voluntary disclosure as well as being corrected on the next available return. Looking forward, under MTD, it is proposed that the optional summary accompanying returns will have a box for declaring adjustments from other periods. Most larger businesses say they are likely to complete this.

2.39 Although some inaccuracies can be adjusted on later returns, there is still a requirement to notify them to HMRC so they can consider whether or not a penalty is due. If a business does not notify HMRC, any penalties are likely to be higher. Issues concerning penalties on voluntarily disclosed inaccuracies were frequently mentioned to us in strongly negative terms during the work on this review.

2.40 Before 1 April 2009, if a non-fraudulent error was voluntarily disclosed by a business, it knew that it would not receive a penalty. Since then, it has been possible for voluntarily-disclosed inaccuracies to attract a penalty of up to 30% of the tax involved.[10]

2.41 This change was unpopular with the businesses that engaged with this review. While people did not suggest the possibility of a penalty was an actual disincentive to making a disclosure, they did say that it reduced that incentive, making businesses think twice - and particularly so if the business was the subject of a currently suspended penalty (discussed below).

2.42 Businesses can receive a penalty for voluntarily disclosing a careless inaccuracy, but in practice very few actually do. The maximum penalty is 30%, which can be reduced to 0% if a business fully co-operates with any HMRC enquiry into the matter, as is commonly the case. Accordingly, a penalty, whilst not impossible, is unusual.

2.43 Although businesses are unlikely to receive a penalty for voluntarily disclosing an inaccuracy resulting from a failure to take reasonable care, everyone who raised this with us pointed to the administrative burdens caused and the uncertainty of not knowing whether a penalty would be imposed, particularly as HMRC's consideration of these matters can take some time.

2.44 These undesirable features of the system, and the relative rarity of a penalty being imposed, need to be weighed against the incentive the rules provide for businesses to co-operate fully with enquiries into their voluntary disclosures, because of the possibility of the penalty being reduced to £nil.

2.45 Businesses may be sufficiently encouraged to check the accuracy of the VAT returns by removing the prospect of a penalty for at least smaller errors that are corrected on the following return.

[10] Schedule 24 Finance Act 2007, in relation to inaccuracies resulting from carelessness, rather than any intent.

Core Recommendation 3: HMRC should consider ways of reducing the uncertainty and administrative costs for business relating to potential penalties when inaccuracies are voluntarily disclosed.

2.46 Options might include:

- considering whether in the MTD context the £50,000 disclosure threshold remains appropriate for larger businesses
- a rule that where an inaccuracy is voluntarily disclosed, it will not be liable to a penalty[11]
- a rule that where an inaccuracy is corrected, within the voluntary disclosure rules, on a subsequent return it will, for penalty purposes, be treated by HMRC as having been voluntarily disclosed

Behavioural test for penalties

2.47 Having discussed penalties in the context of voluntary disclosures, this section looks more widely at the tests applied in considering whether careless inaccuracies should attract a penalty.

2.48 This review does not address late filing or late payment penalties as these are shortly to be reformed under MTD. Neither does it consider deliberate inaccuracies, no-one having expressed concerns to us about how HMRC deal with these.

2.49 The current penalty regime was introduced on 1 April 2009, following the creation of HMRC, to align powers, deterrents and safeguards across taxes. Behavioural-based penalties for errors in tax documents and returns were applied to the main taxes.

2.50 HMRC now has five principles which underpin its approach to penalties. They were outlined in Making Tax Digital: Tax administration (para. 3.2)[12] and are:

3. penalties should be designed from the customer perspective, primarily to encourage compliance and deter non-compliance
4. penalties should be proportionate to the offence and may take into account past behaviour
5. penalties must be applied fairly, ensuring that compliant customers are in a better position than non-compliant ones
6. penalties must provide a credible threat
7. customers should see a consistent and standardised approach

2.51 HMRC will be undertaking a public consultation on inaccuracy penalties, following on from those on late submission and late payment penalties, in which it is to be hoped that they will consider the issues raised here.

2.52 The current penalty regime requires HMRC to make decisions about the extent to which an error resulted from carelessness on the part of the taxpayer. This can be difficult to do. In 'HMRC Penalties: A discussion document[13]', HMRC confirmed that 'decisions about inaccuracy penalties

[11] In this context, the reference to an inaccuracy means one resulting from failure to take reasonable care, or one that happens even though the business has been reasonably careful. Inaccuracies that result from deliberate actions should be penalised.
[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/546001/Making_Tax_Digital-Tax_administration-consultation.pdf
[13] https://www.gov.uk/government/consultations/hmrc-penalties-a-discussion-document

can be time-consuming to reach and subjective in nature and difficult for the customer to understand and accept'. The arguments presented in this paper should help inform the planned consultation.

2.53 Some contributors to this review expressed a desire for a more objective process, which they considered had been a feature of the regime before 2009. It is questionable whether this was the case, as the pre-2009 system required a necessarily subjective judgement about whether or not there was a reasonable excuse for the error. While there were fewer VAT penalties under that system, this was because an inaccuracy had to exceed 30% of the gross amount of tax on a VAT return (correct output tax plus correct input tax), which is no longer the case.

2.54 Taken to an extreme, a more objective approach without a floor limit on the value of errors within scope for penalties might mean there would be more penalties, as they would normally be imposed without consideration of the individual case.

2.55 On balance, the OTS does not see a persuasive case to move away from the current system, but HMRC may wish to consider the issues discussed above relating to the application of the behavioural test for inaccuracy penalties in the forthcoming HMRC consultation.

Suspended penalties

2.56 Another area of the current system frequently commented upon was suspended penalties.

2.57 These were also introduced as part of the April 2009 changes. A penalty imposed on a business that has made a careless inaccuracy can be suspended if the business agrees to put in place improvements to prevent the error from happening again.

2.58 Respondents appreciate the recognition given for putting improved systems in place, but not the uncertainty caused by a suspended penalty. Creating and dealing with the necessary paperwork about suspension conditions can be time consuming, and the existence of a potential penalty can require provisions to be made in the business' accounts. In addition, the fact that the penalty can be released from suspension if there is the smallest infraction in any tax during the suspension period was widely criticised.

2.59 One business said that it had declined to take up the offer of a penalty being suspended, preferring instead the certainty of paying the penalty and resolving the matter then and there. Another reported that it currently had a suspended penalty of some £15m hanging over it, which might be imposed if any minor error occurred in any tax during the period of suspension.

2.60 HMRC figures show that in 2016/17, 74,600 penalties for careless inaccuracies were issued for a total value of £91.2m. Of these, 29,600 were not suspended, for a total value of £26.3m. While substantial sums are involved, HMRC's approach is that penalties are primarily to encourage compliance and deter non-compliance, not to raise revenue.

2.61 It appears to us that it should be possible for the system to give business the opportunity to put improvements in place while removing the uncertainty inherent in suspension. One approach could be to borrow from the VAT default surcharge system, with which businesses are already familiar. This deters late submission of VAT returns and payments by imposing, following one warning, increasing levels of penalty up to a maximum of 15%. As with that system, consideration could be given to waiving 5% penalties if they fell below a certain value. However, several contributors to the review questioned the waiving of 2% and 5% small default surcharges, stating that an early surcharge of even a small amount can be a valuable wake-up call to a business before things go too far wrong.

2.62 So, for inaccuracy penalties, such a system could involve no penalty for a careless inaccuracy the first time one is discovered, a probationary period (notified by a Penalty Liability

Notice) of one year being put in place. During this period, the discovery of a further careless inaccuracy would result in penalty of 5% and extension of the probationary period for another year. A further inaccuracy in the extended period would result in a 10% penalty and extension of the period, a further inaccuracy would result in a 15% (maximum) penalty.

Recommendation 11: HMRC should review options to reduce the uncertainty caused by the suspended penalty rules.

Appeals

2.63 As with penalties, disputes between businesses and HMRC are a significant friction point and the OTS consider that more can be done to alleviate this.

2.64 Businesses have the right to appeal direct to a tribunal or to ask HMRC for an independent statutory review. The documentation that accompanies the appealable decision sets out the business's rights, which must be exercised within thirty days (unless this period is explicitly extended at the business's request). If the business is dissatisfied with the outcome of the HMRC review, it can still appeal to the tribunal.

Statutory review

2.65 In 2015 – 2016, 68% of HMRC non-penalty decisions (across all taxes) were upheld at the statutory review stage. Another 10% were varied and 22% cancelled altogether. VAT penalty cases saw decisions upheld in 35% of cases, varied in 13% and cancelled in 52%.[14]

2.66 Despite this evidence, many respondents to our review regarded the statutory review process as a rubber-stamping exercise, generally upholding the original decision. Some respondents also said that the statutory reviewer had only engaged by correspondence, when they would have preferred phone or face-to-face contact. If that is possible, it could be better publicised.

2.67 From discussions with HMRC it is clear that a great deal of care, time and effort goes into statutory reviews. The original decision maker must complete a detailed template in which he or she is asked to set out the law, the facts and their views of the strengths and weaknesses of both HMRC's and the business's case. The review is conducted by an officer wholly independent of the original decision maker or their line management chain and the letter notifying the outcome normally goes into considerable detail as to how the review outcome has been arrived at.

2.68 Accordingly, the OTS does not consider that the rubber-stamping accusation is generally a fair criticism. Nevertheless, the perception exists and it is in the interest of businesses, advisers and HMRC that there should be better communication about the workings of statutory reviews. Hopefully these comments will contribute to this. Achieving this better communication through accountancy and business organisations and the network of VAT Practitioner Groups should be considered.

Lack of clarity/understanding

2.69 Those who engaged with us reported occasional uncertainty about who was reviewing their case and whether they were independent of the original decision maker.

2.70 The OTS found some evidence of uncertainty even within HMRC as to the nature of the process in practice; the original decision maker, or somebody in his/her team, appearing to have

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/536912/How-we-resolve-tax-disputes_HMRC_2015-16.pdf

looked at the case on a number of occasions prior to any statutory review. This was not necessarily seen as a bad thing, some businesses feeling the original decision maker could be trusted to look again at the decision fairly, particularly if looking at evidence not previously available. This does not prejudice the business's rights because provided the request for a review has been received within thirty days of the original decision, the time limit for appealing is then extended.

2.71 There should be greater awareness of the ability of time limits to be extended, thus allowing local discussions, where appropriate, to take place.

Alternative Dispute Resolution (ADR)

2.72 The HMRC Litigation and Settlement Strategy defines a dispute as 'as covering all situations in which HMRC and the customer or their agent have a difference in view over what is the right tax at the right time.'[15] One of the ways of resolving such a dispute is ADR.

2.73 ADR is a way of enabling someone who has not been involved in the dispute to work with the business and the HMRC officer dealing with it to help resolve it. This is an HMRC person but in leading the ADR, they act as a neutral, third party mediator. They don't take over responsibility for the dispute, but work with both parties to explore ways of resolving the dispute through meetings and telephone conversations. They help focus on the areas that need to be resolved and, if needed, help re-establish communications between both parties.

2.74 In 2015 – 2016, there were 581 applications for ADR. Of these, 150 were rejected. Putting aside those cases still ongoing, 262 cases were successfully resolved, only 15 proceeding to litigation beyond ADR, a success rate of 95%.[16]

2.75 ADR was fairly widely praised, although it was stated that some smaller businesses were deterred from participation by the cost (of the involvement of their adviser) and even some large businesses reported finding it difficult to justify the cost to their boards.

2.76 The HMRC policy team responsible for litigation advised us that the use of ADR is encouraged and in addition to being used for individual disputes is now often used to try to resolve the generic issues behind groups of similar cases (input tax on holding companies is a recent, early, example). Also, proposals are being considered to measure the benefits of using ADR pre-decision in a selection of cases, ADR training is being incorporated into the programmes undertaken by new compliance staff, and the ADR training module for experienced compliance caseworkers and managers is being refreshed.

Litigation

2.77 HMRC has for some years been taking a broad perspective when deciding when to defend appeals, considering the cost, proportionality and the burden on the business. There are assurance processes in place and sensitive and serious cases are considered by business level review boards, the Tax Disputes Resolution Board (TDRB) or the Commissioners of HMRC.[17] Additionally, a sample (several hundred) of settled cases are reviewed by HMRC Internal Audit, process improvements being sought and best practice shared. In 2015 – 2016, this found that 77% of cases fully adhered to assurance and governance processes.

[15] https://www.gov.uk/government/publications/litigation-and-settlement-strategy-lss

[16] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/536912/How-we-resolve-tax-disputes_HMRC_2015-16.pdf

[17] The process is set out in HMRC's Litigation and Settlement Strategy.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/387770/Commentary_on_litigation.pdf

2.78 Furthermore, HMRC is planning to look systematically at those cases where the original decision is overturned at the statutory stage or by the First-tier Tribunal, to establish what lessons there might be for caseworkers, reviewers or HMRC more widely.

2.79 These developments demonstrate substantial and welcome progress towards smoothing down the friction points in this area for businesses and advisers.

Conclusion

2.80 The OTS supports the shared wish of both businesses and HMRC to resolve disputes where possible without having to have recourse to the tribunal, and where this is not possible, to clarify the issues and evidence in dispute for the benefit of the tribunal.

2.81 Even if their arguments are not accepted, businesses and advisers should have confidence that their evidence and representations have been fully considered by HMRC. Furthermore, at least at the statutory review stage, business should normally be able to engage, if they wish, without the need for advisor support.

Recommendation 12: HMRC should draw greater attention to the facility to extend statutory review and appeal time limits to enable local discussions to take place where appropriate.

Recommendation 13: HMRC should consider additional ways in which statutory review teams can deepen engagement with business and adviser groups to increase confidence in the process, and for providing greater clarity about the availability and costs of alternative dispute resolution.

Other

2.82 A number of miscellaneous administrative suggestions were made to the OTS.

1. When businesses import goods into the UK from outside the European Union, VAT is payable but can then normally be reclaimed. The evidence required to support the claim is the C79 import certificate but businesses have reported difficulties in receiving paper C79s by the time the VAT return is due. One suggestion made to us was to abolish C79 import certificates and use an acquisition tax approach (the business would pay the import VAT due on its VAT return and claim it back), with the duty due at import being paid via a fully digitalised system. However, the current uncertainty around Customs procedures due to Brexit do not make this an attractive option for the foreseeable future. An alternative, less radical suggestion, was to introduce electronic C79s.

Recommendation 14: HMRC should consider introducing electronic C79 import certificates.

2. HMRC has announced that it will no longer issue payable orders (cheques) to UK-established businesses for VAT repayments. Currently HMRC makes all VAT repayments to overseas businesses (technically, non-established taxable persons) by payable order. However, it makes other VAT payments to overseas persons by BACS so there appears to be no reason why HMRC could not simplify the making of the payment and also allow overseas businesses to receive VAT repayments by BACS.
3. Business organisations also reported difficulties caused by paperwork having to be sent to the registered office of a company and expressed a desire to be able to nominate where it should be sent.

Recommendation 15: HMRC should consider options to streamline communications with businesses, including the process for making payments to non-established taxable persons.

4 Businesses tendering for public sector contracts or applying for grants. Frustration was expressed about a number of cases where the VAT position was unclear, or cases where an initial understanding of the position was challenged, with HMRC and government tendering departments having differing interpretations. Construction and infrastructure were two sectors mentioned to us as being particularly affected. The latter could result in the whole of the profit on a contract being wiped out or a charity being unable to provide as many services as had originally been envisaged. This issue is not unique to government, but it is not unreasonable for customers to expect a joined-up approach from government departments. VAT liabilities should be clearly outlined during the tendering process for public services and contracts. There is also a need for consistency on this between HMRC and the relevant tendering government department.

Recommendation 16: HMRC should look at ways of enhancing its support to other parts of government (for example in guidance) on VAT issues affecting their operations.

Relationship between HMRC and businesses

2.83 Securing practical administrative improvements can only partly be achieved through specific measures such as those explored above. It will be as important to embed that in enhancements to the relationship between HMRC and its VAT customers.

2.84 Two matters arose from the work on this review, which are worth highlighting in this context.

2.85 The first is different perceptions about the level or nature of tax avoidance in VAT.

2.86 It was concerning to find that many people suggested that at least some in HMRC appeared to be under a misapprehension about the level of VAT avoidance or aggressive planning that is taking place. Advisers and businesses suggested that VAT avoidance and aggressive planning were largely a thing of the past. This was said to have resulted from recent anti-avoidance legislation and the negative public attitude towards tax avoidance, especially since the 2008 financial downturn. However, it was widely thought HMRC had not recognised this.

2.87 In this context, there have been a number of recent corporate and other governance developments which, while not being directly connected with VAT, are also likely to influence how likely particularly large companies might be to ‘push the boundaries’. These include obligations placed on Senior Accounting Officers, the requirement for large businesses to publish a tax strategy, and the Professional Conduct in Relation to Tax (PCRT) obligations placed on advisers.

2.88 HMRC recognise that the vast majority of people and businesses in the UK pay the tax they owe and do not attempt to avoid their responsibilities. Nevertheless, where it exists, tax avoidance damages the ability of the tax system to raise revenue fairly and imposes additional costs on all honest taxpayers. Mass-marketed VAT avoidance may have reduced, but bespoke and more nuanced avoidance still exists, along with boundary pushing approaches to legal interpretation. In HMRC’s view, avoidance and these other risks continue to present a real threat and in response they take a risk-based approach to VAT and allocate resources accordingly.

2.89 The OTS has not sought to come to any conclusion about the level of tax avoidance or aggressive planning. However, we do want to draw attention to this difference of view between HMRC and business/advisers - and a lack of trust as a result, which appears sometimes to be adversely affecting partnership working, although it would be wrong to say that this is the case everywhere in the system.

2.90 The second matter concerns customer service and the provision of certainty.

2.91 Different customer groups have different needs from HMRC.[18] SME businesses and individuals with relatively simple tax affairs and limited interaction with HMRC are often content with the service they receive and express relatively high levels of satisfaction. However, businesses with more complex affairs and agents were less consistently satisfied.

2.92 Those business and advisory sectors dealing with HMRC's Customer Relationship Managers (CRMs) in Large Business, generally spoke highly both of the concept and of the individuals with whom they dealt, although some concerns were expressed at the high turnover of CRMs. Some smaller business groups and their advisers spoke of the frustration of not having CRMs and suggested that they be appointed for business sectors.

2.93 In this context, we note that the OTS report 'Simplification of the Corporation Tax Computation' recommended that the CRM role should be embedded, in line with HMRC's published strategy, to provide greater certainty.[19] In this regard, the OTS is engaging with the current HMRC Large Business consultation, as the Chancellor has asked us to do.[20]

2.94 It's important that we conclude this chapter by making clear that we found a real desire on both sides for a better relationship between business/advisers and HMRC and we trust this can be built on to maximise partnership working in the system.

2.95 One arrangement which can help facilitate this is the Working Together Groups, in which representatives from HMRC and the advisory sector meet periodically online to discuss common issues and problems. HMRC also regularly consults representative bodies such as the Chartered Institute of Taxation through the Joint VAT Consultative Committee (JVCC). While we understand that the JVCC and its subgroups works well, it has been said that it can be something of a "club" and that accessibility is not that easy for those not working for one of the Big Four accountancy firms or a major business.

Recommendation 17: HMRC should review its process for engaging with business and VAT practitioner groups to see if representation and effectiveness can be enhanced.

[18] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344753/report285.pdf
[19] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/624328/CT_Review_-_final_report_June_17_web.pdf
[20] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/645034/Large-Business-compliance_enhancing-our-risk-assessment-approach_consultation.pdf

3 Multiple rates

3.1 The UK has, in effect, four different VAT treatments: the standard rate (20%), the reduced rate (5%), the zero-rate, and exemption, plus some supplies being outside the scope of VAT. It is possible for a business to be making sales at all four treatments and to be receiving inputs at all four as well.

3.2 These VAT rates, their scope and any changes to them, are within the framework of EU law, at least while the UK remains within the EU. Although the UK could replace reduced or zero rates with the standard rate, it is not able to widen the scope of the zero rates, and if any supplies were removed from the scope of zero rates this treatment could not then be reinstated.

3.3 The boundaries between these treatments and the need for businesses, advisers and HMRC to work out which treatment applies, is in itself a prime cause of complexity and a source of continuing friction in the system. In addition, there are various situations in which the same services, if offered by different providers, can attract a different VAT rate.

3.4 At the margins, there are some curious anomalies:

Box 3.A: Examples of VAT anomalies

- chocolate milkshake powder is zero-rated but strawberry milkshake powder is standard rated
- many items of children's clothing made with fur skin are zero-rated, including rabbit, gazelle, dog and most goat skin. But goat skin from Tibet, the Yemen or Mongolia is standard rated[1]
- dog food for a working sheep dog is zero-rated (unless it is biscuits or meal), but food made for poodles is always standard-rated. Dry food such as biscuits is always standard-rated[2]
- a gingerbread man with chocolate eyes is zero-rated, but if he has chocolate covered trousers he will be standard-rated

3.5 The complexity inherent in a system with four different VAT rates has been compounded by two broader factors, which need to be borne in mind in considering potential ways forward, discussed below:

1. Wider government policy has changed a lot since 1973, both in its objectives and methods of delivery, but the scope of zero-rating and exemption have not all kept pace. Where changes have been attempted, it has often been on a 'make do and mend' basis due to constraints on policy makers.
2. The VAT system has not always kept pace with our changing society, particularly in the market place and in technology, raising questions about whether today's

[1] There is even an HMRC fur skin flowchart https://www.gov.uk/hmrc-internal-manuals/vat-clothing/vclothing3100
[2] https://www.gov.uk/government/publications/vat-notice-70115-animals-and-animal-food/vat-notice-70115-animals-and-animal-food#pet-food

products and services are within the intended spirit of the VAT rate applying to them.

Changes in government policy and practice

3.6 Government policy objectives have changed in many ways since VAT was introduced in 1973.

3.7 As a prime example, there is now a considerable emphasis on encouraging healthy living[3] which makes it perhaps surprising that chocolate chip cookies and biscuits coated with caramel (made from sugar) remain zero-rated. Back in 1973, nobody would have envisaged that breakfast cereal might one day come in the form of a bar but although cereals remain zero-rated, sweet-tasting cereal bars are standard rated, along with potato crisps and raisin snack pots. On the other hand, flapjacks, corn chips and raisins for baking are not.

3.8 The VAT treatment of particular supplies has been changed at various times to reflect government policy, including changes to exemptions and zero-rates or by introducing lower rates. In the case of food, this has produced a general zero-rating, but with complexity arising from the fact that as well as exclusions for catering and seven other items, there are then rules about seven further types of product which can override those exclusions.[4]

3.9 In the field of domestic building, VAT legislation treats a property as not a dwelling (for the purpose of zero-rating) if it is not capable of separate disposal or there is a restriction on who can occupy the property and/or for how long. The former is known as the "granny annex" test and was introduced to prevent extensions of existing dwellings being zero-rated and the latter was introduced to ensure that a dwelling was being used as a home and not a commercial concern.

3.10 However, planning consent has moved on since these restrictions to VAT were introduced. It is quite common for a planning authority to restrict the occupation of a building which is quite clearly a dwelling to limit its use or to provide that a new dwelling must be disposed of with an existing dwelling, even though they have separate plots and are quite clearly separate buildings. To members of the public, these nuances are not easily understood.

3.11 Similar issues arise with exemptions. For example, in relation to education and vocational training, the legislation lists the bodies whose services can be exempt.[5] However, developments in government policy have brought about a number of changes in educational providers meaning that the legislation has had to be updated frequently to keep up.

3.12 In relation to areas such as adult social care, local authorities are for various reasons increasingly acting as commissioning, rather than delivery, organisations, with a significant number of arms-length bodies being involved across the UK. However, while local authorities can recover VAT on these activities, provided that they are not carried out by way of business, other bodies cannot. NHS bodies similarly can recover some of the input tax they incur on purchases for non-business purposes, but people they commission to provide those services may not be able to recover VAT they incur. VAT implications may need to be considered as part of any further moves towards merging the commissioning and delivery of health and social care.

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[3] https://www.gov.uk/government/publications/the-eatwell-guide
[4] VAT Act 1994 Schedule 8 Group 1.
[5] VAT Act 1994 Schedule 9 Group 6.

3.13 The position of day care services is also tricky, and indeed subject to current litigation.[6] The general rule is that welfare services are exempt if state regulated or provided by an eligible body. However, in England (unlike other parts of the UK), such services are not state-regulated. So, where they are provided to the individual receiving them rather than to the local authority, it is possible that an unintended VAT cost can be created.

3.14 There are many other examples of tensions between VAT legislation and regulations managing other aspects of the social care environment. More widely, the Mirrlees Review, conducted under the auspices of the Institute for Fiscal Studies, came to following conclusion in 2011:

Box 3.B: Quote from Mirrlees Review

"The exemption for services in the public interest, such as health, education, postal, and cultural services, is closely related to the effective exemption applied to many public sector bodies. But the two are not the same, and the relationship between them is becoming more important and more complicated as various forms of privatization, liberalization, outsourcing and public-private partnerships increase private sector involvement in the provision of public services and blur the boundaries between the two sectors. To some extent, what we have is a VAT system which has just not adapted with the economy. Blurred boundaries between public and private sectors lead to arbitrary differences in the tax treatment of similar organizations doing similar things. If public and private sector bodies are competing, they might not do so on a level playing field: public sector bodies many have an advantage in providing services to final consumers or to other exempt bodies because of the lack of output tax, whereas private sector firms' ability to recover input VAT may give them an advantage in providing services to taxable firms".[7]

Charities

3.15 Whilst perhaps few if any complexities in these areas are unique to charities and universities, they are more acutely felt by them, often because more of the complexities can apply and, in the case of some charities, because of the lack of resource to deal with them.

3.16 In 2001/2002, according to figures provided by one respondent, 51% of charities' income came from supplies of services and 49% from grants. In 2014/2015, that had changed to 81% from services and 19% from grants, showing the far greater role charities are playing in providing services.

[6] The First-tier Tribunal has recently ruled that whilst it is not unlawful to have regional differences within the UK in the regulation of care providers, it is unlawful to have regional differences in the way in which VAT rules are applied. HMRC is appealing that decision: Learning Centre (Romford) TC/2014/06045

[7] Mirrlees, Tax by Design pp176 - 177

Box 3.C: Case study

A registered charity derives its income from charitable giving, research council grants and partnerships with industry. It builds a new research facility for, say, £10m.

If 95% or more of its use of the new facility is for non-business purpose, no VAT is charged; whereas if it is used 95% or more for business purposes, VAT is charged which the charity can recover as input tax (unless, as it quite often the case, the business activities are exempt). If the use of the facility is mixed (which is very likely), VAT must be charged and only the proportion relating to the taxable business can be reclaimed.

If VAT has not been charged, and the charitable use proportion falls over the following ten years, the charity is required to pay some VAT to reflect this. However, if the charitable use proportion were then to rise again, there is no provision for the charity to be refunded any of this additional VAT.

3.17 As the Upper Tribunal said in one particular case ''We think it unlikely that Parliament intended such a capricious system… We think the legislation should be reconsidered. It cannot be impossible to relieve charities of an unintended tax burden while at the same time protecting commercial organisations from unfair competition and preventing abuse.''[8]

Universities

3.18 Similar complexities can also be seen in the university sector. Business models here are evolving all the time, with new income streams being generated, more involvement with industry and the local community and more overseas operations. However, it is difficult to determine the VAT treatment of research-related income, which can be exempt (in very limited circumstances); outside the scope of VAT with no right to deduct input tax; outside the scope but with a right to deduct input tax; or taxable at the standard rate.

Changing society

Market

3.19 The market place has changed radically since 1973. The development of new products, or variants on existing products, happens frequently and increasingly manufacturers are developing new products on very quick time scales as they respond to market trends.

3.20 A new product can go from an idea to market in a few weeks. In the food and beverages sector this causes problems when considering the pricing impact of zero rating versus the standard rate when selling directly to consumers. For example, there is now a far greater range of what are generally thought of as crisps. Corn chips are very similar to potato crisps but due to their ingredients have a different VAT liability.

3.21 Similarly, the market for children's clothes has changed. Children have got bigger and so more of them are likely to wear what in VAT terms is regarded as adult clothing, while smaller adults can wear children's clothing and shoes which are zero-rated.

[8] Wakefield College (2016) UKUT 19 (TC) UT/2014/0013

Technology

3.22 Some of the issues here lie in the ability of computer systems to provide financial information and advice that once upon a time only a human could provide. The liability of some supplies is dependent on whether a supply of intermediary services has taken place. A number of examples arise in relation to financial services, which can have multiple chains of intermediation, some human and some electronic. These can give rise to disputes about the nature of particular transactions and therefore the liability of the supplies in question.

3.23 Another challenge arises with supplies of electricity, which are standard-rated when used for business purposes, but reduced-rated (5%) for domestic purposes. To save the need to consider whether individual premises are commercial or domestic, a de minimis limit applies on a per premises basis. However, it is now entirely possible for there to be a number of meters on premises, each one providing electricity from a different supplier. With the advent of smart meters, it may soon be possible for a person or business to change their supplier frequently – perhaps even on an hourly basis. Accordingly, this approach no longer seems fit for purpose.

3.24 Reduced-rate VAT also applies when electricity is provided to buildings used for relevant charitable or relevant residential purposes. Certificates must be supplied to evidence this and we have been told that dozens of these are received by big electricity providers every day. A significant proportion are queried and an average of four people at each of the four largest providers are employed full-time on this work. The 5% provision also leaves scope for tax planning. There is some evidence of boundary-pushing whereby attempts are made to have 5% VAT applied to parts of premises where it is arguably not justifiable.

3.25 The ever-changing nature of the market place and of technology is a strong argument for 'future proofing' the VAT system, to reduce the need for ongoing changes to it.

Possible way forward

3.26 The field of multiple rates, and the boundaries between them, is large and complex and - importantly - has wider ramifications beyond simplification.

3.27 As noted at the beginning of this chapter, for as long as the UK VAT system is governed by EU law there are significant constraints on what changes can be made.

3.28 Generally, it's unlikely to be effective to make isolated or piecemeal changes, rather than considering areas of the system more widely. What follows is aimed at developing a longer term approach.

3.29 Our interim report asked about the impact of introducing broader definitions in areas such as food. Almost unanimously, those bodies and individuals who engaged with us in this area favoured this and the comprehensive review that would be its necessary precursor.

3.30 Broader and more flexible definitions would address a suggestion made to us by some respondents that the law should adopt a more principles-based approach. This would focus more on what the legislation is intended to achieve rather than going into minute detail.

3.31 Against this, such an approach could simply serve to increase uncertainty as the law would allow more scope for interpretation. That is not to say that a principles-based approach is necessarily a bad idea, just that it could have wide-ranging implications which would need careful consideration. For example, tribunals could find it harder to come to decisions.

Core recommendation 4: HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS.

3.32 The aim of this review would be to simplify the rates structure as far as possible, and consider options to ensure that the structure is more able to adapt to changing government objectives and changes in the market and technology.

3.33 In relation to the zero-rating (or reduced-rating) of goods, an alternative approach would be to allow zero-rating only for goods on a list (specified by their tariff nomenclatures) as some other countries do, with any other goods being standard rated.

3.34 It is easy for a business to obtain the appropriate tariff code for its goods by simply entering a description of them online. There is also currently a well-established system in which people can obtain non-binding or binding rulings on the tariff codes applicable to their goods, although as these rulings apply across the EU, there is the potential for significant change following Brexit. Such a system would require the nomenclatures to be recorded on sales invoices as evidence of the applicable VAT liability. Any wholesaler already trading internationally will have already them, and domestic businesses could obtain them.

3.35 This approach would address some of the uncertainties that might arise from very broad definitions but raises the risk of continuing complexity in making narrow distinctions between the liability of different classes of supply.

Recommendation 18: HMRC should explore the possibility of listing of zero-rated and reduced rate goods by reference to their customs code, drawing on the experience of other countries.

Longer term possibilities

3.36 More generally in this area, one radical long-term option would be to make everything taxable that is currently exempt, which includes land, insurance, betting, finance, education, health and welfare and sport and physical education. This would sweep away the complexity of a business needing to determine how much of its input tax relates to exempt supplies, but adding VAT to some of these would be quite challenging and would add some complexity, for example in valuing previously exempt services. Such a change could be balanced to ensure prices/revenue remain broadly the same. If there was a significant VAT loss for the Exchequer, that should be passed through in lower prices.

3.37 As businesses would be able to reclaim previously restricted input tax, applying VAT at a reduced rate of, say, 5% to currently exempt activities might not require significantly higher prices to consumers overall. However, the additional input tax reclaimed by businesses would be likely to outweigh the gain from the reduced rate, resulting in a significant cost to the Exchequer.

4 Partial exemption

Background

4.1 In the context of this review, HMRC, business and advisers agree that there is merit in looking again at aspects of the partial exemption regime. The processes involved are not as efficient as it feels they ought to be, and often they do not provide timely certainty to businesses.

Relations between HMRC and businesses

4.2 External contributors to our review felt that HMRC tended to treat partially exempt businesses with unwarranted suspicion. The fact that tax avoidance and partial exemption are both handled within HMRC by a combined Tax Avoidance & Partial Exemption (TAPE) team was often quoted as an indication of this.

4.3 This conjunction gives rise to a measure of resentment: although this feature of HMRC's operational structure need not imply an inappropriate link, it does affect perceptions. In particular, it means any business engaging with HMRC about partial exemption, however routinely, will receive communications bearing a letter-head featuring the word avoidance.

4.4 We understand that HMRC are open to considering ways to improve interactions. The team name is not intended to imply that partially exempt businesses are engaged in avoidance. HMRC are keen to reassure businesses that there is recognition of the complexity and difficulties involved in finding an appropriate partial exemption method, and will look again at the name as part of their wider consideration of relationships with businesses in this area.

4.5 This chapter explores the complexities of partial exemption, and makes a number of suggestions for simplifying the process, which should reduce resource cost for both HMRC and businesses and improve working relationships.

4.6 A number of recommendations aim to improve the process of dealing with marginal amounts of exempt input tax. Options to simplify partial exemption calculations and streamline the process of agreeing special methods are also explored.

Recovery of input tax

4.7 The law differentiates between taxable supplies and supplies that are exempt from VAT. It is a fundamental principle that VAT paid by a business on what it buys may only be recovered if the purchases concerned are used to make taxable supplies.

4.8 So, businesses that make only taxable supplies[1] can in general claim back all of their input tax. Businesses that make only exempt supplies are not allowed to claim back any input tax and are, in fact, not allowed to be registered for VAT at all.

4.9 However, many businesses are partially exempt – that is, they make a mixture of taxable and exempt supplies. The business must then work out how much of its input tax relates to taxable supplies and can be reclaimed and how much relates to exempt supplies and cannot (generally) be reclaimed.

4.10 There are various methods of carrying out these calculations but all involve the business attributing VAT on their purchases directly to taxable or to exempt supplies so far as possible.

[1] or supplies which are outside the scope of VAT and which carry a right to deduct input tax

Input tax that cannot be attributed exclusively to either taxable or exempt supplies (for example, general overheads such as electricity, or expenses such as accountancy and legal fees) is called residual input tax. A calculation is required to establish how much residual tax can be reclaimed.

4.11 The many, often complex, issues of partial exemption essentially revolve around one basic question: What 'fair and reasonable' method can be used to establish how much of the residual input tax can be reclaimed?

4.12 There are essentially two ways of carrying out these calculations. The default position is for a business to use the standard method[2] or, if this does not give a fair and reasonable result, to propose a special method.

Special methods

4.13 Any special method requires approval by HMRC. The time taken to get this approval is a significant issue for partially exempt businesses and their advisers. Also, once approved, there are no standard time limits under which special methods must be reviewed, so they can easily go out of date and cease to reflect the reality of the business activities.

4.14 In addition, whilst a taxpayer is required to have its special method re-approved when there is a change of business activity, the review team heard that many are not resubmitted due to the length of time the process takes.

De minimis calculations

4.15 We noted above that businesses with input tax attributable to exempt supplies cannot *generally* reclaim it. However, EU legislation allows Member States to ignore "insignificant" amounts of input tax relating to exempt supplies. The UK has adopted 'de minimis' tests to determine these insignificant amounts.

4.16 Once the total amount of input tax relating to exempt supplies is calculated (the input tax directly attributable to exempt supplies plus the exempt element of the residual input tax), this is compared with the de minimis tests.

4.17 The de minimis test has not changed for nearly 23 years and provides that if the total amount of input tax relating to exempt supplies is less than:

- £625 per month on average (£7,500 per annum)
- 50% of the total input tax incurred

it can be claimed in full.

4.18 If the amount is above either limit, it is not recoverable.

4.19 Any business making any exempt supplies must, at least in theory, carry out partial exemption calculations even though there may be little doubt that any exempt input tax will be below the de minimis limits so that the business will suffer no restriction of input tax.

4.20 In 2010, simplified methods were introduced to try to reduce the administrative burden on taxpayers. However, most involve a calculation similar to the de minimis test above, with different limits based on income, etc. which still involves some complexity.

[2] The standard method requires businesses to calculate the value of their taxable supplies as a percentage of their total supplies. That percentage is then applied to their residual VAT to arrive at the amount that can be recovered. https://www.gov.uk/government/publications/vat-notice-706-partial-exemption/vat-notice-706-partial-exemption

4.21 There has not been a significant uptake of these methods. Anecdotal evidence suggests that many taxpayers and advisors are unaware of them or prefer the standard test as it is very well known and understood. Unfortunately, no data is available as HMRC does not collect data on the number of people using particular methods.

4.22 This is one of a number of gaps in available data that limits the evidence base for policy change. Under MTD, some supplementary information will be required to be kept in addition to the standard VAT return entries. One of these items is the annual adjustment required for partial exemption.[3] It is hoped that this may improve the evidence base for future policy development.

Complexity

4.23 The review has identified three main areas of complexity:

1. many businesses are required to carry out partial exemption calculations when they know that they are likely to be fully taxable
2. a de minimis test which measured what was 'insignificant' in 1994 (£625 per month) but has not been increased for a generation
3. the time and complexity often involved in identifying an appropriate partial exemption special method and agreeing it with HMRC

Potential solutions

4.24 Consideration should be given to simplifying the operation of the partial exemption regime, as the impact on lowering the administrative burden would be significant for businesses. This should also offer some savings to HMRC. We set out some options for further policy development below.

1. Allow businesses with less than a fixed percentage of exempt supplies to recover all of their input tax

4.25 If, for example, no more than 5% by value of a business's supplies are exempt, this could be considered de minimis - and the business allowed to recover all of its input tax. To minimise potential revenue loss and opportunities for manipulation this might apply only to businesses with turnover less than £150,000 (the upper band of the entry level to the flat rate scheme).

Advantages

- the methodology is simple
- accounting systems can identify taxable and exempt income quite easily
- taxpayers do not need to carry out complex calculations to see whether the input tax is recoverable

Disadvantages

- this would not fulfil the purpose of the de minimis rules, which is to ignore insignificant exempt input tax. That is because the level of exempt input tax does not necessarily correspond to the value of exempt supplies
- there may be a financial impact to the Exchequer. Restricting it to comparatively small businesses would limit this

[3] http://webarchive.nationalarchives.gov.uk/20160608234203/https://www.gov.uk/government/groups/joint-vat-consultative-committee-jvcc

- businesses might seek to structure themselves to fall within the taxable supplies percentage, so anti-avoidance legislation might be required

2. Allow businesses incurring less than a certain amount of total input tax to recover all of their input tax

4.26 This is a variation of option 1. However, the limit would be based on a set amount of total input tax. For example, if the limit were set at £12,000 per annum, any business incurring input tax under that amount would be able to recover all of it. Other businesses would have to carry out a full calculation. To avoid the possibility of business that have mostly exempt supplies being able to recover all of their tax, there might be a rule that this only applied in cases where businesses made mostly taxable supplies (for example, 75% or more taxable).

Advantages

- total input tax is easy to identify from the VAT records, as it is part of the accounting records. It can be easily compared to the set threshold
- small taxpayers who fell within the scheme would never need to consider partial exemption due to the level of input tax they incur

Disadvantages

- there may be a financial impact to the Exchequer but this cannot be quantified

4.27 The numbers used above show how such arrangements might work. The figures used are for illustration only.

3. Increase the current de minimis limit in line with the Retail Prices Index ("RPI") each year

4.28 Many VAT jurisdictions have de minimis limits. Amongst the highest are those in Australia (approximately £250,000 followed by a flat rate percentage recovery on certain costs), New Zealand (£50,000 and 5% of the total input tax) and Singapore (£23,000 and 5% of the total input tax). However, others have a nil limit (for example Germany).

4.29 EU law allows for "insignificant" amounts of input tax relating to exempt supplies to be recovered. The definition of, or means of valuing, "insignificant" amounts is not prescribed in EU law, so raising the de minimis limit in line with RPI each year would not seem to be ultra vires.

4.30 If the UK de minimis limit of £7,500 a year had been increased by RPI since its introduction in 1994, it would now be £13,700 (as at August 2017).

Advantages

- this would assist those businesses with very low amounts of input tax relating to exempt supplies, as a higher amount of input tax would be treated as insignificant and fully recoverable

Disadvantages

- businesses would still need to perform what is often considered to be a complex calculation to check whether they remain below the de minimis limit and able to recover the input tax incurred relating to insignificant exempt supplies

Impact

- it is not possible to quantify the impact on the Exchequer, as no data is available. In 2010, an Impact Assessment Note was issued where the amount quantified then was approximately £250 million (based on an increase in the de minimis at that time to £12,000).[4] However, we understand that up to date comparative data is not available. HMRC does not require businesses to indicate their partial exemption status in their returns and no recent data has been collected that would facilitate an assessment of the cost to the Exchequer

4.31 Some countries, such as Germany, have no de minimis limit. This means the input tax relating to exempt supplies is disallowed in full, even if it is of insignificant value. We considered this option but do not recommend it, as it would not simplify the tax calculation for any VAT business and would mean that many small taxpayers had to restrict insignificant amounts of tax. Removing this existing relief would be very unwelcome to taxpayers.

Box 4.A: Case studies – special measures

1. Businesses and charities with complex VAT affairs often find that the standard method for the recovery of input tax does not fairly reflect their business models and have to apply for approval to use a special method. This process is long and involved for both taxpayer and HMRC. We have heard from many stakeholders that the process often takes 2 years and occasionally up to 5 or 7 years. This ties up valuable resources for all parties and leads to frustration and "grit in the system".

2. Many kinds of businesses are required to make partial exemption calculations, but it has a particularly significant impact on the charity sector, many of whose activities are exempt because they improve societal wellbeing. Whilst the technical impact is no different to a business that, say, rents out some properties, the resource impact is often proportionally greater. This is because many charities are relatively poor in terms of funds to pay advisors or to hire staff with specialist tax knowledge.

4. Fixed percentage recovery based on sectors

4.32 This would work in a similar way to the Flat Rate Scheme, in that average or typical input tax recovery rates would be calculated on a sector basis, and published and checked regularly.

4.33 In Singapore, where this method is used for the banking sector, the review is undertaken by the Tax Authority annually. Financial institutions are categorised by their banking licence – a bank with a large UK retail operation (so making mostly exempt supplies) would have a lower recovery rate than a branch of an international bank with significant business activities outside the EU.[5] Subject to resourcing at HMRC it is envisaged that the review would work in a similar way as in Singapore to keep the rates current and effective.

[4] http://www.legislation.gov.uk/ukia/2010/71/pdfs/ukia_20100071_en.pdf p7
[5] Supplies of financial and some other services made outside the EU are treated as outside the scope of UK VAT but with a right to recover related input tax.

Advantages

- the methodology is simple. Taxpayers would know what percentage to apply to their total input tax without the need to undertake a complex calculation to determine what input tax relates to which supply
- trade sector bodies could be consulted in deciding the rate, thus maximising the chances of acceptability for business
- the recovery for any sector would be transparent and publicly available
- there would be no need for a de minimis test

Disadvantages

- as with any flat rate scheme, there would be winners and losers, and the Singapore scheme applies in a context where the threshold is very high
- an optional scheme would be used only by those businesses that find it financially advantageous, with associated revenue loss
- mandatory use would reduce revenue cost and simplify administration but is unlikely to be welcome to all businesses
- there would be an additional administrative burden on HMRC to keep the recovery percentages up to date. It may need additional resources to calculate the flat rate percentage

5. Use of frameworks

4.34 Currently, certain sectors (such as higher education and housing associations) have agreed frameworks in place. Frameworks are additional guidance put together by HMRC with the assistance and involvement of sector representative bodies. They cover when and why special methods are likely to be needed in the sectors and provide an indication of what does and doesn’t work for the sector. The aim is to streamline the process of agreeing special methods.

Advantages

- the framework provides a guide to acceptable methodologies for taxpayers
- it is likely to be formed around the type of accounting records used in the sectors where the framework is agreed
- the framework is agreed between HMRC and stakeholders in the sectors

Disadvantages

- the framework calculations are often complex and may have several variants
- in financial terms, there will be winners and losers - for some taxpayers the frameworks will lower their recovery rate as they are agreed across a sector
- Where framework calculations have already been agreed, some in the sectors concerned still prefer bespoke Partial Exemption Special Methods (PESMs)

6. Use of accepted variants of the standard method

4.35 Many PESMs are applied for because a slight tweak to the standard method is necessary to achieve a fair and reasonable result. The introduction of use-based method in 2010 went a little way towards introducing an alternative to the outputs-based standard method, but there are possibly more variations to the standard method that could be introduced that would produce a fair and reasonable result in relevant contexts. contexts

4.36 Discussions with stakeholders identified that in some trade sectors, particular calculation methodologies were more easily agreed as PESMs than others. It may be that there are certain combinations that could be almost "rubber stamped" and these could be publicised with guidance for taxpayers to determine whether they could use them. This approach is used in other areas, for example in relation to automatic permission for the option to tax when exempt supplies have been previously made.

Advantages

- there would be a greater choice of methods available which may make the need for a PESM less pressing
- more authorised variants should lead to less resourcing issues for HMRC and the ability to focus on those PESMs that do require approval

Disadvantages

- more variants would potentially call for more central resources for HMRC to keep them up to date
- there is a risk of having too much choice, as was the case with the de minimis tests that were introduced, with businesses sticking with "the devil you know"

4.37 In giving guidance on methods that may be suitable, the requirements of MTD should be borne in mind. To simplify the process of completing VAT returns, it will be important that any method should be capable of being automated, drawing source data from existing digital records.

7. Remove the requirement for the taxpayer and HMRC to negotiate a PESM before use

4.38 This would reflect the original intention of the "fair and reasonable declaration" which businesses are required to make when requesting a special method.

4.39 Businesses would be required to take reasonable care in arriving at the proposed PESM (for example to take advice and undertake a worked example using the accounting software) before submitting the declaration.

4.40 The PESM would come into effect automatically but HMRC could review it at any time and bring its operation to an end and apply penalties for misuse (for example if the taxpayer was unable to demonstrate that reasonable care had been taken to arrive at a fair and reasonable recovery rate).

4.41 This option could incorporate a period, say 90 days, in which HMRC could reject the PESM before it came into effect. That would enable HMRC to risk-assess the PESMs received and investigate any that caused particular concerns.

Advantages

- this could significantly reduce the time taken to bring PESMs into effect
- HMRC would have the right to review any PESM and have the increased ability to levy penalties for any PESMs that have not been prepared with reasonable care and not "fair and reasonable"

- HMRC would be able to concentrate resources on PESMs that could potentially lead to over-recovery of VAT, rather than negotiating a significant number of routine PESM applications as is the case now
- resource savings for taxpayers as fewer protracted negotiations would be required

Disadvantages

- less certainty for taxpayers as the PESM has not been thoroughly reviewed and specifically approved by HMRC
- businesses may feel that the scope of what is "fair and reasonable" is insufficiently clear or certain
- feedback from HMRC is that it is already difficult to prove that the taxpayer knew that their PESM was not "fair and reasonable", principally because it requires a judgment that balances a range of factors
- proving that "reasonable care" has or has not been taken is difficult for both the taxpayer and HMRC, as it is a matter of judgment

4.42 Such a reform could significantly reduce the resource cost for agreeing PESMs for both businesses and HMRC. Reasonable safeguards against misuse should and can be built in and HMRC's risk-based compliance activity would be able to focus on areas where there is a significant possibility of revenue loss.

8. Continue with the current approach to PESMs but provide clearer guidelines as to what is acceptable and introduce a time limit for their agreement

4.43 Some stakeholders were concerned that removing the process of negotiating a PESM with HMRC would itself result in uncertainty.

4.44 One of the issues HMRC have highlighted is that a significant number of PESM approval applications do not provide enough evidence of the need for the proposed PESM.

4.45 If it is not considered possible or desirable to approve methods by default as suggested at item 8 above, HMRC should consider better guidance and shorter time frames for negotiating PESMs to reduce the length of the process and provide certainty.

4.46 HMRC has published a list of suggested documents that it requires to make a decision and speed up the process in Appendix 2 of VAT Notice 706. However, we found evidence that advisers and businesses were not always aware of this or using it.

9. Remove the requirement to renegotiate a PESM for minor changes in activities or income streams

4.47 Strictly speaking, any change to business activities requires a review of the PESM to ensure it is still fit for purpose. However, due to the risk of lengthy negotiations, this is often overlooked, leading to "fraying" or minor adaptations being made to the existing PESM. It could help to regularise this approach.

Advantages

- businesses could continue with the operation of the PESM without the need for renegotiation or approval where there are only minor changes (for example, new taxable or exempt income stream)

Disadvantages

- the term "minor" is also subjective and may need to be defined to avoid confusion
- HMRC may see a need for further legislation to counter any avoidance that may result from such flexibility

10. Introduce a time limit for the duration of the PESM

4.48 Some PESMs have not been renegotiated for a long period of time. Anecdotally, there is one in place that was agreed in 1976, even though the income streams and activities have changed. To counter this, many people have suggested to us that limiting the duration of the PESM might be necessary.

4.49 Typically, periods of between two and five years were suggested. After that, the business would be required to propose a new method (or to declare that the existing method still produced a fair and reasonable result, if appropriate).

Advantages

- businesses would have some certainty as to the length of time that the PESM is valid for and can plan for renewal
- small changes in activities or income would be addressed in a shorter space of time in cases where the business might not put forward a revised PESM when changes occur

Disadvantages

- having to renegotiate or re-approve PESMs periodically may increase the administrative burden on both the business and HMRC, as it would increase the number of approvals
- some form of reminder system may be needed so that taxpayers undertake the review and seek re-approval of the PESM. This creates a potential administrative burden on HMRC, though this could potentially be built into MTD

4.50 For the process of making applications: an aide memoire might help businesses ensure that they provided all relevant information with their method applications, and a specialised hub or gateway for making method applications could ensure that they were monitored for timely responses, and make the guidance more accessible.

4.51 HMRC may wish to consider reviewing the information requirements in Notice 706, and also to consider options to increase awareness among taxpayers and advisers of the requirements for a successful method application.

4.52 Professional bodies and advisors should be encouraged to participate in this process and update their members/clients as to the correct process.

Core Recommendation 5: The government should consider increasing the partial exemption de minimis limits in line with inflation, and explore alternative ways of removing the need for businesses incurring insignificant amounts of input tax to carry out partial exemption calculations.

Core Recommendation 6: HMRC should consider further ways to simplify partial exemption calculations and improve the process of making and agreeing special method applications.

4.53 Options for consideration include: simplified ways of excluding businesses incurring insignificant amounts of exempt input tax from needing to carry out partial exemption calculations; introducing fixed rate recovery percentages; further sectoral framework agreements; accepted variations to the standard method; and no longer requiring PESMs to be approved in advance of their use. The first and last of these options appear to offer the most scope for meaningful change to simplify VAT calculations for businesses without increasing the risk of tax loss.

Recommendation 19: HMRC should consider ways of ensuring partial exemption special methods are kept up to date, such as giving them a limited lifespan.

5 Capital Goods Scheme

Introduction

5.1 This scheme aims to ensure that input tax recovery on certain capital assets reflects the actual usage of those assets over time.

5.2 The assets subject to the capital goods scheme (CGS) are:

- land, buildings and civil engineering work costing £250,000 or more
- computers and computer equipment costing £50,000 or more
- aircraft, ships, boats or other vessels costing £50,000 or more

5.3 The input tax has to be adjusted to reflect the asset's use over a period of 5 years (computers, boats and aircraft) or 10 years (land and property). Where a business is partially exempt or has non-business activities, the calculation follows standard principles: if the building is used for a purpose which is wholly taxable or wholly exempt then it is either recovered in full or not at all; if used for general business purposes the annual recovery percentage should be used for each year in which the scheme applies.

5.4 A number of issues with the scheme have been identified during this review.

5.5 The threshold for land and buildings has not increased since its introduction in 1990. The value of commercial property has of course increased significantly in that time, resulting in an increase in the number of businesses subject to the scheme. The number of extra taxpayers caught by the CGS as a result is not currently known.

5.6 The scheme applies to extensions, alterations and refurbishment of existing buildings as well as initial fitting out, so some businesses have multiple CGS calculations running on the same property.

Box 5.A: Examples

- Year 1 – building purchased for £500,000 plus VAT. This creates the need for an annual CGS calculation for the next 10 years
- Year 3 – building is refurbished, the value of which is £330,000. This creates a second CGS item with an annual calculation for the next 10 years
- the business at this point has one CGS item with 7 years of calculations left and a second item with 10 years of calculations left. Both are for the same building but based on different amounts and potentially for a different mix of use

5.7 The £50,000 threshold for single pieces of computer hardware is rarely triggered, as most computer hardware is low in value and often not treated as a capital item in the businesses' accounts. The threshold is usually only triggered by single items of computer equipment, rather than whole systems. It does not include equipment that is computer controlled (for example laboratory equipment and robots) Historically, including computers and computing equipment in the scheme was relevant as individual pieces of equipment were expensive to buy. However, in today's technological age, the relevance is less clear. Complex and sophisticated servers and computer equipment suitable for most business needs rarely cost more than £50,000.

5.8 Similarly, we understand that the £50,000 threshold for boats and aircraft is also rarely triggered, with many businesses that own such craft treating them as used for private purposes and not claiming the VAT.

5.9 The time and administration required for what are often relatively small adjustments is significant for business. One business explained that it took 70 hours to do its CGS adjustments, resulting in an extra recovery of less than 1% of its annual irrecoverable input tax. We understand this is not unusual where there are large numbers of CGS items. In addition, where external advisors are employed to check or perform the calculations, there are additional costs.

5.10 At the other end of the scale, a number of businesses that should be within the CGS do not make adjustments, as they do not realise the scheme exists or applies to them. A typical example, is a business acquiring a building and initially using it for their own taxable purposes. Later, they may rent out a floor and do not opt to tax that rental. HMRC guidance on CGS is available. HMRC also have an e-learning product for landlords. This refers to Notice 742A (Opting to Tax) but does not mention CGS.[1] It suggests that taxpayers should consider consulting a professional adviser for help with the complexities of VAT on property. There is no single landing page that outlines the VAT implications of property ownership for those who do not have specialist advisers.

5.11 HMRC may wish to consider ways of making information about the CGS scheme easier to access, for example by collating the information on the VAT implications of property ownership in one area on the gov.uk website.

5.12 The definition of 'use' has been subject to significant litigation over the years, leading to confusion and complexity, including whether it is economic or physical use that is the test for the CGS. There may be a high amount of income generated for, say the rental of part of a building, but the occupation or use may be small in terms of floor space. HMRC tends to favour economic use. Case law has reached different conclusions as to which should apply over a period of time.

Potential improvements

5.13 We have identified a number of potential improvements to the operation of the CGS.

1. Raise the value of items caught by the CGS in line with inflation

5.14 The threshold could be linked to inflation, which would mean an increase to approximately £522,000 (if inflation uplifts were applied to the original limit). It has not been possible to obtain data on the yield impact from this as HMRC do not have data about the extent of the use of the scheme.

Advantages

- this would remove the need for complex and time consuming calculations for smaller property purchases and refurbishments

[1] http://www.hmrc.gov.uk/courses/syob3/new_letting/HTML/new_letting_menu.html

Disadvantages

- discussions with stakeholders suggest that a limit of £522,000 would not make any significant difference to the number of calculations that are required, essentially because property price inflation is so much greater than general inflation
- it would exclude businesses that would benefit from being able to adjust the input tax incurred and who would have been within the scheme at the current threshold. One option would be to allow voluntary use of the CGS for those businesses, though clearly that would have an additional yield impact
- there is likely to be an impact on the Exchequer and, as mentioned above, no data is available to quantify this. This is data which could potentially be captured more easily following the introduction of MTD for VAT

2. Introduce a new increased threshold for owner-occupied properties only

5.15 Businesses with investment properties may be more likely to have the infrastructure and mechanisms to track and calculate CGS amounts.

5.16 However, businesses that get caught out are often those occupying property for their own use and which then change the extent of that use. These businesses do not often realise that the CGS exists. Focusing any threshold increases on these situations could make sense.

Advantages

- if the threshold is increased significantly for property occupiers, it would remove the need for a significant number of them to undertake the CGS calculations

Disadvantages

- having multiple thresholds increases confusion and complexity

3. Remove the formal requirements to make CGS adjustments

5.17 Many countries, such as Australia, do not have a CGS methodology but adjust for use as necessary as part of the preparation of each VAT return. The calculation is not prescribed and only needs to be "fair and reasonable". Therefore, it is possible to calculate the use of the asset in a variety of ways.

Advantages

- there is no prescribed additional annual calculation
- a business might choose to make calculations over periods of time suiting its circumstances, if the law was changed to allow that

Disadvantages

- the current UK calculation has a prescribed methodology. Introducing an undefined method would require businesses to devise their own. This is likely to confuse some businesses and might encourage others to adopt creative ways of calculating use and/or to engage in avoidance
- removing the requirement to make CGS adjustments could mean that input tax on large acquisitions is not related to use over time, as businesses would not be required to make adjustments after the first year of use

4. Introduce a de minimis test to limit the need for calculations under the CGS

5.18 When a business's input tax recovery percentage does not change very much from one year to the next, the requirement to carry out CGS calculations can be disproportionate. This could be addressed by not requiring adjustments unless and until the change in the recovery rate exceeded a certain amount, or the absolute level of the adjustment was large enough.

5.19 In the UK, businesses are required to show that they have considered the impact of the CGS on capital items, even if the business only makes taxable supplies. Ireland does not require this - only businesses that use buildings for exempt supplies are required to consider CGS and make relevant adjustments.

Advantages

- this would remove the need for a CGS calculation for those businesses that have minimal changes in use or only use the asset for fully taxable purposes, and would be easy to identify by reference to annual adjustment calculations

Disadvantages

- we would expect this to be broadly revenue-neutral – as some adjustments might have increased recovery and some might have reduced it. No data is available as to the quantum of adjustments made by businesses under the CGS. This could potentially be built into the process followed under MTD

5. Application of the CGS over longer intervals

5.20 The requirement to undertake annual calculations can be onerous for businesses with multiple CGS items. Often these calculations yield insignificant amounts of input tax by comparison to the size of the business turnover or input tax incurred. One suggestion, as an alternative to the suggestion above, is for the calculation to be done every 2 or 3 years for land and buildings.

Advantage

- reduction in administration for businesses

Disadvantage

- the number of individual calculations for land and buildings calculations would be reduced, as there would be only three or four instead of ten: if not done every year, businesses might forget to do the calculations, or forget how to do them

Under current EU law the minimum number of intervals for a capital goods scheme calculation is five annual periods.

6. Deduction of VAT on construction services prior to VAT registration

5.21 If a business registers for VAT because it makes or intends to make taxable supplies and has incurred VAT on goods and services prior to registration, UK law allows the recovery of this VAT provided it was incurred within four years of the registration (for goods) or within 6 months of registration (for services).

5.22 Building contracts are often lengthy and are paid for in stages. If a business registers more than 6 months after it first incurs costs on construction services, it will not be able to recover the VAT on them.

5.23 It is often possible to backdate a VAT registration (with HMRC's permission). If backdated registration is not allowed, the business will suffer a potential VAT loss.

5.24 The rules regarding the recovery of VAT on construction and other services relating to land and property could be reconsidered to mirror the four-year period for goods to remedy this. This could lead to exploitation so anti-avoidance legislation might also be needed.

Advantages

- businesses would be able to recover pre-registration VAT on construction and other relevant services used as capital items in their business
- the rules for recovering VAT prior to VAT registration on goods and services that create a capital asset would be aligned

Disadvantages

- the change is likely to have some revenue cost. It is not possible to estimate this cost, given the lack of information available about the use of the CGS
- having two different time limits for recovery of input tax on pre-registration services could cause added complexity

Core Recommendation 7: The government should consider whether capital goods scheme categories other than for land and property are needed, and review the land and property threshold.

Recommendation 20: The government should consider introducing a de minimis level for capital goods scheme adjustments to minimise administrative burdens.

7. Alignment with capital allowances regime

5.25 One suggestion we received was that it may be helpful to align the CGS and capital allowances regimes. While we have not identified a straightforward way of doing this, this is something that could be worth further consideration in the future.

6 The option to tax land and buildings

Background

6.1 Supplies of commercial land and buildings (other than buildings less than three years old) are by default exempt from VAT. The option to tax provides businesses with the ability to change what would otherwise be an exempt supply of commercial land or buildings to a taxable supply, enabling input tax recovery on costs associated with that supply.

6.2 Notifying an option to tax is a relatively simple process, but it can take time for HMRC to acknowledge receipt of the option and to respond to queries about whether land or buildings are opted.[1] This is because of the resources required to deal with the volume of enquiries and the need to balance this against other priorities, although increased resources have been allocated over the last year.

6.3 It is not uncommon for taxpayers to believe that the option is automatically in place because the previous owner has opted to tax, not realising that each person has to opt their own interest in the land or buildings. Uncertainty about whether a piece of land or a building has been opted can cause difficulties when the property is being sold.

Issues identified during the review

6.4 Three main themes were identified during the review. We summarise them below and then address each area in more detail:

- obtaining information from HMRC about whether there is an option to tax in place can take a long time
- for various reasons, including the lack of notification of historic options (prior to 1 March 1995, it was not always necessary for taxpayers to notify HMRC of options) and a loss of data due to the migration from paper files to electronic folders, the current system has incomplete data and appears to be administratively difficult to maintain
- the anti-avoidance legislation for dis-applying an option is unduly complex, is circular in places (in that it does not lead the user logically to a decision as to whether it applies), catches taxpayers not undertaking avoidance and has led to some creative planning

Potential solutions

1. Enable online notification and confirmation of an option

6.5 Currently, a business wishing to notify HMRC of an OTT has to submit a form, usually VAT1614A, to HMRC. This form is an interactive online PDF, which needs to be printed, signed and scanned to be submitted.

[1] Land or buildings in respect of which an option to tax has been made are sometimes described as "opted".

6.6 If the OTT notification is being completed alongside a VAT registration application, the OTT form can be uploaded to the HMRC online portal with the VAT registration application. However, if there is no VAT registration application involved, the form must be sent by post or email to HMRC.

6.7 Most advisors use email because an acknowledgement email is then received. Recently this email has also included a timescale for receiving a full reply.

6.8 Where a business submits the form, HMRC's guidance advises that it should be sent by post. Forms sent by post can get lost and the business does not know with certainty if the notification has been received, unless it is sent via a signed-for delivery service. In some cases, the internal processing of paper letters and attachments within HMRC has given rise to delays.

6.9 Where a confirmation of HMRC's record of an historic option is required, the request may be sent by post or by email. Usually, the information needed is the address of the property, Land Registry title number, and the name and VAT registration number of the business.

6.10 Practical issues frequently arise in relation to anticipated property transactions, either where an option to tax (OTT) is being made or where confirmation is required as to whether there is an historic OTT in place (lawyers often want to see official confirmation of the position). This tends to be a last-minute request which, while not HMRC's problem, means that HMRC's normal 30 working day turnaround target does not accommodate this.[2]

6.11 One solution would be to enable OTTs to be notified online via a business's or authorised agent's HMRC portal without the need to print forms. This type of process is used for registering for VAT. An automated acknowledgement could be evidence of the notification.

6.12 Once HMRC has processed the OTT notification, a copy of the letter that is currently routinely sent out could be filed in the taxpayer's online HMRC portal. This would be similar to the existing system for storing the taxpayer's VAT Registration Certificate. A request for confirmation of an historic OTT could be handled in the same way.

Advantages

- the online portal system is well used and understood by taxpayers and advisors when it comes to VAT registration applications
- the VAT registration system is fast and transparent, with a reference number that taxpayers can use to chase up applications or cross refer to
- an automated digital system would be easier for HMRC to monitor and manage
- HMRC could concentrate its OTT staff on more complex OTTs and anti-avoidance issues
- taxpayers would have a single source of information and an audit trail for information required in legal transactions. The OTT response from HMRC could be viewed and printed by the taxpayer or authorised agent

[2] HMRC aim to turn around OTT requests in 15 days. However, this target is not being met. See paragraphs 8.3 to 8.5 of this meeting between HMRC and the Joint VAT Consultative Committee.
http://webarchive.nationalarchives.gov.uk/20160608234203/https://www.gov.uk/government/groups/joint-vat-consultative-committee-jvcc

Disadvantages

- HMRC's technology may need to be upgraded to achieve this and its operational procedures adapted
- it will not solve the issue of historic OTTs that have been lost or not notified (but over time may go some way to improving the situation)
- there will be an initial increase in HMRC resources to upload the existing OTTs to taxpayer portals (if indeed that link can be made in advance)

2. A database of options to tax accessible by business and advisers

6.13 One of the commonest issues with stakeholders is the length of time it takes to receive a response from the Option to Tax Unit. One solution would be for HMRC to develop a database that could be accessed by the business to search for whether the OTT exists and when it was effective from, or alternatively to add information to the Land Registry's existing databases.

Advantages

- this would reduce the administrative burden for everyone, as the business could search the database and locate the information. HMRC would be able to deploy staff to concentrate on the more complex issues and anti-avoidance

Disadvantages

- both stakeholders and HMRC were understandably concerned that a publicly accessible database could breach taxpayer confidentiality. HMRC is required to protect taxpayer information: the circumstances in which it can be shared are limited, and prescribed in law. This is a key issue that would need to be explored and addressed, though it is possible now for people to get information about property they don't own.[3] HMRC is naturally cautious to ensure that individual taxpayer information is secure, but we consider it worth exploring whether limited property-specific information could be made public. Legislative change would be required to facilitate this
- HMRC's own record of options to tax is not complete. As noted above, prior to 1 March 1995 there was not always a requirement for the taxpayer to notify HMRC of any option to tax. Many taxpayers also did not keep records of the decision to opt to tax. Therefore, it is conceivable that there are some options to tax for which there are no records
- in addition, during the migration from HMRC paper files to electronic taxpayer folders, some options to tax were not retained. Where the taxpayer has no record of the option to tax, none will exist
- maintaining an accurate database in the future may cause an additional administrative burden on HMRC

Core recommendation 8: HMRC should review the current requirements for record keeping and the audit trail for options to tax, and the extent to which this might be handled on-line.

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[3] https://www.gov.uk/get-information-about-property-and-land

3. Simplification of anti-avoidance legislation contained in Paragraphs 12 to 17, Schedule 10, VATA 1994

6.14 The anti-avoidance legislation is exceptionally complex. It is difficult for advisers to follow. The relevant public guidance (VAT Notice 742A) reflects the complexity of the legislation and is almost impenetrable for most businesses.

6.15 Currently, if there is an option to tax on a building that is or will be a CGS item and an occupier or prospective occupier is not fully able to recover its input tax, and is connected to the person making the grant or financing the development in any way, the legislation provides that any OTT is ineffective.

6.16 These rules were introduced to counter situations where exempt or partially exempt taxpayers were able to use the OTT to obtain higher input tax recovery or a cash flow advantage.

6.17 A typical example of this was 'sale and leaseback'. This involved a partially exempt business purchasing a property with a VAT charge that they could not recover. To obtain recovery of input tax, the purchaser opted to tax the building and then sold it to a connected party. The exempt business could claim their VAT back because they used the building to make a taxable supply (to the connected party). That connected party opted to tax, claimed their purchase VAT back, and then leased the building back to the original owner, charging smaller payments under the lease.

6.18 This complex legislation also catches taxpayers who are not engaged in avoidance and has led to some strange behaviours as taxpayers try to ensure they are outside the terms of the anti-avoidance legislation.

6.19 This complexity also means it is difficult for businesses to determine whether they are caught by the legislation. Simpler legislation would mean that businesses would know what was expected of them and would provide greater certainty for businesses.

6.20 Since this legislation was introduced, a number of other legal changes have been made or are in progress to reduce active VAT planning. These significant changes to the legal landscape offer an opportunity for HMRC to review the OTT anti-avoidance provisions.

Options considered but not recommended for further development

6.21 OTS considered a number of other options to simplify the VAT treatment of UK property. Options considered but rejected included the following.

Removing the ability to opt and making all relevant transactions exempt

6.22 This would simplify the land and property schedule significantly. However, construction services would still be standard rated, causing an irrecoverable amount of VAT for property owning taxpayers. This might have an effect on productivity as these taxpayers would have to fund the irrecoverable VAT, potentially reducing the overall level of property construction projects. In addition, if the exemption included new domestic dwellings, it would increase their cost, as there would be an irrecoverable amount of VAT by residential developers.

Removing the option to tax and making all land and property taxable at a reduced rate

6.23 This would be simple, with one rate of VAT for all property transactions. Occupiers who cannot reclaim all their VAT would suffer less irrecoverable VAT, leading to potential revenue loss. If a reduced rate were to apply to residential dwellings, this would offset any potential revenue loss but there could be an increased cost to the consumer or a reduction in profit to the developer as a result.

Making all commercial land and property taxable at the standard rate with an option to exempt

Automatic standard rating would take away the need for an acknowledgement of the option to tax required by legal teams when completing property transactions. A new data base would have to be set up to capture the options to exempt. Unpicking the existing system would involve considerable administrative effort and cost for both HMRC and businesses.

7 Special accounting schemes

7.1 A number of special accounting schemes have been created to simplify the operation of VAT for small or medium-sized businesses generally, and also for businesses operating in sectors where the administrative burden of the standard VAT rules would be disproportionate.

7.2 Most of the schemes do not require a business to apply to HMRC to use them (the Annual Accounting and Flat Rate schemes are exceptions to this). As a result, first-hand data about how extensively they are used is not readily available, so it is difficult to make judgements on how useful they are. The introduction of MTD and the information that businesses will have the opportunity to provide may offer a way for HMRC to obtain information of this kind. We suggest HMRC bear this in mind in their MTD work.

7.3 We discuss below the operation of those schemes where we have recommendations to make.

Retail schemes

7.4 Retail schemes are intended to help retailers to calculate the VAT due from sales of goods and services such as catering. The schemes recognise that some retailers face challenges in undertaking normal VAT accounting (in particular issuing a tax invoice for every sale) especially given the complexity of dealing with many product lines which may bear different rates of VAT.

7.5 Historically, a number of general schemes were available, but there are now just three - the point of sale, apportionment and direct calculation schemes - available as standard methods for retailers with turnover of less than £130m. There are also some specific schemes for certain types of retail business, such as retail florists and chemists.

7.6 Retailers with a turnover of more than £130m are obliged to apply for a bespoke retail scheme. This is done in much the same way as a partial exemption special method (see Chapter 4) and is subject to similar issues as those discussed there.

7.7 It appears that the current retail schemes are not keeping up with technological developments. For example, many retailers have installed sophisticated tills that read barcodes, quick response codes (known as 'QR' codes) and manual price look-up codes. These methods enable the VAT treatment to be pre-programmed and identify the different VAT liabilities on the till rolls. Many are capable of interfacing directly with accounting software, which then feeds into the VAT return.

7.8 Some countries, such as Portugal, have introduced requirements for the tills to produce a receipt for every transaction and to report the transaction directly to the Tax Authority to cut down on fraud. France is due to introduce something similar in early 2018.

7.9 Such developments suggest that, apart from the smallest of retailers, it is likely that the VAT liability could be determined at the point of sale. So, apart from the smallest of businesses (for example turnover of less than £250,000), the need for any scheme other than the point of sale is becoming less clear. We suggest that HMRC monitor this and consider this as a potential direction of travel.

Tour Operators Margin Scheme ("TOMS")

7.10 This is an EU-wide simplification scheme for businesses selling packages of accommodation, travel and other services, to travellers. It was introduced in the UK in 1988 and in many cases, it enables VAT to be accounted for on travel supplies without businesses having to register and account for tax in each Member State in which the goods and services are enjoyed.

7.11 It is based on the overall profit margin achieved by travel agents and tour operators on particular packages; in the UK, the tax point is the date of departure, rather than any of the dates on which the deposit or other payments were made by the customer. This reflects the difficulty of quantifying the margin at an earlier stage. Under these arrangements, customers do not receive VAT invoices.

7.12 Originally, the UK applied TOMS to B2C travel only, but in 2010 following infraction proceedings, the UK scheme was changed to include supplies made to businesses for their own purposes, such as travel and hotels used by employees on company business.

Issues

7.13 In 2013, a decision by the Court of Justice of the European Union[1] suggested that the tax point of departure date used in the UK is ultra vires and VAT should be accounted for at each stage of the package provision. However, we are aware that the EU Commission is currently reviewing TOMS,[2] including the tax point question.

7.14 There is a potential clash between the TOMS scheme and the place of supply rules for services relating to the provision of conferences, exhibitions, training, sporting and cultural events. From 1 January 2011, services provided B2B in respect of organising of such events fall under the general rule and are taxed where the recipient is established. However, where accommodation and travel are provided as part of a package, TOMS applies to all the supplies within the package.

7.15 This suggests that conferences including accommodation (a common practice) and/or travel, fall to be taxed under TOMS and not the B2B rules. Indeed, it would mean conference services cannot be provided as a single supply to the client if accommodation and/or travel are included, even where this is ancillary to the main supply.

7.16 Where businesses receive supplies covered by TOMS, they often do not understand why their suppliers use the scheme. VAT registered businesses are frequently confused by the lack of a VAT invoice for supplies which, outside the TOMS scheme, would be required.

7.17 Sometimes, even when there is no VAT invoice from the supplier, a business may still try to claim input tax on the supply using alternative documentation, presuming that HMRC would use its discretion to accept such documentation.

7.18 There is a current trend in the Meetings Incentives Conferences & Exhibitions (MICE) industry for supplies to be made on an "open book" basis, where for example the component parts of a conference are effectively provided at cost to the customer. The supplier then charges an administration or management fee for organising the event. The correct tax treatment can be unclear in such cases – should they work on the basis that there is no profit margin, because the

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[1] The Commission v the Kingdom of Spain (C-189/11)

[2] https://www.gov.uk/government/publications/revenue-and-customs-brief-5-2014-tour-operators-margin-scheme/revenue-and-customs-brief-5-2014-tour-operator-margin-schemes

main supply is simply the fee, or that the fee is the profit margin and TOMS should be applied across the whole package?

7.19 We have been told that because of this uncertainty, affected businesses often take steps to ensure they are legally acting as an agent for the provision of the supplies, rather than as principal, which itself leads to further complexity and administrative work.

7.20 We understand many Member States do not seek to apply TOMS to the MICE sector, despite the judgments in a range of cases,[3] which state that B2B travel is included within TOMS, as it "is the best way of achieving the aims of the scheme."

7.21 In addition, if the conference organiser is an hotel, the CJEU has found[4] that in-house supplies (those supplied from the business' own resources) do not fall within the scope of TOMS. However, despite this, the UK applies TOMS to in-house services of accommodation provided as part of a package.

Other considerations

7.22 Large tour operators are happy with the operation of TOMS. By and large, their accounting systems are set up to account for the calculation. Post Brexit, these tour operators would probably prefer to keep TOMS, which simplifies the rules on registration in other EU Member States.

7.23 Small businesses are often inadvertently brought within TOMS. They may be a club or society running a trip to Europe or a professional body providing a conference to members including accommodation. Although there is currently a de minimis provision (1% annual turnover) for small businesses, this has not been changed since the introduction of TOMs in 1988. The TOMS calculation involves over 20 steps, which do not fit easily with the accounting processes of most small businesses. We understand that it would be feasible for the UK to raise the de minimis limit under current EU law.

7.24 Finally, as mentioned above, we are aware that the Commission is undertaking some work in the TOMS area. Possible approaches to revamping TOMS include a Mini One Stop Shop approach ("MOSS"). This would bring supplies in the travel sector broadly in line with those in the electronically supplied, broadcast and telephonic services – where B2C supplies would be accounted for under MOSS and B2B services accounted for under the general rules. Some larger businesses are concerned at this approach due to the additional administrative burden for an extra return, the complexities of incorporating other Member States' invoicing rules, VAT rates etc. within their accounting systems, and the uncertainty as to whether VAT incurred in other Member States would be recoverable under the MOSS system.

Potential approaches

1. explore options to relieve smaller taxpayers that make infrequent TOMS supplies from being caught by the legislation

2. remove MICE businesses from the scope of TOMS. This may need to wait until the completion of the EU review of TOMS and/or until after Brexit. However, in the meantime it may be possible to remove those MICE businesses that provide accommodation that is ancillary to the supply of a conference. Suppliers that

[3] The Commission v The Czech Republic, Finland, France, Greece, Italy, Poland, Portugal and Spain (C-293-11, C-309/11, C-C296/11, C-293/11, C-236/11, C193/11 and C450/11 and C-189/11 respectively)
[4] Maria Kozak v Dyrector Izby Skarbowej w Lublinie (C-557/11)

provide accommodation as an in-house supply may also not need to be within TOMS, given the case-law referred to earlier

3 simplify the calculation for smaller businesses, so that there are fewer steps in the calculation. Whilst not every step is applicable to each person within TOMS, taxpayers often find it hard to work out which steps must be included in their own calculation

Recommendation 21: The government should consider the potential for increasing the TOMS de minimis limit and removing MICE businesses from TOMS.

Do-It-Yourself Housebuilders' Scheme

7.25 This scheme alleviates the VAT burden on individuals building a new house for themselves or family members, and on charities building a building for charitable purposes. Since 1 July 2001, the scheme has also included conversions of buildings.

7.26 Claimants must submit relevant claim forms, together with documentation (planning consent, completion status, invoices etc.) to HMRC within 3 months of the completion of the building works. HMRC then has 30 days to verify and pay the claim.

7.27 This relatively short window to make claims causes a barrier to DIY housebuilders who often have other issues to contend with (such as converting the self-build mortgage into a traditional mortgage) when a dwelling is newly completed. A longer period of 6-9 months would provide extra time for the correct information to be gathered and any queries or gaps to be addressed prior to submission.

7.28 The 2017 government Housing White Paper[5] aims to make it easier for people to self-build houses. The Minister of State for Housing and Planning recently stated[6] that the government wishes to double the number of self-build housing units. This is likely to increase the number of DIY house-builder claims and the call on HMRC resources.

Issues

7.29 We have been told by stakeholders that there is a high rate of rejection of claims by HMRC, usually because there is insufficient information to process the claim.

7.30 There could be many reasons for this happening. One may be that the claimant does not fully understand the requirements and has struggled with the available guidance and obtaining information within the 3-month timeframe to submit the claim. Another may be that there is not sufficient time for HMRC to ask for more information within the 30-day timeframe stated in the guidance. This timeframe is not incorporated into the law and appears to be a target set by HMRC itself.

7.31 The online HMRC guidance is quite thin on the landing page on gov.uk, although there are a series of links to the more detailed information. The main guidance is attached to the claim form as notes. This document is 22 pages long and the guidance notes are at the end of it.

7.32 This is a relatively complex area of the tax, and there are many circumstances in which mistakes by DIY housebuilders which can result in loss of relief.

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5 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/590464/Fixing_our_broken_housing_market_-_print_ready_version.pdf

6 http://selfbuildinsurance-blog.co.uk/2017/09/alok-sharma-opens-uks-first-plot-shop-self-custom-build-homes/

7.33 One area of complexity is ensuring that the correct rates of VAT are applied to construction in this sector. Another flows from the exclusion of services excluded from the claim. This is at odds with the position for a commercial builder who can recover the input tax on relevant professional services. This would appear to put commercial builders at an advantage to someone building his/her family home. These are also costs that have a direct link with the actual construction of the dwelling.

7.34 In addition, as with the commercially developed dwellings mentioned in Chapter 3, planning permission conditions mean that some dwellings are excluded from the definition of dwellings for VAT purposes.

Potential approaches

1 guidance designed from the perspective of the DIY house-builder. Currently there is some guidance in the DIY form pack, but it is not comprehensive. VAT Notice 708 does provide a detailed list of the items that VAT can and cannot be recovered on. A useful list in the form pack would help taxpayers to make more accurate claims. Guidance on the impact on VAT recovery of planning restrictions for DIY claims would be useful, so that taxpayers can avoid these hidden pitfalls and negotiate with the planning authority. This could potentially be incorporated into a "before you start a development" pack

2 extend the scheme to include recovery of VAT on professional fees associated with the construction of the dwelling. Professional fees in this context mean those of an architect, surveyor or project manager. This would put DIY housebuilders on the same footing as commercial developers in terms of VAT recovery. This would clearly have an Exchequer cost implication

3 extend the time limit for submitting claims from 3 months to 6-9 months. Stakeholders have stated that the short time frame can often be a barrier to making the claim. This could also reduce the number of rejected claims

Recommendation 22: HMRC should consider updating the DIY House builder scheme to include clearer and more accessible guidance, increased time limits and recovery of VAT on professional services.

EU Refunds and 13th Directive claims

7.35 Businesses that incur VAT in EU countries where they are not registered may, in certain circumstances (for example, when employees visit those countries), recover this via either the electronic EU Refund Claim Scheme or the 13th Directive Claim Scheme.

7.36 The electronic EU Refund Scheme was introduced in 2010. UK claims are submitted via the taxpayer's HMRC online filing portal for recoverable VAT for each calendar year. Claims must be submitted by 30 September following the claim year. EU Member States generally have 4 months to repay the claim.

7.37 Taxpayers have experienced delays in receiving repayments and many decide not to make claims because the process is still quite labour intensive. However, the refund scheme is determined by EU law and cannot be changed or amended unless by the Commission. We are not aware of any proposed changes and will not be commenting further in our report.

7.38 13th Directive claims are made by taxpayers established outside the EU, but in countries which have an indirect tax system of some sort. The claim is made on a paper form and invoices must accompany the claim, together with a certificate from the taxpayer's home tax authority to evidence that it is in business in its home country.

7.39 In practice, HMRC accepts scanned copies of invoices, but not of the tax certificate. This can act as a barrier to overseas businesses making claims, particularly where there are large numbers of companies in a corporate group. An example often quoted is the time it takes to obtain a tax certificate from the Internal Revenue Service in the United States of America.

Issues

7.40 Anecdotally, non-EU taxpayers are deterred from submitting claims due to the administrative burden of a paper-based system and the preference for original documents. In today's digital age, this would seem to be outdated.

Potential approach

7.41 To facilitate the recovery of VAT incurred in the UK by non-EU taxpayers and subsequently improve the inward investment by overseas businesses in the UK, it may be preferable to digitise the claim system, in line with the approach to VAT recoverable by overseas individuals under the Retail Exports scheme.

Recommendation 23: HMRC should consider digitising the process for the recovery of VAT by overseas businesses not registered in the UK.

Other schemes

7.42 We also considered a number of other schemes. However, we found no significant evidence of difficulties and have no recommendations to make about them.

7.43 The schemes concerned were:

- annual accounting
- flat rate scheme
- cash accounting
- retail exports
- second-hand margin
- racehorse owners
- agricultural flat rate

7.44 The government has confirmed that the annual accounting scheme will continue to apply with the current conditions under Making Tax Digital. The other schemes listed above are expected to continue largely unchanged also. One change to all of these schemes under Making Tax Digital will be the requirement that business VAT records are kept in digital format and that VAT returns are submitted using software that is compatible with HMRC systems.[7]

[7] https://www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses/making-tax-digital-for-vat-legislation-overview

A Terms of reference

VAT General Simplification Review

A.1 Value Added Tax (VAT) was introduced into the UK in 1973. It is often referred to as being (or intended to be) a simple tax and in principle it should be easy to administer. However, as with most forms of taxation, since its introduction it has been subject to a continuous process of evolution and change. It is now recognised as being complex to administer which in turn creates compliance challenges for all types of businesses ranging from sole proprietors to large corporations.

A.2 The Office of Tax Simplification (OTS) has agreed with the Chancellor and the Financial Secretary to carry out a review of a range of aspects of VAT in order to consider whether the VAT system is working appropriately in today's economy and to identify simplification opportunities. The basis of the review is that, as demonstrated by previous OTS reviews, simplification of the VAT system is desirable.

A.3 The overall aim of the review will be 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 stand point.

A.4 In conducting the review the OTS will provide a report in the autumn of 2017 that:

- Provides analysis and evidence of the main areas where simplification could be achieved and the benefits that could result for businesses and in the administration of VAT
- Recommends specific steps that could be taken to secure simplification
- Considers and offers an initial evaluation of the impacts for businesses, HMRC and the Exchequer.

A.5 The OTS will provide an update on its work and call for evidence in the spring of 2017.

Terms of reference

A.6 The review will consider how to help ensure the VAT system works appropriately in today's (and indeed for tomorrow's) economy. This will include consideration of:

- the issues and impacts which would be involved if the VAT registration threshold were either higher or lower than at present
- the extent to which the definitions of the types of supply which are currently exempt from VAT, subject to a reduced rate or are zero-rated, fit the modern context, create complexity for businesses and administration
- the level of demand and practical challenges arising from having a more widely available formal ruling system for businesses uncertain of a particular VAT treatment, for example in relation to TOGC
- the potential for simplifying the operation of partial exemption methodologies, the option to tax and the Capital Goods Scheme with a focus on the impact on smaller businesses
- Special Accounting Schemes

- the general administration of VAT including the penalty regime and the appeals process
- the opportunities available to align VAT more with other taxes (or vice-versa) as part of the Making Tax Digital plans
- the relative significance and impact of the issues identified on businesses of different sizes or in different sectors

A.7 The review will not, in the main, be concerned with the VAT rate structure. Neither will it focus on issues 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 VAT rules such as MOSS. However, it will actively bear the Brexit context in mind in looking at opportunities to simplify VAT for the future.

Further guidance for the review

A.8 In carrying out its review and developing its recommendations, the OTS should:

- research widely among all stakeholders
- involve HMRC's Administrative Burdens Advisory Board
- take account of the principles and design of HMRCs Making Tax Digital reforms, including digital tax accounts, integrated reporting and payment
- consider the likely Exchequer implications of recommendations
- be consistent with the principles for a good tax system, including fairness and efficiency
- take account of relevant international experience

B Consultative Committee

B.1 We are very grateful for the time and support of our Consultative Committee members.

Individual	Organisation
Roger Bennett	University of Exeter
Martin Blanche	PWC
Ian Carpenter	RSM UK
Matthew Dix	HM Treasury
Neil Gaskell/Nick McChesney	Institute of Chartered Accountants of England and Wales
Neil Hedger	HM Revenue and Customs
Nick March	Hewlett Packard
Neil Owen	VAT Advice
Martin Scammell	British Property Federation

C Who we met

C.1 We are very grateful to the wide range of bodies, businesses and individuals who gave their time to meet with us and for the submissions we have received. All contributions are listed below and we apologise for any that we have inadvertently omitted. Furthermore, many of the organisations listed below arranged meetings and forums for us, enabling us to reach a very wide range of impacted stakeholders, for which we are additionally grateful.

Action with Communities in Rural England (ACRE)
Administrative Burdens Advisory Board
Alastair Postle
Amisha Upadhyaya, Grant Thornton Australia
Association of Accounting Technicians
Association of British Insurers
Association for Financial Markets in Europe
Association of British Travel Agents
Association of Taxation Technicians
Barclays
Dr Ben Lockwood, University of Warwick
British Bankers Association
Bob Mitchell, Shop Direct
Business Services Association
British Property Federation
BT Group
British Universities Finance Directors Group
Chandra Morar
Charity Tax Group
Chartered Institute of Taxation (CIOT)
Confederation of British Industry (CBI)
Co-Operative Conferences
Crunch
Deloitte
David Massey, University of Central Lancashire
Electricity Tax Forum – VAT Group
Ernst & Young
Evcom
FreeAgent
FTI Consulting
Gary Richards
Glyn Edwards
Guild of Travel Management Companies
Heritage Alliance
Home Builders Federation
Hotel Booking Agents Association

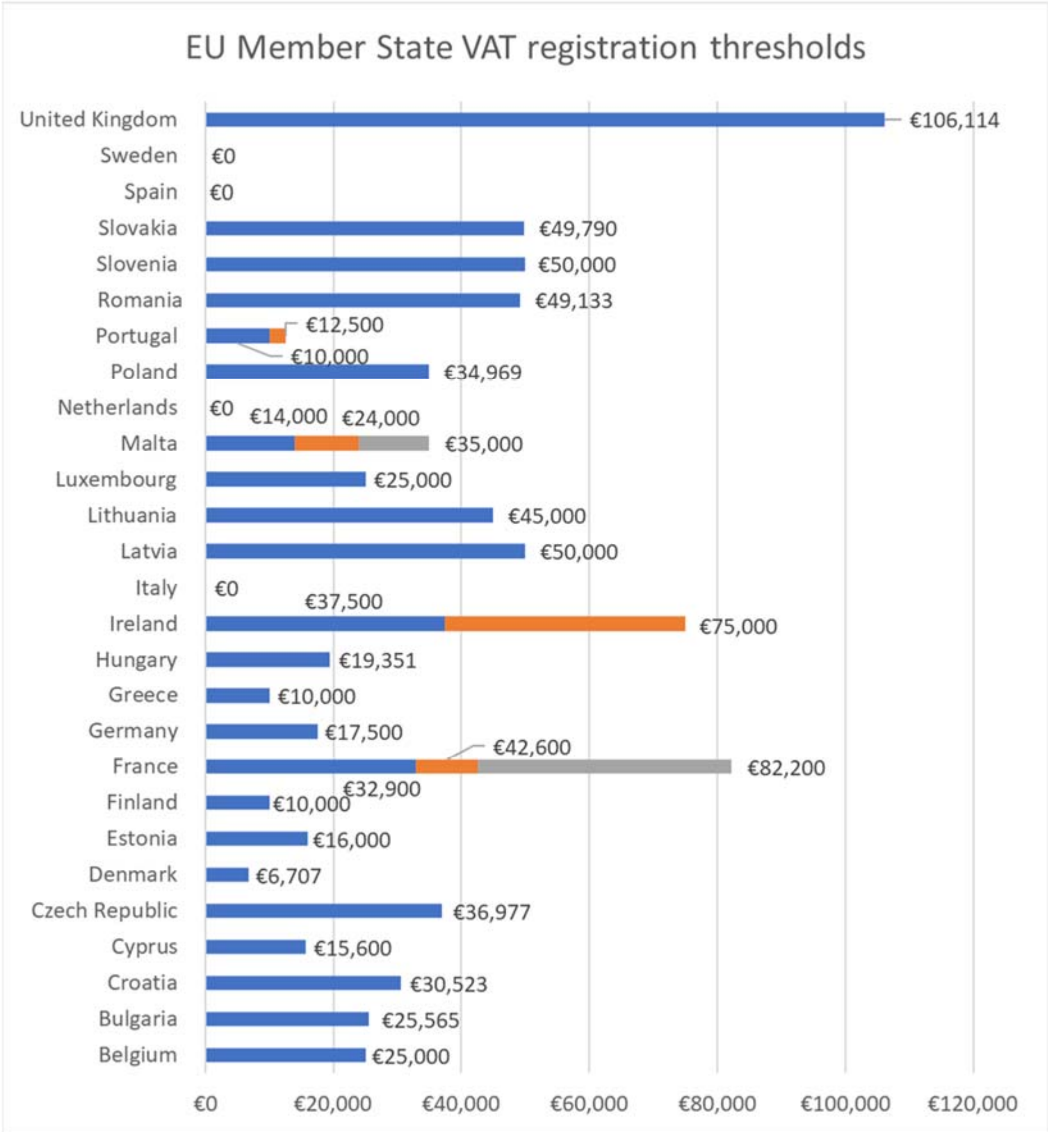
Institute of Cancer Research
Institute of Chartered Accountants of England & Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)
The Investment Association
John Bostock, Department for Education
John Lewis
Jonathan Main
KPMG
Martin Pooley
N8 Research Partnership
National Council for Voluntary Organisations (NCVO)
National Farmers Union
Neil Warren
Nicholson Roberts Company Ltd
Nick Kavanagh
Orca Law VAT Financial Services Conference
Padmani Gurren
Pinsent Masons
PwC
Royal Mail
Sean Ferguson
Tax 200 UK Group
Transport for London
UK 200 Accountants
VAT in Industry Group
VAT Practitioner Groups:
- East Anglia
- East Midlands
- Finsbury
- North East
- North West
- North of England
- Policy
- Scotland (Victor Durcatz Memorial Chapter)
- Severn
- South Coast
- Southern
- West End

Vodafone

Government Departments

Department for Business, Energy and Industrial Strategy
Department for Education
HM Revenue and Customs
HM Treasury

D EU VAT registration thresholds at April 2016



Source: European Commission

Notes: Portugal: Exemption for small businesses €10,000 or €12,500.

Malta: €35,000 for goods, €24,000 for low value services, €14,000 for other economic activities.

Ireland: €75,000 for goods, €35,000 for services.

Italy: Italy has no general registration threshold. It has a range of exemptions for small domestic businesses.

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

Office of Tax Simplification contacts

This document can be found in full on our website at:
https://www.gov.uk/government/organisations/office-of-tax-simplification

If you require this information in an alternative format or have general enquiries about the Office of Tax Simplification and its work, contact:

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