



Association of Accounting Technicians response to Treasury Select Committee VAT inquiry

1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the VAT inquiry published on 27 March 2018.
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.
- 1.3. AAT has added comment to add value or highlight aspects that need to be considered further.

2. Executive summary

- 2.1. **The AAT 2017 VAT Survey indicated almost equal support for increasing and maintaining the VAT threshold.** This demonstrates the difficulty policymakers will have in gaining support for changes to the VAT threshold, especially any attempts to lower the threshold.
- 2.2. **Online trading and VAT compliance has been a cause of increasing concern in recent years but the Government has recently made a number of welcome changes to address the problem.** This includes the introduction of joint and several liability for online marketplaces and a new obligation requiring sellers to display their VAT numbers online.
- 2.3. **Political commentary suggesting accountants actively encourage or facilitate aggressive VAT arrangements is overplayed.** Policymakers should direct their concerns in this area to the substantial unregulated sector where it remains perfectly legal to call yourself an accountant, with no qualifications, no membership of a professional body and no requirement to meet any commitment to maintain professional standards. This cohort are responsible for most complaints about accountants to HMRC and paints the profession in an unfavourable light.
- 2.4. **Government should publish a clear, broad tax strategy, which includes VAT.** This would provide greater certainty for tax and accountancy professionals and their 12 million clients, whilst assisting Government and the Treasury in providing an agreed direction of travel and policymakers in understanding what they should be working towards.

3. AAT response to the inquiry

VAT Registration Threshold

- 3.1. The *AAT 2017 VAT Survey* showed that:
 - 36% of AAT members favour a substantial increase in the VAT threshold to something similar to Singapore (£500,000)
 - 32% would like the status quo maintained
 - approximately 9% favoured a reduction to a £0 threshold and
 - just under 5% would like to see the threshold reduced to the same level as the personal allowance (now £11,850).
- 3.2. The current VAT registration threshold negatively impacts many small businesses and in turn is damaging to the UK economy. These negative impacts include stunted productivity and growth as well unpaid tax in the hidden economy.
- 3.3. Contrary to popular belief, VAT administration is not a significant burden. Almost half of VAT registered businesses have registered voluntarily (44%). In addition, AAT licensed accountants participating in a recent focus group, members of AAT's tax technical panel and our general experience, consistently indicates that the majority of small businesses cope well with VAT compliance.

- 3.4. Any new VAT registration threshold must be set at a level where it impacts the smallest number of companies whilst maximising tax revenue. To alleviate threshold problems a balance should be struck between the likely loss of VAT receipts (higher threshold) and increased bureaucracy (no threshold) whilst also taking into account the increased output and productivity of the UK's small business community, and of course the likely increase in tax receipts from increased SME turnover.

Does the growth of on-line trading require a new approach to VAT compliance?

- 3.5. HMRC have previously suggested VAT evasion through online shopping on sites such as eBay is costing up to £1.5bn a year in lost tax¹.
- 3.6. HMRC is taking some action here, as demonstrated by the fact 7,185 overseas sellers had registered for VAT in 2016 compared to a mere 695 in 2015. This indicates HMRC's new powers and the threat of action is having some positive impact in this area but clearly much more remains to be done.
- 3.7. Many platform operators go to significant lengths to avoid responsibility for any tax issues relating to users of their platforms. For instance, Amazon has repeatedly stated that it has no responsibility for the tax compliance of its users.
- 3.8. Two years ago, AAT suggested the likes of eBay and Amazon should require their users to display valid VAT numbers to help reduce the very high level of VAT fraud on sites as highlighted by the likes of www.vatfraud.org. AAT added that if such requests were refused then imposing a degree of liability on platform operators would inevitably help change their mind set.
- 3.9. Platforms did refuse and so the Autumn 2017 Budget introduced joint and several liability for online marketplaces and introduced a new obligation requiring sellers to display their VAT numbers online (effective since March 2018). This is likely to further reduce VAT avoidance.
- 3.10. Even before this, there was some evidence of good work in this area. For example, in 2015 HMRC targeted 14,000 people suspected of failing to declare their online selling activities on Etsy, eBay etc. on their self-assessment forms. However, as reliance for information was based on companies' good will, a legislative approach is likely to prove far more effective.

What role do advisers play in encouraging or facilitating aggressive VAT planning arrangements? Do businesses, tax advisers and professional bodies have concerns about the nature of the advice given by some practitioners?

- 3.11. To date, there has been no evidence that any of AAT's 4,250 licensed accountants either encourage, facilitate or enter into aggressive tax planning arrangements of any type.
- 3.12. More widely, none of the Paradise Papers examples highlighted in the media this year have involved any of AAT's 140,000 members – whether a full member, licensed accountant or student – and none of the Panama Papers leaks from Mossack Fonseca 18 months ago involved a single AAT member either.
- 3.13. This does not mean AAT is complacent but it does serve as a useful example to highlight that some in the media and a number of politicians do the majority of accountants a disservice when seeking to tar the profession with the same brush.
- 3.14. AAT's Codes of Professional Ethics have been in place for a number of years, were updated last summer and require all members to be straightforward and honest in all professional and business relationships.
- 3.15. The code also requires that members be professional, which means compliance with all relevant laws and regulations and avoiding actions that may bring the profession into disrepute (which would certainly include aggressive VAT arrangements).

¹Accountancy Daily, March 2016:

<https://www.accountancydaily.co/budget-2016-plans-target-non-uk-online-vat-evasion>

- 3.16. In addition to its own rigorous code of ethics, AAT was also involved in the development of and is a co-signatory to the Professional Conduct in Relation to Tax (PCRT).
- 3.17. In the event that an AAT member was found to be in breach of the AAT code of professional ethics or of PCRT then AAT's disciplinary procedures determine the most suitable action to be taken. In the most serious of cases this could result in loss of membership and a substantial fine. The message is clear, AAT expects its members to behave professionally and with integrity at all times.
- 3.18. That said, AAT recognises there is a significant problem with unregulated accountants. Indeed, HMRC revealed that the non-regulated sector constitutes one third of the accountants it deals with yet is responsible for two thirds of complaints. This telling statistic should be cause for greater concern amongst policymakers.

VAT fraud penalties – a step too far?

- 3.19. AAT supports efforts made by HMRC to reduce VAT fraud.
- 3.20. In 2016 AAT expressed strong concern that the HMRC proposals for new VAT penalties did not differentiate between the penalties raised against a business that 'knew' it was participating in VAT fraud, compared to a business owner who 'should have known'. Naming and shaming of business owners who 'should have known' an arrangement was fraudulent penalises those who genuinely did not have any deliberate intent to evade VAT. Such actions could have severe repercussions on their business and, in extreme cases, lead to closure. Establishing a distinction between "deliberate" or "careless" actions may be administratively inconvenient for HMRC but nevertheless the principle remained sound.
- 3.21. Many 'deliberate error' penalties have been downgraded to 'careless errors' on appeal. This has either been through an internal review or at a first-tier tribunal hearing. The onus of proof has been on HMRC to show that a person has been guilty of being dishonest rather than careless.
- 3.22. Some business owners are less capable than others and as a result the decision that an owner 'should have known' they were participating in VAT fraud can vary according to the skills, experience and background of the owner in question.
- 3.23. Despite AAT's concerns, and those expressed by many others, HMRC now has what can only be described as draconian powers in this area.
- 3.24. Businesses unknowingly caught up in VAT fraud can face heavy fines (up to 30% of the VAT due) in addition to being "named and shamed".
- 3.25. HMRC cannot be sanctioned when wrongly pursuing innocent parties, as they sometimes do, and similarly, costs cannot be awarded in cases where the business wins, thus creating an incentive not to appeal but to simply accept an unwarranted fine. These penalties even apply to companies trading indirectly, and through the supply chain, if HMRC deem the party 'should have known' even though it is virtually impossible to check.

The European Union

- 3.26. VAT is based on European law and so future Governments will be free to scrap VAT on fuel or other contentious items if they wish to – or to extend exemptions in any other areas.
- 3.27. However, VAT accounts for 20% of the UK's total tax take and is relatively easy to collect.
- 3.28. Furthermore, if exemptions are granted this obviously has cost implications that will need to be made up elsewhere.
- 3.29. It is therefore very unlikely that any Government will make significant changes to existing legislation in this area. In fact, if the Government were to accede to all the demands from the various special interest groups for a VAT reduction on the item of concern, then VAT receipts would shrink by almost a third².

² Chancellor of the Exchequer, Philip Hammond MP, March 2018:

<https://hansard.parliament.uk/Commons/2018-03-01/debates/81ECBD0F-9580-4EB8-B022-9BCE11470545/Treasury>

- 3.30. The EU has recently made various SME VAT registration threshold proposals that are being consulted on by Government. AAT believes these are largely irrelevant in solving the UK's ongoing VAT registration threshold problems.
- 3.31. EU proposals for the introduction of a smoothing mechanism by which businesses would be allowed to exceed the threshold by 50% for a single year without registering appear to be superficially attractive but this is another layer of unnecessary complexity that fails to address any threshold problems other than to act as a sticking plaster for 12 months.
- 3.32. Furthermore, its applicability to the UK is highly doubtful, not simply because of Brexit but due to the €100,000 (£89,000) registration threshold cap above which businesses cannot be exempt. This is because the UK's £85,000 VAT threshold is already the highest in the EU and so the difference is marginal.
- 3.33. Other EU proposals to introduce simplification measures for all registered businesses that turn over up to €2,000,000 (£1,770,000) in the form of simplified invoicing, the option of filing annual VAT returns, without making interim payments, and simplified obligations relating to storage of invoices would probably prove welcome to many small businesses.

Will MTD be sufficient on its own to reduce error and significantly improve the collection of VAT? What other action would help businesses to get their VAT returns right?

- 3.34. Some politicians, professional bodies and special interest groups, have called for the MTD registration threshold to be maintained at the VAT threshold of £85,000 on a permanent basis. Indeed, a small number of our own members have called for the same.
- 3.35. However, this ignores the fundamental basis upon which MTD was devised, which is to help reduce the tax gap.
- 3.36. In 2015-16, approximately 50% of the tax gap (£18.3bn) was due to errors in the tax returns of SMEs. Less than 8% of this comes from companies with a turnover above the VAT threshold. In other words, the vast bulk of the savings are likely to be made by engaging companies with much lower turnovers. In fact, almost 60% of the £18.3bn gap is attributable to those with a turnover between £15,000 and £85,000 so it wouldn't make any financial sense to exclude them from MTD on a permanent basis.
- 3.37. Whilst MTD will doubtless help reduce errors, it will not be a panacea. There are numerous other steps that could and should be taken to reduce complexity and thus reduce error.
- 3.38. According to the *AAT 2017 VAT Survey*, the largest level of support amongst members was to retain the current system largely as it is whilst examining definitions and boundaries and seeing if the complexities caused can be reduced or better managed (36%).
- 3.39. This was followed by scrapping the exemption schedule and making everything taxable at either a standard, reduced or zero rate (30%) and applying the standard rate to everything (22%).
- 3.40. By comparison just 11% of respondents thought the current system is fit for purpose and should be retained.
- 3.41. The standard rate, is straightforward. It is the exceptions which cause the boundary issues and complexities. Suffice to say that reducing the exceptions will reduce the boundary issues and help more to get their VAT returns right.
- 3.42. The categories which give rise to the most boundary issues are easily discernible by reference to HMRC's manuals. Over the years HMRC has written manuals for the trade sectors with the most complexities. These manuals are probably the best available resource for identifying the trade sectors creating the most boundary problems.
- 3.43. In a market economy products are always changing or new ones developed. Some of these will create new boundary issues which will not be apparent until the product is launched. Inevitably, VAT legislation will always lag market developments.

- 3.44. Broader definitions for the exempt, reduced and zero-rated supplies may help as tax legislation is always responding to market changes. This often results in ragged boundaries. AAT proposes identifying some of the most complex areas and reviewing them with the aim of amending definitions so that they are more appropriate to today's market and social needs.
- 3.45. Firstly, the less radical option of properly establishing if complexities can be reduced or better managed should be given serious attention (as supported by 36% of AAT members) but rather than being ongoing this should be over a time limited period, perhaps a one year timeframe would be most appropriate.
- 3.46. If significant progress is not made within this one year period, then AAT would like to see HMRC thoroughly explore the implications of applying the standard rate of VAT to all Vatable items as a radical simplification measure. In other words, abolishing the 5% reduced rate, the zero-rate and exemptions (including obscure ones such as the 4% agricultural rate). To ensure fiscal neutrality, this would also require a reduction in the standard 20% rate.

Is the process of making VAT policy sufficiently open to scrutiny and debate? Are there ways in which the current process can be improved?

- 3.47. This year HM Treasury has consulted on the VAT registration threshold whilst in 2017 HMRC held a public consultation on VAT fraud in labour provision in the construction sector as well as holding a public call for evidence on alternative methods of VAT collection. In addition, the Office for Tax Simplification undertook a comprehensive review of VAT last year, having consulted widely on the issue first.
- 3.48. This would suggest a willingness to engage and consult to ensure a wide range of views are considered, an evidence base is built and that policy development is properly informed.
- 3.49. There are always ways in which the current process could be improved. According to the 2018 AAT Policy Reform Survey, one of AAT members' key concerns is that Government should publish a broad tax strategy for each Parliament and stick to it. This would include setting out clear plans for VAT.
- 3.50. In 2010 the Treasury published a "road map" for Corporation Tax, which was well received, but the exercise wasn't repeated in subsequent Parliaments and was only for one specific tax rather than looking at taxation as a whole.
- 3.51. Since 2016 HMRC has required all large companies in the UK, with a turnover above £200m, to publish their tax strategies but, in contrast, has failed to do so itself.
- 3.52. A VAT inclusive tax strategy would provide greater certainty for tax and accountancy professionals and their 12 million clients, whilst assisting Government and the Treasury in providing an agreed direction of travel.
- 3.53. This isn't a new idea. In 2014 the House of Lords Economic Affairs Committee said, "*We continue to believe that tax policy would be developed more coherently if, at the beginning of every government, clear statements were to be published, similar to the 2010 company tax road map. These would give details of the government's overall strategic aims for different parts of the tax system. We recommend this for the future.*"
- 3.54. Although it isn't a new idea, it's one that's time may have come as demonstrated by AAT's survey of MPs in December 2017. This survey showed cross-party support for such a move from almost two thirds of MPs (63%). Only 16% disagreed with this suggestion.

4. About AAT

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are more than 4,250 licensed accountants who provide accountancy and taxation services to over 400,000 British businesses.

- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any queries, require any further information or would like to discuss any of the above points in more detail, please contact Phil Hall, AAT Head of Public Affairs & Public Policy at:

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