

Association of Accounting Technicians response to HM Treasury Call for Evidence on the Value Added Tax (VAT) Registration Threshold

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Call for Evidence on VAT registration threshold, published on March 13 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.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT's 4,250 licensed accountants.

2. Executive summary

- 2.1. **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, stunted growth and unpaid tax in the hidden economy.
- 2.2. **Contrary to popular belief, VAT administration is not a significant burden.** Almost half of VAT registered businesses have registered voluntarily. In addition, AAT licensed accountants at the most recent tax focus group, AAT tax technical panel members and AAT's general experience consistently indicates that small businesses in the main cope with and manage VAT very well.
- 2.3. **EU SME VAT proposals are largely irrelevant in solving the UK's ongoing VAT registration threshold problems.** There are numerous reasons why this is the case as detailed at 3.37-3.39.
- 2.4. **The AAT 2017 VAT Survey showed that 36% of AAT members would 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 (£11,500).
- 2.5. **Any new VAT registration threshold must be set at a level where it impacts the smallest number of companies whilst maximising tax revenue.** This is further explained at 3.55 below.

3. AAT response to HM Treasury Call for Evidence

The current VAT Threshold and the impact on business growth

What experience or knowledge do you have of small businesses managing their turnover to remain below the VAT threshold and are there particular types, regions or sectors of businesses where this is particularly prevalent?

- 3.1. In summer 2017, a focus group, drawn from AAT's 4,250 licensed accountants, revealed a universal experience of small business clients managing their turnover to remain below the VAT threshold. These members represented a diverse range of businesses and were spread from across regions within England.

- 3.2. All were agreed that the problem was only in the micro-business sector (0-9 employees). This is a sector that totals 5.5 million (96% of all UK businesses) accounting for 33% of employment and 22% of turnover.¹
- 3.3. The examples given were primarily where business owners simply stopped working and went on holiday or business owners who reduced either their working hours, the working hours of their staff or both. There was also some evidence of members' clients continuing to promote their services but then carried over any new work won into the next financial year (tradesmen were the example given).
- 3.4. HMRC will doubtless be concerned about another potential behaviour and that is of the small number of business owners who might falsely declare a lower turnover than reality. Whilst AAT has no direct experience of this and it is not something that any AAT licensed accountant would be involved with, it is something that is likely to happen in some sectors.

What is your experience of competition challenges faced by registered traders just over the threshold, compared to unregistered businesses? If challenges exist, what effect do they have on the ability of registered businesses to grow?

- 3.5. Dependent upon their client or customer base, micro-businesses can gain a financial advantage or suffer a financial disadvantage by registering for VAT. These financial implications are the main motive driving decisions about registration.
- 3.6. The financial advantage or disadvantage flows from the client base of the business concerned. If the client base is all or mostly VAT registered businesses, micro-businesses are best advised to register voluntarily. They normally do not have to absorb any output tax whilst being able to reclaim input tax which increases profits. The same benefit does not accrue to businesses whose client base is mainly persons who are not VAT registered.
- 3.7. Micro-businesses whose customer base is wholly or mainly made up of non-registered persons are normally best advised not to register until their turnover exceeds the registration threshold. It is often the case that once registered these businesses must absorb at least some, if not all, of the output tax as market forces mean they are often unable to increase prices. If they increased prices by 20% VAT, they would lose many customers to unregistered competitors. A good example of this would be small hairdressing salons. Such organisations incur little input tax and their customers are often price-sensitive. Annual turnover of £84,999 would mean no VAT is charged, whereas at £85,000 there will be a VAT charge of £14,166, usually with little opportunity to pass the VAT charge on to their customers and little input VAT to offset. Thus an £85,000 turnover would lose the business over £14,000 due to an increase in turnover of just £1.
- 3.8. Of course, competition challenges between VAT registered and non-registered businesses could be eliminated by requiring all trading entities to register as in several countries including Spain and Sweden.
- 3.9. Irrespective of whether the threshold remains the same or is substantially increased, there will always be a cliff edge that impacts upon behaviour. Having a £0 threshold would solve this problem although it should be noted that this was not supported by those present at the AAT licensed accountants focus group and was supported by only 8.8% of members via AAT's 2017 VAT Survey.

As the OTS suggest, does the current threshold contribute to the size of the hidden economy and how?

- 3.10. The OTS are correct to state that the current threshold contributes to the size of the hidden economy but any threshold is likely to contribute to the hidden economy. The level at which the threshold is set will determine its influence on the hidden economy.

¹ Business statistics, Parliament UK briefing, December 2017:
<http://researchbriefings.files.parliament.uk/documents/SN06152/SN06152.pdf>

- 3.11. For example, no threshold would require all businesses to report and pay VAT thus reducing the size of the hidden economy and similarly, a lower threshold would naturally increase the numbers of businesses registering. As the consultation document highlights, this might also have positive knock-on effects in terms of compliance with other taxes.
- 3.12. Likewise, a substantial increase in the VAT threshold to levels enjoyed in Singapore (£500,000) would limit the hidden economy because no small business would be liable to pay VAT anyway and therefore there would be nothing to hide from.
- 3.13. There are various elements of the threshold that contribute towards the hidden economy. There are those just below the VAT threshold who may not declare their full turnover to avoid paying VAT. There are those just above the threshold who may do the same for similar reasons. As the consultation also makes clear, there is another element to consider and that is; *“...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.”*

In your experience, does the current threshold have any effect on growth and/or productivity? If so, how significant is that effect? In your experience, does the current threshold have any effect on growth and/or productivity? If so, how significant is that effect?

- 3.14. Yes, the current threshold does impact upon growth and productivity.
- 3.15. There is considerable evidence – not simply from AAT members - to suggest small firms do not seek to evade or avoid VAT but instead reduce output to fall under the threshold ². This clearly has a damaging impact on these organisations productivity but more widely this impacts upon the success of the British economy.
- 3.16. At the same time, it should be remembered that for those companies who are either significantly under or significantly over the VAT threshold (most companies) the VAT threshold will have almost no impact on productivity at all.
- 3.17. Removing the VAT threshold completely or significantly increasing the threshold would boost productivity as it would mean nobody (no threshold) or fewer businesses (much higher threshold) would stop working to avoid exceeding the VAT threshold. Of course, such steps would need to be balanced against the likely loss of VAT receipts (higher threshold) or the 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.

Administrative Burden

Does the administration of VAT discourage businesses from registering?

- 3.18. Popular perception would suggest so, particularly if the lobbying of organisations such as the Federation of Small Businesses (FSB) is to be believed³.
- 3.19. However, the facts appear to suggest otherwise as HMRC figures show 44% of businesses registered for VAT actually operate below the VAT threshold i.e. there is no requirement for them to register but they choose to do so anyway.⁴
- 3.20. In addition, AAT licensed accountants at the most recent tax focus group, AAT tax technical panel members and AAT’s general experience has consistently indicated that small businesses in the main cope with and manage VAT very well.

² The effect of VAT thresholds on the behaviour of small firms, Finland, June 2015

³ FSB Press Release, November 2017:

<https://www.fsb.org.uk/media-centre/press-releases/lowering-vat-threshold-would-drain-small-firms-of-time-and-money>

⁴ HMRC VAT factsheet 2.7 (2015-16)

If so, what are the main aspects of VAT administration that are putting businesses off registering and for businesses that have gone from being unregistered to registered, is there a difference between the perception and reality of VAT administration? Was the administration easier or harder than anticipated?

- 3.21. AAT members have previously indicated considerable levels of client trepidation about the “onerous burdens” of VAT registration prior to doing so but that these concerns almost entirely dissipate once registration has occurred.
- 3.22. This is one of the reasons why having an agent to help business owners navigate the VAT process is so often helpful. They are able to explain exactly what is involved in simple terms, why it is or isn't in their best interests to register and to then assist the client if necessary. Those without such assistance may find the process more daunting.

Ipsos MORI research suggests that dealing with VAT returns are likely to be the most time-consuming aspect of VAT administration. What is it about VAT returns that are particularly time consuming for small businesses?

- 3.23. FSB research published last year suggested that VAT calculations were the most time-consuming element of adherence for over 40% of small businesses, whilst filling returns and researching guidance were lesser but still significant issues for many. In total, small business owners were estimated to be spending an average of 44 hours a year managing their VAT administration.⁵
- 3.24. In contrast, many small and micro-entities with a pro-active accountant find that they spend very little time undertaking such work because their accountant is able to provide guidance, undertake calculations and complete paperwork on their behalf.

Will new technology, such as the introduction of MTD, facilitate changes or simplifications in VAT administration? If so, what are they, and what changes would you like to see in response?

- 3.25. Making Tax Digital (MTD) will have considerable implications from a VAT perspective but the nature of that impact remains very unclear.
- 3.26. Indeed, AAT members were asked if MTD would mean that VAT annual accounting and other simplified schemes will become redundant. Members were evenly split on the likely implications with 34% thinking they will not make them redundant, 30% thinking they will and 35% not knowing (*AAT 2017 VAT Survey*).
- 3.27. This even split may help to demonstrate the level of uncertainty about just how MTD will facilitate changes or simplification in VAT administration.

EU SME proposal

What would be the likely impacts of the EU's proposal on the administration of VAT for SMEs, how in particular will it help incentivise SME growth and are there constituent parts of the proposal which are particularly attractive or unattractive?

- 3.28. 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 in reality, 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.
- 3.29. 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 appears to be marginal.

⁵ FSB Press Release, November 2017:

<https://www.fsb.org.uk/media-centre/press-releases/lowering-vat-threshold-would-drain-small-firms-of-time-and-money>

- 3.30. 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, not having to make interim payments, and simplified obligations relating to storage of invoices would doubtless prove welcome to many small businesses although the filing of annual VAT returns is obviously at odds with the introduction of Making Tax Digital and quarterly returns.

Administrative smoothing

Do you think the mechanisms described in paragraph 4.8 would help businesses better manage the administration of VAT, upon registration? If so, would the positive effect be significant

- 3.31. Extending the first period for which a business has to account for and pay their VAT obligations to 6 months as opposed to their standard 1 or 2 monthly returns is simply delaying the problem, business owners will still have to register but at a slightly later point in time.
- 3.32. Applying the threshold test over 2 years (£170,000) rather than 1 (£85,000) would make more sense and could potentially reduce administration for those companies that find themselves over the limit in one year but below it the next. However, some businesses would inevitably seek to ensure that they operated below the threshold as detailed above, stopping work to ensure that this is the case, simply extending the cliff edge problem to cover a two year period rather than being an annual consideration.

Financial smoothing

Would these mechanisms be effective in incentivising business growth in the UK? Are there any other solutions that could work?

- 3.33. With regard to the idea of applying different thresholds for different sectors as occurs in Australia, this may have some merit but such changes are likely to be outweighed by the confusion and complexity it would introduce as well as a sense of unfairness, whether real or perceived, that other sectors are being treated more favourably.
- 3.34. In response to the OTS suggestion of a smoothing mechanism whereby businesses would be allowed a form of relief on their first VAT bills, decreasing over time, AAT is surprised that this suggestion was made by the OTS given it introduces additional complexity rather than acting as a simplification measure.
- 3.35. Recommendations that the VAT system should work more like the income tax system, with increasing rates applicable as turnover increases, have some appeal given it is a concept which already exists, is widely understood and works well in relation to another tax. However, again this would be a layer of additional complexity, goes against administrative efforts to simplify the tax system and is likely to add to the general VAT administrative burden. It could also adversely impact on businesses with high turnover and low profit margins.
- 3.36. Over two million small businesses are VAT registered, a huge number do so voluntarily and in the main these cope with and manage VAT very well. This would appear to suggest that there is no need for a financial smoothing system.
- 3.37. Furthermore, these facts also suggest that there would not be significant problems if the threshold was either maintained, lowered or perhaps more radically - abolished. Indeed, abolition would require no smoothing at all.

Assuming the UK has the freedom to do so, would increasing or decreasing the threshold simply move the threshold problems or alleviate them?

- 3.38. 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) although it should be noted this was closely followed by 32% who wanted the status quo maintained.

- 3.39. Support for a reduced threshold was less prevalent amongst AAT members. According to the *AAT 2017 VAT Survey* just 4.6% would like to see the VAT threshold reduced to the personal allowance level (currently £11,500) with greater support for a zero threshold as in Spain and Sweden (8.8%) instead.
- 3.40. This was largely mirrored at last year's AAT member focus group where there was support for both an increase and a decrease in the threshold. There was no support for maintaining the status quo.
- 3.41. Irrespective of whether the threshold remains the same or is substantially increased, there will always be a cliff edge that impacts upon behaviour. The only "perfect" solution to this particular problem would be to require all to register.
- 3.42. If the government is not minded to abolish the threshold then it should be set an optimum level that makes the cliff edge as smooth as possible by a) setting it at a level where it impacts the smallest number of companies whilst b) maximising tax revenue.
- 3.43. As highlighted at 3.21, in seeking to alleviate threshold problems there needs to be a balance struck between the likely loss of VAT receipts (higher threshold) or the 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.

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:

E-mail: phil.hall@aat.org.uk

Telephone: 07392 310264

Twitter: @PhilHallAAT

Association of Accounting Technicians, 140 Aldersgate Street, London, EC1A 4HY

