



Chartered  
Institute of  
Taxation

Excellence in Taxation

**House of Commons Treasury Committee  
VAT Inquiry  
Response by the Chartered Institute of Taxation**

**1 Introduction**

- 1.1 We are pleased to submit comments in response to the Treasury Committee's VAT Inquiry.
- 1.2 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 1.3 Our objectives for the tax system include:
- A legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences.
  - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
  - Greater certainty, so businesses and individuals can plan ahead with confidence.
  - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
  - Responsive and competent tax administration, with a minimum of bureaucracy.
- 1.4 The Inquiry is extremely wide-ranging. We have sought to keep our points under each theme / question relatively brief, but we would be happy to elaborate further if this should be necessary.

**2 Executive summary**

- 2.1 We believe that to significantly cut the VAT tax gap, HMRC will need to:

- Provide better guidance and taxpayer support to reduce errors and assist taxpayers to pay the correct tax at the correct time;
- Increase HMRC headcount allocated to VAT compliance - whilst VAT inspections are often a cause of concern for businesses, they help provide a level of assurance, and identify errors sooner rather than later;
- Review their system capabilities, IT analytical powers and tools to ensure that in the era of big data and the connected world that HMRC has the right tools, staff and training to detect high risk behaviours and transactions;
- Consider now how Brexit will increase or change opportunities for fraudsters to defraud the country and what preventative steps can be built in to mitigate this;
- In the haste to close loopholes exploited by a small minority, not introduce widespread changes that are disruptive to the majority of compliant businesses;
- Share more detailed VAT gap figures with professional and trade bodies, with a view to identifying effective, targeted measures to reduce the VAT gap.<sup>1</sup>

2.2 We note that this requires investment and potentially increased HMRC staff numbers in an environment that has seen a reduction in both offices and staff numbers together with a move away from face to face meetings with taxpayers. However we wonder whether any decrease in the VAT gap can be expected without additional investment, as unpopular a concept as that might be.

2.3 The tax profession, in particular the seven 'PCRT bodies', have strengthened their disciplinary code to address issues around aggressive tax planning. VAT avoidance appears to be at an all-time low.

2.4 Currently we perceive that the biggest concern for businesses around Brexit is uncertainty, ie what the VAT regime will look like, when, and how it will impact their business. This is affecting business decisions now. Post Brexit, issues likely to arise include the time and cost consequences of differing import / export processes, a loss of simplification mechanisms, and the divergence of the UK VAT system from the EU VAT system.

2.5 Whilst Brexit will offer some opportunities, particularly around simplification, many complicating factors do not arise as a result of the EU VAT system, but are 'home grown'. Much can already be done to eliminate some of these complexities.

2.6 VAT is a self-assessed tax, yet we receive continued reports of inadequate / inaccurate / out of date guidance. This, coupled with the difficulties in getting rulings from HMRC, makes it difficult for many businesses to comply with their VAT obligations. The availability of guidance and rulings needs to be improved.

### 3 VAT and the tax gap

3.1 *What are the root causes of the UK VAT gap and how might they be addressed?*

3.1.1 The VAT gap is estimated by HMRC to be £12.6 bn in 2015-16,<sup>2</sup> which equates to 9.8% of net VAT total theoretical liability (VTTL). The VAT gap figures for 2016-17

<sup>1</sup> We have not yet approached HMRC, but preparation of this response has identified this as a sensible course of action.

<sup>2</sup> See section 2, 'Measuring tax gaps 2017 edition', published on 26 October 2017

are yet to be finalised, but preliminary estimates put it at £12.0 bn, or 9.0% of VTTL.<sup>3</sup> If these figures are borne out, it will continue the downward trend in the VAT gap in recent years.

3.1.2 HMRC do not publish a full breakdown of the VAT gap figures. This is, we understand, because HMRC will only publish figures on the tax gap where they can be supported with a sufficient degree of accuracy / confidence. In relation to 2015-16 the following figures were published:

- The tax gap due to VAT avoidance is £0.1bn.
- VAT debt is estimated at £1.6 bn.
- The Missing Trader Intra-Community (MTIC) fraud estimate is between £0.5 bn and £1 bn.

3.1.3 Whilst not published with the tax gap figures:

- It is noted in the Inquiry that, according to HMRC, over £3.5bn was lost due to mistakes in VAT returns.
- It has been stated that the VAT lost from non-EU traders who sell goods (located in the UK at the time of sale) to UK customers accounts for £1-1.5bn of the total VAT gap.<sup>4</sup>

3.1.4 We have not previously discussed the VAT gap figures with HMRC, although we imagine HMRC will have a much greater understanding of the causes of the VAT gap than that set out above.

3.1.5 Turning to the published figures first:

- VAT avoidance remains at an all-time low. This is consistent with the feedback we receive from our members around their activities, and their clients' appetite for aggressive tax planning; although this didn't prevent the government introducing detailed new rules to report VAT avoidance.<sup>5</sup>
- VAT debt continues to form a significant part (13%) of the VAT gap, as compared to other taxes where the proportions are much more modest. This is perhaps understandable considering the 'real time' nature of VAT, and the different method of calculation for VAT as compared to direct taxes, but the government should look further into how it might reduce such a high level of non-payment.
- MTIC fraud estimates have remained broadly stable since 2010-11, suggesting that measures to combat this behaviour have to date been ineffective.<sup>6</sup>

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<sup>3</sup> See 'Second estimate of the VAT gap for 2016-17', released on 13 March 2018.

<sup>4</sup> See, for example, the Fulfilment House Due Diligence Scheme consultation document published on 16 March 2016.

<sup>5</sup> Section 66 and Schedule 17 to the Finance (No 2) Act 2017, effective 1 January 2018.

<sup>6</sup> Although ONS stats suggest that MTIC fraud trade has itself reduced from 2010/11 levels. See <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/timeseries/ofnn/mret>

3.1.6 We would make the following observations in relation to the remainder of the VAT gap:

- Illegal activity, such as where cash transactions are suppressed / unrecorded, is likely to represent a large element of the VAT gap. A 'discount for cash' still appears to be common in some B2C service sectors.
- The estimate of £3.5 bn of 'mistakes' is perhaps not surprising, considering the complexities of the VAT system. This is compounded by:
  - the lack of clear, up to date guidance, on which businesses can place reliance, which is necessary to help businesses get their VAT affairs correct, and
  - the frequent inability to obtain a ruling from HMRC as to the VAT treatment of a transaction when the business requires help or clarification from HMRC.
  - The cessation of early educational visits by HMRC officers to newly VAT registered businesses has also removed an important layer of initial support.

In order to reduce the alleged £3.5bn of mistakes, HMRC should place more focus on helping taxpayers (their 'customers') understand and comply with their VAT obligations. We would endorse the recent report by the Office of Tax Simplification<sup>7</sup> which (amongst other things) recommended:

- Simplifying elements of the tax (such as VAT rates, partial exemption etc) to avoid errors by otherwise compliant taxpayers
  - Improving clarity and timely updating of guidance
  - Improving responsiveness to requests for rulings
- The VTTL is, by definition, a theoretical figure and the consequent 'VAT gap' is therefore also theoretical. This makes it difficult to accurately estimate the VAT gap, suggesting that the VAT gap on its own should not act as a driver of government policy.
  - In relation to illegal activity, recent research undertaken on behalf of HMRC<sup>8</sup> concluded that three steps were required to reduce evasion:
    - Increase the perceived likelihood of getting caught – to reduce the impression that evaders will get away with it.
    - Improve understanding of potential consequences – to provide a compelling reason to stop evading tax.

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<sup>7</sup> See

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/657215/Value\\_added\\_tax\\_routes\\_to\\_simplification\\_print.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/657215/Value_added_tax_routes_to_simplification_print.pdf)

<sup>8</sup> Understanding evasion by Small and Mid-Sized Businesses, September 2017

- Focus on the particular ramifications for the evader – what incentivises such behaviour and would this be impacted if they are caught.
- 3.1.7 It remains surprising that HMRC resources continue to be cut, when the appropriate additional resource would undoubtedly reduce the perceived VAT (and wider tax) gap.
- 3.2 *Is government policy-making sufficiently responsive when a weakness in the UK VAT regime is identified?*
- 3.2.1 Structural weaknesses in the VAT system as it applies to the business world tend not to happen overnight, but usually develop over a period of time; such as a failure to adapt to the increase in trading on the internet or the growth in [apparent] self-employment (identified by the Committee as areas of focus). It is often surprising how long it seems to take for the government to recognise these issues.
- 3.2.2 Because of this time lag, there is then a tension between acting quickly, and undertaking sufficient consultation around how the issue might be effectively resolved. This gives rise to inconsistencies in approach:
- The Fulfilment Houses Due Diligence Scheme was announced at Budget 2016 and comes into effect on 1 April 2019 (the registration process for businesses having opened on 1 April 2018). Whilst there was a consultation on the measure (said to be held at stages 1 and 2 of the consultation process), the decision to have the Scheme had already been taken. Therefore, the opportunity to consult on what alternative measures might have been available and effective was lost, seemingly irrespective of the impact it would have on affected businesses.
  - Conversely, proposals around alternative methods of VAT collection (aka split payment) and the role of online platforms in ensuring tax compliance by their users, both of which are also in the sphere of internet trading, have started at early stages with calls for evidence. This early stage consultation is welcome and is helping to identify both opportunities and challenges in this area.
- 3.2.3 In any event, as VAT is a European tax, the UK can currently only take steps which are compliant with EU rules, or seek a derogation from the EU rules where necessary to combat a particular type of mischief (or alternatively risk infraction proceedings if no derogation is allowed). In recent years, very few derogations have been sought; the focus being on administrative measures, or on pursuing EU-wide solutions which, given their nature, can take many years to implement, such as the proposed rewrite of the Principal VAT Directive in relation to financial services.
- 3.2.4 As noted elsewhere, one of the weaknesses in the VAT system is its complexity. VAT is no longer a 'simple tax'. If VAT were simplified, and made easier to comply with, errors are likely to reduce and voluntary compliance increase.
- 3.3 *Are there ways in which HMRC's compliance strategy for VAT could be better targeted to close the VAT gap? Could its resources be deployed more effectively?*
- 3.3.1 This is perhaps more a question for HMRC themselves (and we will discuss Brexit in more detail below) but we understand that Brexit has caused many 'front-line' staff to be moved into a Brexit-related role because of the complexities and limited timescales involved. In addition, staff are moved around from project to project, so

currently a great deal of HMRC resource is focused on Making Tax Digital and (perhaps more historically) issues such as MTIC fraud.

3.3.2 This must cause disruption to HMRC's compliance activities. There is a perception that revenue-raising activities are more highly prioritised than 'customer focused' work,<sup>9</sup> which might target one element of the tax gap (that relating to non-compliance), but does not assist those who need HMRC's help to remain compliant.

3.3.3 As highlighted above, deployment of resources to help businesses get their VAT correct would help reduce the alleged £3.5 bn lost through mistakes.

3.4 *Do developments such as the growth of on-line trading or changes in the labour market reflecting modern working practices require a new approach to VAT compliance?*

3.4.1 Yes. It is important that VAT compliance activity (and tax compliance activity generally) keeps pace with modern working practices, though in practice we recognise this can be difficult. HMRC (and HMT) has taken both bold and novel steps in this area:

- Launching an agreement between HMRC and operators of online marketplaces, obtaining those marketplaces' commitment to provide data to HMRC, education for sellers, and act in instances of non-compliance.<sup>10</sup>
- Proposals for a 'split payment' mechanism so that the VAT element of online transactions is captured and paid directly to HMRC.<sup>11</sup>
- Looking at 'conditionality' ie the requirement to be registered for relevant taxes before being granted other types of licence (eg waste management, scrap metal etc).<sup>12</sup>

3.4.2 The call for evidence around the VAT registration threshold<sup>13</sup> also invites comments and suggestions as to how to mitigate the impact of becoming VAT registered, recognising that the current threshold can incentivise businesses to manage their turnover (or suppress income), as well as avoid the administrative complexities of the regime.

3.4.3 However, effective VAT compliance in these areas is naturally difficult:

- The VAT risk in relation to online sales typically involves overseas businesses, which makes HMRC's compliance activity much more difficult, (hence the measures in relation to the online marketplaces on which they trade).
- Changes in the labour market have naturally increased the number of 'businesses' within HMRC's scope – a business with 100 staff is still one business, yet with a potentially high compliance yield; whereas a business

<sup>9</sup> See, for example, the recent announcement around HMRC's re-prioritisation of projects.

<sup>10</sup> See <https://www.gov.uk/government/publications/hmrc-and-online-marketplaces-agreement-to-promote-vat-compliance/tackling-online-vat-fraud-and-error-the-role-of-online-marketplaces-in-co-operating-with-hmrc-the-agreement>. This is in addition to the various new measures around joint and several liability of online marketplaces.

<sup>11</sup> See <https://www.gov.uk/government/consultations/alternative-method-of-vat-collection-split-payment>.

<sup>12</sup> See <https://www.gov.uk/government/consultations/tackling-the-hidden-economy-public-sector-licensing>.

<sup>13</sup> See <https://www.gov.uk/government/consultations/vat-registration-threshold-call-for-evidence>

with 100 self-employed contractors (whether individuals or small companies) is 101 businesses, with a potentially low compliance yield.

3.4.4 In relation to online sales, we suggest that time is given for recent measures to 'bed in' and their effectiveness evaluated. We note separately that there are concerns over the implementation costs for businesses of a split payment model, and we would recommend that this is only progressed once a full evaluation of the costs / benefits has been carried out.

3.5 *Is HMRC's approach to large, medium-sized and small businesses appropriate for the nature of the risk to the VAT element of the tax base that each sector poses?*

3.5.1 Without a more detailed breakdown of the source of VAT revenues, and the VAT gap, it is difficult to respond to this question, other than by making general remarks:

- Large businesses – will typically have a greater VAT throughput, and engage in more complex transactions. This potentially poses a risk to the revenue, although such businesses will usually have in-house expertise in managing such risk, and HMRC typically address this through allocation of a Customer Compliance Manager (CCM). The level of routine interaction and information provided will also be greater and enables HMRC to more closely monitor the business' activities, and also gives the business a direct route into HMRC in cases of query or potential dispute.
- Small businesses – will typically have a smaller VAT throughput. Most will engage in more routine transactions, although many small VAT registered 'businesses', such as charities, clubs and associations face significant VAT complexities. There are also a large number of these small businesses. One of the greatest risks would appear to be deliberate evasion (the 'discount for cash' approach) in the B2C service sectors, which HMRC seems to have difficulty in reducing, largely because of the perceived low risk of being caught (through the actual or apparent reduction in the number of compliance visits being undertaken on businesses of this size). Smaller businesses are also relatively poorly served by HMRC and the tax system, in that they may have a limited awareness of VAT complexity (thus making mistakes out of ignorance), nor the resources to obtain clear guidance from HMRC on GOV.UK or on the VAT Helpline when they do (thus making mistakes through misunderstanding).
- Medium-sized businesses potentially have the worst of both worlds. By their nature they are more likely to be involved in more complex areas of VAT (such as international trade, or being partially exempt), and yet have relatively large VAT throughput. However, they do not have an allocated CCM and so do not have that direct relationship with HMRC, both to monitor the business' compliance, and to provide assistance in areas of complexity.<sup>14</sup> Whilst these businesses may be able to afford advice, they remain a poorly serviced part of the business community. Recent evidence also shows that efforts by HMRC to support this size of business have not been successful.<sup>15</sup>

<sup>14</sup> This is perhaps borne out in the recently published results of HMRC's Mid-size Business Customer Survey ([https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/708599/Mid-Size\\_Business\\_Survey\\_2016\\_-\\_HMRC\\_Research\\_Report\\_475.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708599/Mid-Size_Business_Survey_2016_-_HMRC_Research_Report_475.pdf)) which noted that only 31% of business reported positively on 'Access to taxation specialists'.

<sup>15</sup> See, for example, <https://www.thetimes.co.uk/edition/business/revenues-tax-advice-scheme-flops-6jsrg0tq8>

- 3.6 *In what ways is the tax base in the UK vulnerable to exploitation by those determined to circumvent VAT rules, push boundaries or develop aggressive VAT planning arrangements? How might either the law or HMRC's processes and procedures be improved to reduce that vulnerability?*
- 3.6.1 There will always be those who do not play by the rules, evidenced by the continued incidence of MTIC fraud, and those fraudsters will often be 'ahead of the game'. In the areas of deliberate non-compliance, we believe that legislative steps (such as extended time limits, higher penalties, or additional obligations) have limited effect, particularly whilst the perceived likelihood of being caught is low. Increased front-line resourcing for HMRC is the only realistic way of changing this behaviour.
- 3.6.2 Aggressive VAT planning arrangements have declined substantially since the Halifax judgement of the ECJ was handed down well over 10 years ago. The appetite for such planning has long-since expired, as evidenced by the 'handful' of VAT Disclosures, the experiences of our members, and that the tax gap due to VAT avoidance is just £0.1 bn. Further, any such planning in the current climate has a strong possibility of being identified by HMRC, and challenged, resulting in protracted and costly litigation – a strong deterrent in itself.
- 3.6.3 VAT training in HMRC used to be focused on VAT evasion from small cash businesses including suppression of retail takings and also the suppression of purchases to support the credibility of their mark-up. MTD will not address this vulnerability. There is almost no other way of stopping this behaviour except by visits in person by well-trained VAT officers, which increases the perception of being caught. We are now in a position where most small/medium VAT registered businesses will not be visited more often than every 10 years, if at all. In addition, due to the closure of HMRC offices nationally many of these non-compliant businesses will be many miles from the nearest HMRC office and know that the chances of being caught are minimal.
- 3.6.4 Where VAT officers are insufficiently well trained, eg on inspections, officers have failed to pick up on errors or approved VAT deductions they ought not to have.
- 3.7 *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?*
- 3.7.1 Our Professional Conduct in Relation to Taxation (PCRT) makes it clear that *'Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.'*<sup>16</sup> Any member who contravenes these rules can be referred to the independent Taxation Disciplinary Board.
- 3.7.2 However, PCRT only applies to members of seven professional bodies. Members of other professional bodies may be subject to different standards, and advisers who are not a member of a professional body (or a regulated firm) are not subject to any such requirements. Whilst HMRC have introduced a 'standard for agents',<sup>17</sup> which

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<sup>16</sup> See

[https://www.tax.org.uk/sites/default/files/PCRT%20Effective%201%20March%202017%20FINAL\\_211216.pdf](https://www.tax.org.uk/sites/default/files/PCRT%20Effective%201%20March%202017%20FINAL_211216.pdf), in particular paragraphs 2.28 to 2.39.

<sup>17</sup> See <https://www.gov.uk/government/publications/hmrc-the-standard-for-agents>

draws on the fundamental principles of PCRT, there is no sign as yet of HMRC enforcing those standards. Further, our members continue to report examples of questionable advice given by unqualified agents; either through inadequate knowledge or pushing the boundaries of credibility.

## 4 VAT and Brexit

### 4.1 *What opportunities and challenges for the UK VAT regime are presented by the UK's exit from the European Union?*

*What are the chief concerns for HMRC and for business?*

4.1.1 It is convenient to take these two questions together. First, however, it is important to address the current period prior to Brexit, a period of great uncertainty for businesses. This makes it extremely difficult for them to plan ahead and invest with confidence, because the impact of Brexit on significant elements of the VAT rules remains unknown.

4.1.2 Subject to the outcome of the negotiations, the main opportunity provided by Brexit is the additional flexibility to change the UK VAT regime to make it simpler, or more competitive as compared to other countries' regimes. The Office of Tax Simplification review also makes reference to such opportunities. However, this opportunity is fraught with potential challenges – the more the UK's VAT regime becomes out of line with the EU VAT system, the more difficult it will be for UK businesses to trade with the EU (and internationally).<sup>18</sup> Careful consideration will need to be given to each and every departure from the current EU VAT regime, to balance the benefits to UK businesses with the complexity it will create for businesses that trade overseas. However some areas, such as in relation to our domestic zero rates (see later), and partial exemption de minimis limits, could be areas which might benefit from simplification, without too much concern around inconsistency with the wider EU VAT system.

4.1.3 The challenges for the VAT regime and UK businesses are potentially many, including:

- There is currently uncertainty over whether there will be a transitional period and, if so, its specific length and scope.
- Legal aspects, such as the relationship between the UK and EU VAT law (eg the purposive approach to interpretation), applicability of principles of EU law (now, immediately post Brexit and in the future), and possible wider reforms to the EU VAT system (eg the move to the definitive system).
- Any 'hard' borders will potentially bring financial and administrative burdens for businesses, and resourcing requirements for HMRC.
- Following on from the above, borders could give rise to bottlenecks at ports etc, significantly impacting on production and 'just in time' systems.
- The loss of some VAT simplification measures, such as the Mini One Stop Shop (MOSS) (currently available to UK businesses which provide electronic

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<sup>18</sup> Or indeed for Irish businesses that simply trade north and south of the border.

services to EU consumers), triangulation, and requirement to adopt alternative procedures (eg for refunds of VAT incurred in EU member states).

- Keeping up to date with any changes to the VAT regime (both in the UK and in the EU), either through the impact of Brexit, or as the VAT regimes diverge.

4.1.4 We should not forget, however, that many of the complexities and associated features of the UK VAT regime are ‘home grown’, such as the high VAT registration threshold which can have a distortive ‘cliff edge’ for some business sectors, our zero rates (which are frequently illogical and difficult to navigate), and the difficulties in understanding these complexities (through a lack of clear guidance and rulings). Some of these issues could, if desired, be tackled irrespective of Brexit.<sup>19</sup>

4.2 *What impact will Brexit have on HMRC’s efforts to reduce the VAT element of the tax gap?*

4.2.1 Again, much will depend upon the outcome of the negotiations, and how much the UK VAT system will change. Impacts could include:

- The VAT gap could simply increase as a by-product of the amount of VAT ‘throughput’ if we have ‘hard’ borders and / or we move away from acquisitions / despatches to the EU and they become imports and exports.
- Increased errors, if the VAT rules change as a result of Brexit and businesses are unaware of or misinterpret the changes.
- Resource constraints within HMRC – we have already mentioned the pressures on HMRC resources caused by Brexit, which will inevitably mean less resource for other areas (customer service / compliance).
- Reduced compliance effectiveness, for example a potential reduction in the ability to exchange information with other EU tax authorities.

## 5 VAT and business

5.1 *What aspects of VAT (either process or design) cause the biggest problems for businesses? How might they be improved?*

5.1.1 We have highlighted above three areas for improvement (simplification, improved guidance, and improved access to timely rulings).

5.1.2 It is often said that, in relation to VAT, businesses are ‘unpaid tax collectors’. They need the VAT regime to be as straight-forward as possible, and need help particularly when they undertake transactions outside the ‘norm’ for their business. HMRC should also be more understanding when mistakes are inevitably made – there is often a presumption of deliberate behaviour or carelessness, when in fact the business has simply made an honest mistake. Removing the assurance that penalties would not be levied where the business voluntarily discloses the error to HMRC also potentially increases the costs of putting things right.

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<sup>19</sup> And we recognise that the government is consulting on the design of the VAT registration threshold, and looking at other recommendations following the Office of Tax Simplification’s review of VAT.

5.2 *In 2015-16 over £3.5 billion was lost due to mistakes in VAT returns according to HMRC figures? Will Making Tax Digital 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?*

5.2.1 First of all, we should state that we have previously been unaware of this estimated £3.5bn VAT loss due to mistakes in VAT returns. It is not published in HMRC's Measuring tax gaps 2017 edition which, if a reliable estimate, is surprising as it would represent a significant element of both the VAT gap, and overall tax gap.

5.2.2 Importantly, we have no confidence that Making Tax Digital (MTD) is sufficient on its own to reduce error and improve the collection of VAT. In particular:

- HMRC has provided no evidence that there is a systemic problem with VAT registered businesses making errors in their VAT accounting, either by the nature of the records that they keep, or how they submit their VAT return to HMRC. Notwithstanding this, under MTD for VAT, HMRC are mandating a) digital record keeping in specific formats and b) submission of VAT returns directly from those digital records.
- The preparation of VAT returns can require many adjustments and, for some businesses, the bringing together of records from a variety of programs or locations. In our view (at least in the short-medium term) there is a risk that MTD for VAT will *increase* errors as businesses grapple with getting used to new software, or the digital links that are required to produce and submit the VAT return. What happens within software is often invisible to the typical user, and businesses will simply rely on their software to produce the correct figures, even though software typically deals very poorly with the complexities of VAT.
- MTD was, originally, a small business phenomenon. We were told by HMRC in May 2017 that 80% of the tax gap caused by mistakes (failure to take reasonable care, and error – a total of £9.4bn) arose in businesses trading below the VAT registration threshold. More recently, we are now told that this figure is much lower (nearer 50%), although we are not clear why there has been such a significant change. Of course, the accuracy of these numbers is important when determining the likely revenue benefits from MTD, both for income tax and for VAT. It also perhaps makes it even more surprising that VAT is being mandated first. HMRC is already in a position to request and require significant amounts of accounting data from larger businesses for control purposes.
- Whilst in relation to income tax, a survey carried out by the CIOT and ATT in late 2016 cast doubt over whether MTD would reduce mistakes, with around 40% of members considering that compulsory digital record keeping and quarterly reporting will *increase* errors by their clients, with a similar number considering it will have limited impact.<sup>20</sup>
- The 'business case' for MTD for VAT is unconvincing. An average transition cost of just £109 per business, together with ongoing (net) additional compliance costs of just £31 per annum, seems hugely understated. Further, the estimated revenues are difficult to ascertain, but when calculated seem ambitious. We wonder whether the basis of the revenue benefits still holds

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<sup>20</sup> See <https://www.tax.org.uk/policy-technical/submissions/making-tax-digital-ciota-and-att-member-survey>

good in the light of the recent findings of HMRC pre-populations of SA returns.<sup>21</sup>

- 5.2.3 As highlighted above, in our view the key to reducing errors by businesses is to simplify elements of the tax, and improve both the clarity of guidance and access to and responsiveness to requests for rulings.
- 5.3 *Can disagreements between HMRC and a business about how much VAT is due be resolved quickly and fairly? If not, what are the obstacles and how might they be overcome?*
- 5.3.1 As perhaps expected, this can vary significantly from one case to another. On the whole, the review and appeals system is reasonably well understood, although there is a perception (even if not true) that the internal review system is little more than a 'rubber stamping' exercise. There are, of course, instances where the parties become particularly entrenched, or there is alleged difficult behaviour on behalf of HMRC (or indeed the business or their agent), but it is important that there is effective dialogue if disputes are to be resolved.
- 5.3.2 Further, we do hear that on more than just isolated occasions it is difficult to obtain a clearly stated technical view from HMRC of their position. In such instances, it is difficult for an adviser (or the business) to evaluate the strength of their case and this adds delays and uncertainty for the business.
- 5.3.3 One of the main challenges for a business with a difference of opinion to HMRC is the length of time it can take to resolve the issue, which is neither in the interest of the business, nor HMRC. The statutory review deadline provides a short-term focus for HMRC, but once a dispute is with the tax tribunal it can take a number of years to be resolved; particularly if the matter is appealed and / or referred to the Court of Justice of the European Union.
- 5.3.4 Alternative Dispute Resolution (ADR) is under-used in VAT and, whilst not appropriate for all cases, can in the right circumstances help resolve disputes more quickly. However, it is important that all parties come to the table willing and able to negotiate. We have received reports of HMRC offices being unwilling to move from their original position, rendering ADR a waste of everyone's time. It may also be worth exploring whether certain cases (eg low value, non-precedent value) might be limited to the first tier tribunal (FTT) (without appeal), so as to bring about finality sooner rather than later.
- 5.3.5 The automated nature of the default surcharge regime would benefit from an urgent review,<sup>22</sup> it being the greatest single cause of a tribunal appeal.

## 6 VAT and good tax policy

- 6.1 *How does VAT measure up against the [Treasury Committee principles for tax policy]?*
- 6.1.1 We make brief comment against each of the principles below:

<sup>21</sup> See <https://www.parliament.uk/documents/commons-committees/public-accounts/Correspondence/2017-19/hmrc-relationship-relationship-service-quality-tax-revenue-240418.pdf>

<sup>22</sup> We recognise there are medium-term plans to replace the Default Surcharge with a different regime under Making Tax Digital, but it is unclear how quickly such a regime will be implemented.

- 6.1.2 Be fair – the underlying aims of VAT are broadly fair – to be a tax borne by consumers. However, there are elements of unfairness, for example:
- Organisations that undertake similar / identical activities can be subject to different rules - a local authority undertaking an activity might benefit from full VAT recovery on associated costs by virtue of section 33 of the VAT Act, whereas a charity would incur irrecoverable VAT on those costs.
  - Different interpretation of VAT rules by VAT officers around the country. There appears to have been a loss of central control over tax policy so that local officers make contradictory decisions in what would appear to be similar cases.
  - Cases where the FTT finds against HMRC but where HMRC say they 'do not accept the decision is correct', but do not appeal. HMRC continue to pursue the original policy, but the business who has appealed gets a benefit over those who do not. Appealing to the FTT can incur significant costs and this benefits those who can afford litigation. There is a perception from some members that this tactic is to prevent binding legal decisions going against HMRC in the upper tier tribunal (UTT) (*Will Woodlands* and *Chester Zoo* being recent examples).
  - There is also a determined difference in treatment between organisations structured in a vertical rather than horizontal manner.
- 6.1.3 Support growth and encourage competition – the VAT registration threshold is currently a barrier to growth for many small businesses and we are pleased that this is currently under review. The above example also highlights one of many instances where the VAT system can distort competition between different entities.
- 6.1.4 Provide certainty – as we have explained above, VAT rules can be extremely complicated, yet need to be applied by businesses themselves on a day-to-day basis, which inevitably gives rise to significant numbers of disputes.
- 6.1.5 Provide stability – on the whole, legislative changes to the VAT system are relatively few. The greatest catalyst for changes in VAT typically comes from decisions of the tribunals or courts; which cast doubt on or change the previous interpretation of a matter. This can be extremely disruptive for businesses (and HMRC) and we would suggest that a review is undertaken of recent, key decisions, to help identify whether better legislation or guidance could have prevented these situations arising. However, the volume of expected primary and secondary legislation to deal with Brexit will create instability, particularly due to the Government's decision to redraft (rather than 'copy and paste' the Union Customs Code, which will inevitably lead to different interpretations and lessen the reliance taxpayers can place on existing Customs case law.
- 6.1.6 Be practicable – VAT accounting systems can be complicated, particularly for large / complex organisations. Many of these will have designed bespoke systems or procedures to deal with the disparate sources of information needed for their VAT returns, and to undertake the adjustments required prior to submission of those returns. MTD has the prospect to throw this all into disarray, making it more difficult for some businesses to maintain records in a manner which suits their business, and / or prepare and submit their return.

- 6.1.7 Be coherent – you only have to recall the ‘pasty tax’ headlines, or the Jaffa Cake / Pringles / plethora of food VAT liability cases to recognise the disjointed and illogical nature of elements of the VAT system. Many of these issues stem not from EU law but from UK reliefs initiated under derogations from EU law. Irrespective of Brexit, these types of issue are well worthy of further review.<sup>23</sup>
- 6.2 *Is the process of making VAT policy sufficiently open to scrutiny and debate? Are there ways in which the current process can be improved?*
- 6.2.1 We would refer to our comments above, and those in our recent response to the House of Lords Constitution Committee inquiry into the legislative process.<sup>24</sup>
- 6.2.2 Whilst in VAT we do consider there is a relatively good collaborative process to implementing changes outside of the legislative process (through discussion at the various stakeholder groups operated by HMRC), we remain concerned over the inconsistent approach to consultation on legislative measures (as outlined above), and the extent of scrutiny and debate these measures receive.

## 7 Acknowledgement of submission

- 7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

## 8 The Chartered Institute of Taxation

- 8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 18,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation  
31 May 2018

<sup>23</sup> This is not limited to food cases. Issues such as the different treatment of hard copy (zero rated) and online (standard rated) publications are a further example.

<sup>24</sup> See <https://www.tax.org.uk/policy-technical/submissions/house-lords-constitution-committee-inquiry-legislative-process-ciot>