

Alternative method of VAT collection Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 The Chartered Institute of Taxation (CIOT) is pleased to set out its comments in relation to the above call for evidence.
- 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 In our response, we have restricted our comments to the areas in which we have relevant expertise. Those organisations operating in the payments cycle are better placed to answer many of the questions posed, and so we have not answered questions 3, 5, 6, 7, 8, 10 and 12.
- 1.4 However, we consider we can provide valuable VAT technical and practical input throughout the development process and we are keen to engage in the face-to-face working groups (paragraph 2.2).
- 1.5 At the outset, we should state that we found the scope of the call for evidence unclear. There were a number of uncertainties such as whether any ‘split payment’ model would be limited to sales of goods situated in the UK by overseas suppliers (in order to target the non-compliance identified in paragraph 1.4), or would it apply to a much greater range of online sales (see paragraphs 1.9 and 1.12). Members have commented that the lack of clarity here means that the effectiveness of this consultation has been compromised. Additionally, election purdah has meant that stakeholder meetings were cancelled; meaning that crucial opportunities to clarify and explore issues were lost at this early stage in the consultation process.

2 Executive summary

- 2.1 We broadly agree with the design principles. However, we question what is meant by 'tax efficiency'. Whilst split payment might accelerate and secure the payment of tax to HMRC, it will inevitably bring complexity for businesses, payment handlers, advisers and HMRC. It is vital that these complexities and costs are fully understood before split payment is progressed, to ensure that the benefits and costs are balanced.
- 2.2 To keep in line with the policy objective of combatting fraud and ensure a proportionate response, we suggest that consideration should be given to whether split payment can and should be introduced for overseas sellers first/ only. This will enable the model to be targeted at the population with the greatest risk of non-compliance and also ensure that largely compliant UK businesses (who represent the majority of sales to UK customers) will be either unaffected, or affected only once the regime has been properly implemented for overseas sellers.
- 2.3 A fundamental principle to establish at the outset is whether the split payment reflects an amount of VAT (paid in advance/ on account) or it is the actual payment of VAT. Any proposals to change the underlying VAT rules concerning the supply could create significant complexity, which, in our view, would not be necessary to tackle the non-compliance targeted by this measure.
- 2.4 We consider the scope of this call for evidence is unclear and are concerned that valuable input may have been missed because of this. We recognise that this consultation asks much broader questions about the feasibility of real time reporting for VAT collection, giving an indication that HMRC is exploring this approach in the future. However, we are concerned that the consultation may not have reached the optimum target audience because it is being considered as part of a package of measures to target fraud relevant to online sales by overseas businesses. We would like to see greater clarity and transparency at the next stage of the consultation process.
- 2.5 Members are concerned about the financial impact on business of adverse cash flow changes as split payment will reduce, eliminate or even reverse cash flow for businesses. We recommend careful consideration should be given to mitigating the impact on businesses, both in relation to the transition into split payment (when both 'normal' and split payment VAT would be due) and on an ongoing basis.
- 2.6 The aim of this policy is to combat fraud. HMRC should ensure that any proposed split payment method is proportionate to the level of non-compliance. The extent of current levels of non-compliance are unclear. Paragraph 1.5 states that 'the losses from overseas businesses selling goods to UK consumers via online marketplaces was £1-1.5 billion of VAT in 2015 - 2016', but also that the new measures (set out in paragraphs 1.6 to 1.8) 'are proving effective' and 'acts as a strong deterrent to overseas businesses evading VAT'.

3 Question 1: Please indicate what type of organisation/individual you are.

- 3.1 Please see the introductory remarks, and paragraph [15], for more information about the CIOT.

4 Question 2: We are interested in any experiences you may have had in countries that operate a split payment mechanism where tax is extracted in real time. We would be like to understand when it works well and when it doesn't work well.

4.1 It would appear from the call for evidence that HMRC has already undertaken enquiries of other countries which have introduced (or are considering introducing) split payment models. We are aware of Spain, Italy, the Czech Republic and Poland either running or considering introducing similar measures.

4.2 The following issues have been raised in relation to Italy's split payment rules:

Effective date – difficulties with the interpretation of the time of supply rules and the way in which split payment provisions interact with traditional VAT chargeable event rules.

Refund of VAT - Because the seller no longer receives the VAT element of a sale, they are out of pocket when they need to make a refund to customers (including the VAT element). Consequently, a special refund mechanism has been established to prevent the seller from being at a cash flow disadvantage.

Reporting of output and input tax - Reporting requirements have been changed to reflect that a supplier no longer receives output tax but pays input tax (for which it is entitled to deduct). Without these changes, the supplier could be (incorrectly) in a credit position.

VAT Adjustments – adjustments regarding transactions made before the split payment rules came into force remain regulated by the traditional rules. Confusion arises around the transition and overlap of reporting periods.

Exceptions for certain transactions - the Italian mechanism does not apply to transactions subject to the reverse charge and withholding tax. Also excluded are transactions subject to other special VAT schemes (eg farmers and travel agents).

Taxpayer categorisation - the tax authority has identified which public entities are involved in the split payment mechanism.

4.3 We have received the following comments on the system that the Czech Republic has introduced:

Effective against fraud - An acknowledgement that the requirement to submit VAT control statements together with the VAT return represents an effective tool to fight carousel fraud. It allows the tax authorities to monitor whether every single taxable supply (at the value exceeding CZK 10000) reported by a customer has been reported also by a supplier.

Additional administrative burden and cost - the submission of VAT control statements is a time consuming process and it takes even more time to answer queries from the tax authorities. The review of the VAT control statements sometimes leads to a delay in repayment of VAT refunds. It has been also necessary to invest money into developing new /upgrading current IT software. Altogether, there has been an increase in the administrative and financial cost of reporting.

Increased enforcement for the Tax authority - There has been an increase in enquiries from the authorities. For example, where the customer claims input VAT

and the supplier has not recorded the same taxable supply in his VAT control statement (if it is not possible to match the taxable supplies on both sides), the tax authorities contact the customer and ask them to confirm the original VAT control statement or to make a correction. This can mean that the tax administrator contacts larger companies several times every month.

Harsh sanctions - The sanctions for not submitting / late submitting of the VAT control statement have proved to be too high and too strict. The VAT law has been already partly changed.

Scope and timing – we have found that costs related to reporting are high for small entrepreneurs and the rules / equipment are too complicated for some. Online reporting is being introduced step by step and there is still the chance that the reporting will be cancelled or at least more categories will be removed from the obligation to report.

5 Question 4: Do you think these are the right design principles for a split payment model? Is anything missing or is there anything that should be excluded? If you think the design principles should be different please provide evidence on alternatives.

5.1 Our comments in relation to HMRC's proposed design principles are set out below:

- *VAT split payment should increase tax efficiency for both businesses and HMRC*

This depends upon what is meant by 'tax efficiency'. Whilst split payment might accelerate and secure the payment of tax to HMRC, it will inevitably bring complexity for businesses, payment handlers, advisers and HMRC (see later). It is vital that these complexities, and costs, are fully understood before split payment is progressed, to ensure that the benefits do significantly outweigh the costs.

- *The split should be initiated at a point in the payment cycle by one of the participants and be driven by payment technology*

We agree that it is appropriate for a defined participant to initiate the split, and that should be applied consistently. Who that participant should be may be dependent upon the nature of the model suggested. For example, if the split is to reflect a set proportion of each sale, then the payment handler could initiate it. However, if the split is to reflect factors such as the liability or nature of the supply, the seller's input tax / cash flow position etc, the split may need to be initiated by payment handler in conjunction with the seller; although this could lead to a greater risk of non-compliance, and additional interaction (and hence costs) between the seller and the payment handler.

- *VAT split payment should be simple for the seller*

We believe that split payment should be simple not only for the seller, but for all participants, including HMRC.

- *VAT split payment should be invisible to the UK consumer, who will continue to pay by whichever method the consumer chooses, for example credit or debit card or by using a payment service provider*

We agree, although consideration might be given to positive messages that can be communicated to the customer at / after the time of the transaction, along the lines that the payment includes an amount of VAT has been paid directly to HMRC.

- *UK consumers' rights will not be affected*

We agree that consumer rights should not be adversely affected. This should extend to the timely and seamless processing of refunds etc.

- *There should be significantly less opportunity for fraud as the VAT will be extracted in real time in the payment cycle and later deposited with HMRC*

We agree. This is the driving force behind split payment and if meeting this principle is in doubt then the proposal should be re-assessed. See comments below about whether the amount split out represents VAT or is VAT.

- *VAT split payment will be in UK legislation (set out in statute)*

We agree, and further we suggest that split payment should, as far as possible, be set out in primary (rather than secondary or tertiary) legislation, as it constitutes the rules around collection and payment of VAT. We share a common aim with HMRC to support a legislative process that translates policy intentions into statute in an accurate and effective way; mitigating unintended consequences.

- *VAT split payment should be proportionate and fair and every effort will be made to ensure a level playing field for all sellers to UK consumers*

We agree, there should be a fair balance between the powers of HMRC and the rights of taxpayers.

We suggest that consideration should be given to whether split payment can and should be introduced for overseas sellers first / only. This will enable the model to be targeted at the population with the greatest risk of non-compliance and also ensure that largely compliant UK businesses (who represent the majority of sales to UK customers) will be either unaffected, or affected only once the regime has been properly implemented for overseas sellers.

- *Every effort would be made to ensure VAT split payment is cost efficient to build, implement and maintain*

We agree, and would in fact go further in saying that split payment must generate a significant 'net' revenue yield, after deducting the costs of all parties affected.

5.2 We also consider that the following principles should also be explored:

- *Split payment treatment does not influence or dictate the underlying VAT treatment of a transaction*

A fundamental principle to establish at the outset is whether the split payment reflects an amount of VAT (paid in advance / on account) or it is the actual payment of VAT.

Any proposals to change the underlying VAT rules concerning the supply would create significant complexity which, in our view, would not be necessary to tackle the non-compliance targeted by this measure.

We are of the view that the Split payment should simply represent an on-account payment of the seller's ultimate VAT liability as declared on its VAT return (asking to a trader who is in the Payments on Account regime). It should not be taken to influence, dictate, or otherwise affect the VAT position of a transaction which, in accordance with normal rules, should be determined by the seller.

- *There should be clearly defined exceptions and exemptions*

For example, small businesses could be excluded from split payment, and there would need to be clearly defined rules regarding what is 'small' for these purposes, and how businesses would need to monitor turnover and who / when to notify when they are no longer 'small'.

Like the Italian model, consideration should also be given to excluding certain supplies within particular regimes, such as the reverse charge, margin schemes, the Retail Export Scheme etc.

Further consultation would be required to determine which businesses or types of income or transaction should be excluded from the regime.

6 Question 9: What are the key challenges, from your perspective, to the development of a split payment model for VAT? Please provide evidence about the challenges you have identified and any solutions you think might help in overcoming those challenges.

6.1 In response to this question we focus on tax technical/ practical elements of the proposals. At present, these are 'high level' comments, and we look forward to considering these and other issues in more detail if the proposals develop further.

6.2 Clarifying the scope of the split payment mechanism

The scope of this call for evidence is unclear meaning that responses to HMRC could be less informative than they might otherwise have been.

For example, it would seem to apply to sales targeted by the Fulfilment House Due Diligence Scheme and related measures, where goods are already in the UK. However, it also considers transactions where goods are situated outside the UK when the sale is made; meaning this call for evidence has a wider remit than the previous fulfilment house anti-avoidance measures. The policy objective is not clear.

The consultation is also silent on EU v Non-EU overseas businesses. This distinction may be irrelevant once we have left the EU but, in the interim (and possibly transitional) period, different VAT rules apply to those categories of suppliers and EU law is applicable until such time.

We also recognise that this consultation asks much broader questions about the feasibility of real time reporting for VAT collection, giving an indication that HMRC is exploring this approach in the future. However, we are concerned that the

consultation may not have reached the optimum target audience because it is being considered as part of a package of measures to target fraud relevant to online sales by overseas businesses,

Our concern is that greater clarity and transparency is needed if the consultation process is to be effective.

6.3 Stakeholder meetings

Another barrier to the consultation process so far is that election purdah meant that consultation meetings were cancelled. We would be keen to meet with HMRC to explore these issues further as the consultation process progresses.

We recommend that HMRC offers greater clarity in the next stage of the consultation process and seeks to engage with a wider range of stakeholders.

Perhaps HMRC can offer stakeholder meetings now that purdah has ended, after the deadline, with the ability for us to update our written response in the light of that meeting?

6.4 Is this necessary now?

We welcome paragraph 1.6 of the consultation which champions the success and effectiveness of existing and recently introduced powers to tackle this type of fraud. HMRC state that non-compliant businesses are being removed from online marketplaces, joint and several liability notices are being issued and there has been a tenfold increase in the number of online overseas businesses applying to register for VAT. The Fulfilment House Due diligence Scheme measures also seem likely to be re-introduced in a subsequent Finance Bill.

Given all of this, we question whether this measure is striking the right balance between combatting fraud and minimising complexity/ administrative burden for taxpayers and HMRC? Especially at a time when businesses are being required to cope with Making Tax Digital and the inevitable changes brought about as a result of the UK leaving the EU.

6.5 Nature of split payment

As mentioned at Question 5, it is crucial at the outset to be clear on whether the split payment is, effectively, an advance payment in lieu of a VAT liability, or the VAT amount itself.

If the split payment is an amount of VAT, there will need to be a significant departure from the basic principles of VAT. This will need considered thought, legislation and guidance.

We recommend that this issue is explored in greater detail at the next stage of the consultation.

6.6 Determining the right amount of VAT

Determining how much VAT / advance payment to deposit with HMRC could present quite a challenge. Some of the examples in the consultation around different VAT liabilities demonstrate the complexity of working out how much VAT to extract.

Matters such as responsibility for determining the VAT liability of the goods sold, dealing with errors, adjustments, refunds, and who will be accountable for penalties, all need to be considered. The relevant information to make these decisions will need to be available to the responsible parties.

The interaction with import VAT and custom duties (and the payment thereof) needs to be considered further. Particularly as the post-'Brexit' landscape may mean that all overseas goods will attract import VAT.

6.7 How to apply the split

It will be necessary to apply a number of principles to identify which transactions fall within the split payment regime. We suggest a model similar to that for determining the place of supply for telecommunications, broadcasting and electronic services, which established a number of principles/ rebuttable presumptions etc.

6.8 Fixed or variable split

The call for evidence highlights a number of different models which split out different amounts for goods or services, or different proportions of the tax depending upon the nature of the taxpayer.

Whilst it might be possible, over time, to develop a system which more closely reflects the 'net' VAT liability of a transaction (eg after allowing for input tax deduction), we would suggest that initially only a fixed proportion (say, 30%¹) of the output VAT is split out and paid over to HMRC. We suggest this predominantly for simplicity, but also supported by the additional comments set out below.

6.9 Cash flow

The UK VAT system, perhaps quite generously, allows businesses the cash-flow benefits of receiving a VAT-inclusive price from customers, but not having to pay the VAT element to HMRC until (in the most extreme instances) over four months later. Whilst the same can be said for input tax deduction (and hence the negative cash-flow consequences), payment traders will generally benefit from the cash-flow effects of the VAT system.

Split payment will reduce, eliminate or even reverse these cash flow effects, and careful consideration should be given to mitigating the impact on businesses, both in relation to the transition into split payment (when both 'normal' and split payment VAT would be due) and on an ongoing basis.

6.10 Credit for input tax

When setting the rate of the split payment, consideration should be given to the input tax credit available in relation to the acquisition of the goods being sold, and overhead costs. Consequently, we do not consider it appropriate for the split payment to represent 100% of the VAT due on the sale.

6.11 Query resolution

Despite all parties' best efforts, there will inevitably be mismatches between data eg what payment handlers report to HMRC and what sellers believe has been deducted.

¹ This percentage is for illustration only and is not our recommendation for the amount to be split.

The process for resolving these differences should be set out in legislation, and be clear and understood by all parties and a pragmatic resolution process introduced.

Member's confidence in HMRC's capacity to quickly resolve differences/ errors and adjustments is not high and reassurance would be sought on how this would be resourced in order to be effective.

6.12 Customer refunds

Sales subject to a split payment will result in the supplier receiving (say) £114 out of a VAT-inclusive price of £120 (if 30% of the VAT is the split payment amount). If the customer returns the item the supplier is obliged to refund the whole £120, meaning that the supplier is out of pocket by £6. Multiplied across a number of refund transactions could give the supplier significant cash flow problems.

Consideration should be given to introducing a mechanism to ensure that the supplier is not adversely affected because of this.

6.13 Exemptions/ exceptions

Careful consideration should be given to properly targeted exemptions from split payment, to mitigate the impact on businesses, whilst recognising the complexity that exemptions and exceptions bring.

For example, in our view it would seem appropriate to exclude services, B2B supplies, and non-standard rated supplies. If possible, split payment should only apply to overseas businesses, to reflect the risk that they present.

Similarly, smaller or start-up businesses might be excluded, although it would be necessary to clearly define the parameters for these exemptions to avoid

6.14 Special schemes

Interaction with special schemes such as the Retail schemes and the Flat rate scheme (possibly distance selling) need to be considered further. The administrative impact on taxpayers using these schemes may be greater.

Business using a retail scheme will use a variety of methods to calculate their VAT. Reconciling this with the split payment may introduce further complexity (when the aim of the retail scheme is to facilitate simplicity), misunderstanding and non-compliance.

6.15 Vires

Lastly, but certainly not least, is the vires for the introduction of such a measure. Whilst this almost goes without saying, any split payment model must, whilst we are a member of the EU, not contravene the VAT Directive.

7 Question 11: Do you see a role for the card schemes in ensuring payment sector participants adhere to any future UK split payment legislation?

7.1 There will need to be clarity on who deals with the reporting obligations, risks and responsibilities. Also, who is accountable for errors and penalties and who seeks

redress from HMRC? Who has to pay the costs of introducing these measures? Will there be financial support from Government?

- 7.2 This question hints at introducing similar measures to the Fulfilment House Due Diligence Scheme where parties in the supply chain are required to monitor and enforce tax obligations on HMRC's behalf.
- 7.3 We are wary of this approach because it burdens business further with enforcement obligations that we believe should be properly carried out by HMRC along with existing powers. This provides for a more cohesive, targeted approach to enforcement of tax obligations.

8 Acknowledgement of submission

- 8.1 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.

9 The Chartered Institute of Taxation

- 9.1 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
30 June 2017