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BSA Response: Office of Tax Simplification (OTS) Review of Value Added Tax (VAT)

The BSA welcomed the opportunity to meet with representatives from the OTS recently and is pleased to offer the following recommendations for its review into VAT:

- **Exempt VAT rate** - This is a key opportunity to remove the exempt rate, or restrict it to financial services only. This would immediately simplify the VAT regime, and where there are concerns about the financial impact on the consumer, the zero-rate could be used instead, which is much more straightforward for businesses to operate. This immediately removes many of the issues and complexities of VAT - partial exemption, the capital goods scheme and land and property/option to tax would all be simplified. Many businesses incur considerable costs to ensure that they are compliant with these regimes, requiring third party tax expertise.
- **Partial Exemption** - We would suggest that if an exempt rate is still used (as opposed to restricting it to financial services only), then partial exemption calculations should be greatly simplified. For large businesses over a certain turnover where the vast majority of business is taxable (i.e. 98% or more) then no partial exemption adjustments should be required at all. Where taxable sales are below say 98%, then a very simple calculation should be applied. As one BSA member states: "I have spent years negotiating special partial exemption methods when the vast majority of our sales and attributable costs are taxable, so very little revenue is to be gained by HMRC. Negotiations become very detailed and confusing, with the risk that both parties become 'lost' in the rules and minutiae. The agreed method is usually very onerous and it can take days to collate and check a partial exemption calculation in practice. Most businesses need to pay for third party advice at considerable cost to ensure they are compliant with partial exemption."
- **Penalties and appeals** - A simpler penalty regime should be introduced. The whole concept of 'prompted' and 'unprompted' disclosure is very difficult to apply in practice, it is too subjective, as is the concept of 'reasonable care'. The voluntary disclosure regime is fair and easy to apply. If a business voluntarily reports an error, then no penalty should apply, with interest charged on any loss of revenue. If an error is discovered by HMRC, then a penalty should be applied. The appeals process does not work well and is costly and time consuming. One BSA member had two VAT issues that were subjected to a statutory review, with the outcomes both in HMRC's favour, so they therefore proceeded to tribunal. Both issues were halted before going through to the final tribunal stage, with HMRC withdrawing in both cases. The business incurred considerable costs with proceeding to tribunal which they were unable to recover. HMRC should also engage a legal expert to undertake statutory reviews, and not just an impartial VAT Officer, who is often unfamiliar with the details of the VAT law.

During the meeting with OTS representatives, BSA members provided other examples that echo the comments in the Interim Report that businesses are strongly penalised even where they have given voluntary disclosures in which they thought they had taken all reasonable care but made an error. Even when penalties are suspended to give companies more time to address them, in some cases businesses may find it easier to simply pay the penalty rather than have it hanging over them to deal with over a protracted period of time. Reform should focus on ensuring that the penalty system so explicitly targets wrongdoing to incentivise good behaviour, and does not impose fines on companies that have made honest accounting mistakes.



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Sector-specific issues - BSA members have expressed concern about their experience of high levels of irrecoverable VAT, which is often ‘unseen’ but ends up being a large, direct cost. VAT liabilities should therefore be clearly outlined during the tendering process for public services and contracts. There is also a need to get consistency on this between HMRC and the relevant tendering government department, as members have had experience of dealing with contracts where each body had its own interpretations of liabilities. Construction and infrastructure, for instance, is particularly affected by the current complexity of VAT law. Large construction companies with multi-site locations and numerous sub-contractors often have hidden VAT compliance issues that lead to them missing out on tax recoveries at each VAT quarter end.

The BSA has also previously discussed with HM Treasury the difficulty of VAT recovery faced by VAT exempt organisations when they outsource services. Depending on the agreement reached with the EU, the Government may gain discretion to decide what goods and services are eligible for VAT reduced rates and exemptions. We have urged the Government to address the VAT rule which restricts a level playing field from operating in certain areas of public sector delivery, including social housing and further education colleges. As social housing organisations are exempt from VAT, for example, independent providers need to be at least 20 per cent cheaper to begin to be competitive.

One other example given by a BSA member is that if they provide a laundry service to a hospital they add VAT but if it is provided in house there is no VAT. We would therefore encourage the OTS to consider how the VAT rules operate in relation to outsourcing specifically and to explore the merits of reforming legislation to aid the efficiency which a private company can bring - whereby a Zero rated supply is applied to where services would otherwise be provided in house.

- **HMRC Guidance and Communications** - Given VAT is a self-assessed tax, there is a need for HMRC guidance in this area to be much clearer to give businesses confidence that they are calculating their tax correctly. Guidance can often be inconsistent, out of date or incomplete, hard to find or access via tools such as gov.uk, and there is sometimes a disconnect between outfield HMRC officers’ understanding of VAT policies and those held by the policy team at HMRC. Business services companies operate across a range of sectors, involving complex supply chains, and are therefore acutely exposed when there is ambiguity. Guidance could be enhanced through better case studies or, as suggested in the Interim Report, by introducing a search function or site map for these sources. A notification feature for all new and amended guidance would also be welcome.

However reducing ‘complexity’ is secondary to improving businesses’ interaction with HMRC on VAT matters, where it is felt there could be significant improvement. BSA members have had experiences where their cases have been passed between different parts of HMRC without clear explanation, for instance, which can prove costly and time-consuming. The Customer Relationship Manager (CRM) model is viewed positively and provides a strong foundation for communication, although as with any civil service function it is subject to changes in personnel. One idea may be to enable businesses to speak with solicitors directly to give them more certainty. The overriding aim should be to develop an open and transparent dialogue between government and business, where neither side feels it is having to overwork to obtain certainty.