



Chartered
Institute of
Taxation

Excellence in Taxation

**HMRC consultation: Alternative method of VAT collection – split payment
Response by the Chartered Institute of Taxation**

1 Introduction

1.1 The Chartered Institute of Tax (CIOT) welcomes the opportunity to respond to HMRC's consultation document entitled '[Alternative method of VAT collection – split payment](#)' published on 13 March 2018.

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 stated 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 In our response, we have restricted our comments to the areas in which we have relevant expertise; we have answered questions 5, 6, 7, 9, 11.

1.5 However, we consider we can provide valuable VAT technical and practical input throughout the development process and we have already expressed our interest in taking part in the face-to-face working groups (para 1.12).

2 Executive summary

- 2.1 We support measures to combat tax fraud and action to address non-compliance, be that because of a lack of understanding, complexity of legislation or deliberate non-compliance. However, the extent of current levels of non-compliance are unclear, especially when taking into account the impact of recent Budget measures to deal with VAT loss from online marketplaces. We would welcome further analysis to establish a more accurate picture.
- 2.2 Whilst split payment might accelerate and secure the payment of an amount representing VAT 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 sufficiently outweigh the costs.
- 2.3 To keep in line with the policy objective of combatting fraud and ensure a fair and proportionate response, we think that split payment should only be introduced for overseas sellers at this stage. This will enable the model to be targeted at the population with the (assumed) greatest risk of non-compliance and ensure that largely compliant UK businesses (who represent the majority of sales to UK customers) will be unaffected.
- 2.4 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.
- 2.5 The cash flow impact on business of options 1 and 2 needs much greater analysis. If output tax is to be paid on a real time basis but any input tax recovered in arrears through the quarterly VAT return, then businesses will become effectively repayment traders on a cash flow basis. Free cash flow is a key business metric and split invoicing could have an impact on business valuation and credit worthiness. Some businesses may struggle to fund the new requirements.
- 2.6 Greater clarity is still needed on the scope of this proposal. We have received very few comments from our members on this consultation and, anecdotally, it seems there is a still a vagueness around precisely who and what type of transactions these new rules are aimed at. This is, we feel, detrimental to the effectiveness of the consultation process.
- 2.7 We do not support Option 1 as it does not meet the design principles of a fair and proportionate response.
- 2.8 We do not support Option 2 as it legislates to put UK companies at a competitive disadvantage.
- 2.9 We have a number of questions about HMRC's preferred Option 3.
- 2.10 Concerns remain about how errors, refunds and disputes are dealt with. There are cashflow issues as well as compliance and commercial risks from having to rely on 3rd party information in order to fulfil VAT obligations.

- 2.11 Split payments done in this way are a departure from the basic principles of HMRC seeking to collect the right amount of tax from the right person at the right time.

Consultation questions

3 Q5. Do you agree with the government's assessment of these options for determining how much should be split from the gross payment?

- 3.1 HMRC has developed 3 possible options for collecting "as close to the full amount of VAT as possible"¹ none of which "rely on any party in the payment chain knowing the actual VAT liability of any single transaction"².

3.2 Option 1 – standard rate split

This assumes that every transaction is liable to standard rate VAT and does not take into account any input tax deduction. This would involve withholding 20% of each sale, regardless of its actual liability.

We consider this to be draconian and disproportionate response. Where a business sells zero rated or reduced rated goods, this option would penalise them unfairly. The comparison with UK sellers of zero rated and reduced rated goods is a false one as they are not currently paying over 20% output VAT and the cash flow impact is harsher.

Also, this option does not take account any input tax deduction. Overseas businesses would therefore likely become repayment traders, bringing with it associated fraud risks and cashflow issues. In Italy, 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.

HMRC's assertion that the advantage of this option being that it could encourage overseas sellers to register may also be doubtful. Could it encourage overseas businesses not to bother registering as the VAT has already been paid and any input tax deduction would be written off along with the expense of administering VAT returns. Does HMRC consider this to be an acceptable outcome?

We do not endorse this option on the basis that it does not meet the design principles of a fair and proportionate response. This option is a blunt instrument which does not take into account any input tax credit.

3.3 Option 2 – Flat rate scheme

HMRC suggests mandating overseas sellers to use the flat rate scheme using one of a small number of new flat rates for this purpose. This could include overseas businesses over the current maximum threshold for the existing flat rate scheme.

This approach may be difficult to justify if overseas businesses are allowed to participate in the flat rate scheme over the existing turnover threshold of £150,000 a year, excluding VAT (or the in-scheme eligibility cap of £230,000) and UK

¹ Para 3.5

² Para 3.9

businesses are not. This is not a level playing field and may lead to calls for the entire flat rate scheme to be opened up to all businesses in the same way, potentially producing an unintended exchequer impact.

Eligibility for the flat rate scheme relies on overseas businesses being VAT registered which may not be compatible with the current enforcement issues with existing VAT registration requirements for overseas businesses. Overseas businesses are already required to be VAT registered.

We consider it unacceptable that new legislation would mean overseas businesses paying less tax than their UK counterparts for the same supplies and would expect this competitive disadvantage to be very unpopular. We question if this discrimination is, indeed, lawful.

3.4 Option 3 – net effective rate – HMRC’s preferred option

Working outside of the flat rate scheme, each individual overseas business would calculate its own specific net-effective rate, based on the previous year’s outputs and inputs and use this rate to make advance instalments with an annual reconciliation. This rate would be applied to all sales by that business, carried out by the party effecting the split payment. If this information is not forthcoming, then option 1 would be invoked.

HMRC see this as a fair and proportionate mechanism with the benefit that overseas businesses are given the incentive to register and “ensure it does not pay more tax than it is obliged to”, else option 1 kicks in.

We have some questions in relation to this option:

- Does HMRC envisage the business having to agree this rate with HMRC in advance or would it be self-assessed?
- How would this work in the case of new registrations or those with insufficient history? Having to revert to Option 1 might have the greatest cash flow impact in the business’ earliest days when it needs the cash flow the most?
- The reconciliation process between the real-time split payment and the VAT return reporting (plus and minus adjustments, errors and refunds) introduces new administrative burden.
- Would an overseas business have the option of VAT reporting in the traditional way? If it had a good compliance history?
- How would this option interact with Making Tax Digital reporting obligations?
- Is it legal / moral for HMRC to legislate to collect more tax than it knows is due?

We can see how this option would result in a more accurate result than options 1 and 2. However, this option requires a lot of some overseas businesses who may have little understanding of or interest in the UK’s VAT system. This would also give HMRC an assurance and compliance task that will need to be adequately resourced and managed.

4 Q6. Are there any other options you would suggest to further simplify the process of calculating the amount to be split?

- 4.1 One option that may be worth further consideration is the use of special VAT-only bank accounts which the overseas business have to use in which to collect the VAT and can only use to settle VAT liabilities. HMRC could have the power to monitor these accounts. Italy and Poland have / are proposing the use of this method.
- 5 Q7 Do you think the scope of split payment should be limited to overseas sellers, or should HMRC expand the scope to include online UK businesses?**
- 5.1 HMRC are likely to be aware of the report written by Deloitte for the European Commission: [Analysis of the impact of the split payment mechanism as an alternative VAT collection method, Final Report](#), dated December 2017. In this a variety of options are analysed with the conclusion:
- “The findings of the analysis found no strong evidence that the benefits of split payment would outweigh its costs. The main identified effects were that a wider scope of split payment would potentially provide a larger decrease of the VAT gap, but would also significantly increase the related administrative costs. However, the analysis carried out is highly dependent on the specific design of the policy options as well as on the assumptions that had to be made in order to carry out the quantitative analysis, (especially on the volume of transactions). Therefore, a different design of the mechanism for split payment (e.g. different scope or technological choices) may come to considerably different results.”*
- 5.2 Indeed, the Deloitte report found that although split payment has “high potential to reduce the VAT gap, **broad application of split payment is likely to be an unattractive policy tool**, given the significant rise in costs for business and authorities. However, it has characteristics that are very effective in reducing certain types of fraud and therefore **may be suited as a targeted measure with limited scope**”.
- 5.3 Looking at other countries there are a range of options that have or are about to be introduced – Italy, Poland, Romania, Ghana, Kenya. A brief look at each of these countries shows that there is a wide variety of options – all with pros and cons. We urge HMRC to engage with tax authorities in other countries to benefit from shared knowledge and experience.
- 5.4 We would like to better understand the ratio of UK:overseas businesses who would be affected. If (say) it's 90:10, then it makes sense to apply split payments to overseas sellers first as they are a small part of the system, yet represent the biggest tax loss (if this is indeed the case?).
- 5.5 It would also seem prudent to introduce this for overseas sellers first (where the greatest risk is) and ensure a robust system before widening it out.
- 6 Q9 Do you agree with the government’s thinking regarding how errors, adjustments, and refunds could be handled? Do you think there are better ways of resolving these issues?**
- 6.1 Errors and refunds remain a concern. The proposals require one party to make the split payments and a different party (the business) to be responsible for errors, adjustments and refunds. The reconciliation and timing difference of real-time split

payments and delayed VAT reconciliation, correction of errors & refunds by two separate entities is likely to be complex. This process would need to be carefully considered to overcome undue administrative burden, costs and disputes / penalties. There would need to be robust contractual safeguards.

- 6.2 Members 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.
- 6.3 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). In Italy, a special refund mechanism has been established to prevent the seller from being at a cash flow disadvantage. HMRC should explore this further as otherwise a large VAT refund may create disproportionate funding challenges to small businesses.
- 6.4 We agree with paragraphs 4.12 and 4.13:
- “Currently, each VAT-registered business (and those that are required to be registered) is responsible for ensuring it pays the correct amount of tax, by submitting regular returns to HMRC declaring the amount they owe, and paying that amount...HMRC does not intend for the introduction of split payment to replace or remove this requirement. The only difference will be that the payments to HMRC will in effect already have been made when the VAT return is submitted.”
- 6.5 However, we feel there is much to explore around the technical analysis and impact of what “payments to HMRC will *in effect* already have been made” means.
- 6.6 We have previously commented³ that 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 be a significant departure from the current VAT rules and create significant complexity which, in our view, would not be necessary to tackle the non-compliance targeted by this measure.
- 6.7 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 (akin 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.

7 Q11 Is there anything else the government can do to enable the implementation of split payment.

7.1 Scope of the relevant businesses and supplies – greater clarity needed

We feel it is still quite vague as to who the split payment rules might apply to which is perhaps explained by para 4.4: “The context for exploring the viability of split payment in the UK is to help tackle non-compliance by overseas businesses selling goods online to UK consumers. Nevertheless, the mechanism HMRC are consulting on in

³ <https://www.tax.org.uk/policy-technical/submissions/alternative-method-vat-collection-ciota-comments>

this document has been designed in such a way that it could be adapted to have broader application in the future if necessary.”

- 7.2 We have received very few comments from our members on this consultation and, anecdotally, it seems there is still a vagueness around precisely who and what type of transactions these new rules are aimed at. This is, we feel, detrimental to the consultation process.
- 7.3 Is it HMRC’s intention for split payments to apply to overseas business selling goods to UK consumers – so called B2C transactions? Will B2B supplies be involved?
- 7.4 There is also an assumption that the consultation is concentrating on overseas businesses that have already brought the goods to the UK before making the sale – ie the consultation does not deal with import VAT (and potentially customs and excise duty) directly as part of these transactions. 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.

7.5 **VAT reliefs and fiscal neutrality**

It may be that the majority of goods bought from overseas businesses will be standard rated – has HMRC any data on this?

- 7.6 However, there will be some that are subject to the zero-rate eg children’s clothing, food and printed material and others that may be subject to the reduced rate of 5%. In certain cases eg goods qualifying for the zero-rate when supplied to someone with a disability, the relief may be conditional.
- 7.7 The problem with any form of fixed withholding is that it would mean that the very products that are subject to a relief for social policy reasons are then subject to tax from certain sellers. This would go against the current EU principle of fiscal neutrality which requires similar items (whether they are goods or services), which are in competition with each other, to be treated the same for VAT purposes. It is not yet clear how the EU principles for VAT will be dealt with following Brexit

8 **Other comments / suggestions**

- 8.1 On a practical note, numbering the consultation questions throughout the consultation document (rather than just at the end) would have been useful when preparing a response.

9 **Acknowledgement of submission**

- 9.1 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.

10 The Chartered Institute of Taxation

10.1 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
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ⁱ Para 3.5