



Chartered
Institute of
Taxation

Excellence in Taxation

VAT registration threshold: call for evidence Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 The Chartered Institute of Tax (CIOT) welcomes the opportunity to respond to HM Treasury's (HMT) [call for evidence](#) on the VAT registration threshold.
- 1.2 Following the 2016 Autumn statement, in December 2016 the Chancellor confirmed the government had requested that the Office of Tax Simplification (OTS) examine aspects of the VAT system including *'the issues and impacts which would be involved if the VAT registration threshold were either higher or lower than at present'*. In its 2017 [VAT: routes to simplification report](#), the OTS recommended that the *'government should examine the current approach to the level and design of the VAT registration threshold, with a view to setting out a future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism'*. HMT's call for evidence is a continuation of the review of the VAT threshold in the UK.
- 1.3 The main objectives of the call for evidence are to:
 - Consider how the threshold might currently affect business growth
 - Look in more detail at the burdens created by the VAT regime at the point of registration, and why businesses might manage their turnover to avoid registering
 - Consider possible policy solutions, based on international and domestic examples
- 1.4 To meet the above objectives the call for evidence poses 22 questions across the following 6 areas:
 - The current VAT threshold and the impact on business growth [Q1-5]
 - Why do businesses restrict their turnover to remain under the threshold? [Q6-11]

- Financial and competition burden of VAT registration [Q12-13]
- EU SME proposal [Q14-15]
- Administrative smoothing [Q16-18]
- Financial smoothing [Q19-22]

1.5 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.

1.6 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.

2 The CIOT and ATT VAT threshold member survey

3.1 To inform the CIOT's response to the call for evidence we have undertaken a joint survey of CIOT and ATT members (referred to as 'our survey') to gather evidence in each of the above-mentioned areas, particularly (although not exclusively) from an agent's perspective. As HMT had already prepared an [online survey](#) for small businesses (that we also highlighted to our members in our survey), we considered that agents would also have a wide range of experiences with businesses with turnovers nearing the VAT registration threshold, so could also provide valuable feedback.

3.2 Our questions broadly followed those set out in the call for evidence, with additional questions to assist with understanding or to provide a fuller response. We received 429 responses. A summary of the responses is included at Appendix A to this submission and the feedback from our survey is referred to throughout this response. The CIOT attended a multi-stakeholder meeting with representatives from HMT and HMRC to discuss the issues and some feedback from that meeting is also included in our response. We also received a limited amount of written feedback.

3.3 For ease of readability, percentages have been rounded up or down to the nearest whole number.

3.4 It was not a requirement that respondents answer all questions on our survey. For some questions, respondents could select more than one response.

3.5 Of the 429 respondents to our survey, 355 are agents (83%); 25 are unregistered businesses (6%); 26 are businesses registered for VAT (6%); and the remaining 23 respondents (5%) are mainly tax advisers who had not described themselves as agents, tax professionals that were retired and charity trustees. 70% of the

respondees are members of the CIOT. Full details of the respondees' background, specialist area of expertise, client sectors and geographical region can be found in questions 1 to 5 of Appendix A.

3 Executive summary

- 3.1 In chart A.3 on page 22 of the call for evidence, it shows that approximately 150,000 businesses traded in the turnover bracket of £70,000 to £80,000 (£1,000 to £10,000 under the VAT registration threshold) in 2014/15. This is a comparatively small number of businesses in the UK population compared to the [5.7 million](#) private sector businesses recorded at the start of 2017. Whilst (as indicated by our survey) a proportion of these businesses will be managing their turnovers to remain under the VAT threshold, many will be trading at this level for reasons other than VAT, such as maximum work capacity, lifestyle and complexities around employing staff. Even with the introduction of simplification measures for VAT, these businesses will remain unregistered. This leaves a smaller number of businesses for whom the VAT registration threshold provides a disincentive for growth.
- 3.2 The UK has a high VAT registration threshold as a simplification measure for small businesses to avoid the financial and administrative burdens of accounting for VAT. We would like this simplification to remain available to small businesses, whether that be by retaining the high threshold or by the introduction of extensive simplification measures to significantly ease the burden of becoming VAT registered
- 3.3 Small businesses can choose to voluntarily register for VAT as long as the relevant criteria is met. In our experience, small businesses who register for VAT do so because they are not financially disadvantaged, for example, its customers are able to recover any VAT charged thereby allowing the voluntarily registered business to recover input VAT, and the costs of VAT administration are less than the input VAT claimed. In order to encourage unregistered businesses to grow and register for VAT, the financial burden must be addressed, as the VAT administration for a simple business does not appear to prevent other small businesses voluntarily registering for VAT.
- 3.4 Throughout our survey results attached at Appendix A, respondees set out that the primary reason that businesses manage turnover to remain under the VAT registration threshold is the financial burden experienced by those businesses that bear the cost of charging output VAT when they have limited costs bearing input VAT, and the barrier to competition with similar unregistered businesses. Having a financial smoothing mechanism that addresses the 'cliff edge', whilst also remaining administratively simple, is key to addressing this issue.
- 3.5 Respondees would like to see greater simplicity in the administration of VAT which for many small businesses can be too complex and too easy to get wrong, resulting in mistakes and subsequent penalties.

Around 60% of respondees gave their number one reason for small businesses managing the VAT registration threshold as being due to price pressure from non VAT registered competitors. This suggests that any reduction in the VAT registration threshold would need to be to a very low level in order to capture the majority of businesses. (unless there is an effective smoothing mechanism) For example a reduction to say £60,000 would still allow many sole proprietor businesses to remain

unregistered and thus unfairly compete with slightly larger VAT registered businesses.

- 3.6 74% of respondents thought that Making Tax Digital was a further reason for small businesses to want to remain below the VAT threshold, and most respondents thought it would increase the administrative burdens on business.
- 3.7 For many small unregistered businesses, the VAT registration threshold is just one of several factors why the turnover may be managed, eg the additional tax/legal complexities and costs around taking on an employee can be a major factor for refraining from growth for an owner managed business.
- 3.8 The UK has taken the decision to leave the EU with effect from 29 March 2019. A transitional period where the UK will adhere to EU legislation whilst being outside of the EU is anticipated to be in effect from 29 March 2019 until 31 December 2020. It is not yet certain whether the transitional period or other negotiated agreement impacting EU and UK VAT legislation could be subject to any extension beyond 31 December 2010.

The [European Commission's proposal for a council directive](#) to amend the Principal Directive sets out changes to make VAT simpler for smaller businesses and member states from 1 July 2022. Although the current position is that the UK will not be obliged to implement EU VAT legislation, it is not yet clear what the terms of the UK and EU trade agreement are. Where the UK is not obliged to enact the proposals, we would recommend that the UK government considers what simplifications are made available to small enterprises in the EU and if they do reduce administrative and/or financial VAT burdens, similar simplifications should be made available to small similar sized businesses in the UK so that they may remain competitive globally.

- 3.9 Once the call of evidence responses have been considered, we would urge further consultation with business prior to the introduction of any new measures.

The call for evidence questions

4 The current VAT threshold and the impact on business growth [Q1-5]

- 4.1 *Q1: What experience or knowledge do you have of small businesses managing their turnover to remain below the VAT threshold?*
- 4.2 Over 66% of our respondees to this question thought it was very or fairly common for businesses to manage their turnover to stay below the threshold. Over 47% of respondees thought that it was more common to manage turnover in the service sector, which would be expected as this sector typically has fewer costs that are subject to input VAT, hence exacerbating the financial impact on the business caused by charging output VAT to customers (see Appendix responses Q6-7).
- 4.3 We asked respondents to share the reasons why small businesses would want to remain under the VAT threshold. The single biggest factor was financial reasons coming from both the loss of income arising from paying output VAT to HMRC and concerns over being able to compete with non-VAT registered businesses, with 60% of respondees selecting this reason. Although VAT administration and its associated costs were a factor for wanting to remain unregistered, only 28% of respondees

- cited this as the primary reason for avoiding registration (see Appendix responses Q9-10).
- 4.4 In broader feedback received outside the survey, it was noted that for many small unregistered businesses, the VAT registration threshold is just one of several factors why the turnover may be managed, eg the additional tax/legal complexities and costs around taking on an employee can be a major factor for refraining from growth for an owner managed business.
- 4.5 *Q2: Are there, in your experience, particular types, regions or sectors of businesses where this is particularly prevalent?*
- 4.6 The responses in our survey broadly reflected the business sectors set out on page 6 of the call for evidence, and we would also add the craft sector. The majority of these businesses would be selling to consumers so the financial impact of the cliff edge is a barrier as the turnover would need to rapidly increase to over £100,000 just to provide the same level of income enjoyed just below the threshold. We also had examples of businesses selling to other businesses that were either unregistered or would be unable to recover the VAT charged by the supplier (see Appendix response Q8).
- 4.7 *Q3: What is your experience of competition challenges faced by registered traders just over the threshold, compared to unregistered businesses? If challenges exist, what effect do they have on the ability of registered businesses to grow?*
- 4.8 There were 172 responses in the freeform section of question 13 in the survey, of which 150 gave additional opinions, which we recommend are read in full. The main reasons, which are reflected throughout the survey responses, are:
- Financial: the cliff edge for businesses impacted by charging output VAT, competition & pricing;
 - Administration: VAT registration, VAT returns, invoicing requirements, MTD, the costs of VAT compliance;
 - Complexity: VAT liabilities, difficulties accessing HMRC for advice, penalties.
- 4.9 *Q4: As the OTS suggest, does the current threshold contribute to the size of the hidden economy, and how?*
- 4.10 Feedback was provided by freeform comments in the survey by 129 respondees (139 logged responses less 10 who left no comment) in Appendix A question 15. There were several trends forming similar views.
- 4.11 Of the respondees who did not think the VAT threshold contributes to the hidden economy, reasons included:
- The respondee had not encountered suppression of income due to the VAT threshold in their client base;
 - People who are prepared to commit tax evasion will do so whether they are registered for VAT or not, so the threshold does not impact this;
 - The incentive to evade direct tax was significant;
 - The current VAT threshold is high enough for a sole trader or single employee company to make a comfortable living, reducing the need to evade tax.
- 4.12 Of the respondees who think the VAT threshold contributes to the hidden economy, reasons included:

- For businesses incurring low amounts of input VAT, the impact of VAT registration would create an immediate and significant cost, up to £14,166 for a £85,000 turnover, and this encourages those types of business to suppress income and stay under the VAT threshold;
- Several respondents thought the risk of HMRC enforcement was low, both for unregistered and registered businesses, which encourages the cash culture and suppression of takings;
- Respondees have experienced businesses offering lower prices for cash payment;
- Respondees have experienced clients seeking to artificially split the business to remain under the threshold;
- Difficulties with competition between registered and non-registered businesses.

4.13 *Q5: In your experience, does the current threshold have any effect on growth and/or productivity? If so, how significant is that effect?*

4.14 There was a mixed response to this question, with respondents' views ranging from the threshold having no impact on growth and productivity; some had a small percentage of unregistered clients that restrict growth so considered the impact to be fairly modest; and some respondents considered the threshold to have a significant or very significant impact on growth and/or productivity (see Appendix response Q16).

4.15 Where respondents felt that the VAT threshold did inhibit growth, views included:

- The most common response would be for those businesses that bear a disproportionately large cost of charging output VAT where there are limited input costs bearing input VAT. The requirement to significantly increase turnover to effectively receive the same net income is a disincentive to growth, ie it costs a business more money to have a turnover just over the threshold than under it, in spite of increased sales.
- For some businesses, the turnover threshold can interact with the point of requiring staff, which brings additional burdens to the business such as employment law; auto-enrolment, payroll etc. This has a greater impact for businesses described in the point above;
- Further obligations that come with VAT registration created a disincentive to register, such as Making Tax Digital (see Appendix response Q11)
- The flat rate scheme had allowed eligible businesses to have a simplified approach to VAT accounting, however the limited cost rules brought in by HMRC to limit the risk of exploitation of the scheme, has had a wider impact to small businesses with no intent to manipulate its VAT position and this has contributed to wanting to remain unregistered.

5 Why do businesses restrict their turnover to remain under the threshold? [Q6-11]

5.1 *Q6: Does the administration of VAT discourage businesses from registering?*

5.2 Over 70% of respondents thought that VAT administration contributed to wanting to remain under the threshold (see Appendix responses Q17 and Q20). This was selected as the second biggest factor after financial reasons for wanting to remain unregistered in Appendix response Q9.

- 5.3 Broader feedback noted that for many businesses with ‘simple VAT’, the administration was not particularly complicated although could be time consuming, and there were examples of busy owners deciding to forego claiming input VAT on low value high volume expenses, as the time involved for administration was not cost effective.
- 5.4 *Q7: If so, what are the main aspects of VAT administration that are putting businesses off registering?*
- 5.5 The most popular response was that the additional record keeping was the primary reason, followed by gathering information to prepare the return and finally submitting the return. Additional comments in the freeform responses and broader feedback outside of the survey highlighted that VAT is very complex for some businesses, including determining liabilities, determining the place of supply, partial exemption and niche areas such as the tour operators margin scheme. Respondees highlighted the complexities of administration for EU sales, mentioning MOSS (even though this is a simplification in itself), EC Sales Lists, Intrastat etc. Further, the risk of incurring financial penalties for getting things wrong are a concern and time limits for submission of returns are tight and also subject to a penalty regime (see Appendix responses Q18-19).
- 5.6 *Q8: For businesses that have gone from being unregistered to registered, is there a difference between the perception and reality of VAT administration? Was the administration easier or harder than anticipated?*
- *If harder, why was that? (For example, a struggle to understand what your obligations were, or you made mistakes).*
 - *If easier, why was that? (For example, received the right support from HMRC, at the right time).*
- 5.7 45% of respondents thought that the reality of VAT administration was as expected, 31% thought it was harder and 10% thought it was easier than expected. No additional comments were made for the reasons why.
- 5.8 *Q9: How well do current simplification schemes address these issues?*
- 5.9 Over 53% of respondents agreed that simplification schemes assist businesses, with 23% disagreeing. Although the flat rate scheme was identified as the most useful scheme, many freeform comments clarified that this was prior to the limited cost rules introduced in 2017, which has lessened the simplicity for business. The cash accounting scheme was also identified as a useful simplification, although there were comments that this was a cashflow rather than administrative simplification (see Appendix responses Q22-23).
- 5.10 *Q10: Ipsos MORI research suggests that dealing with VAT returns are likely to be the most time consuming aspect of VAT administration. What is it about VAT returns that are particularly time consuming for small businesses?*
- 5.11 Our response for 4.4 above and Appendix responses 18 and 19 refer.
- 5.12 *Q11: Will new technology, such as the introduction of MTD, facilitate changes or simplifications in VAT administration? If so, what are they, and what changes would you like to see in response?*
- 5.13 Only 18% of respondents agreed that MTD would simplify VAT administration, with 59% disagreeing (of which 32% strongly disagreeing). The more optimistic picture

presented in the call to evidence at paragraph 3.12 stating that *‘MTD could pave the way for further reforms and simplifications of the VAT system and administrative burden reduction’* is generally not yet reflected in the opinions of our respondents (see Appendix responses 27 and 11).

6 Financial and competition burden of VAT registration [Q12-13]

- 6.1 *Q12: In your experience, what, if any, are the sectors that are particularly affected by the financial costs and competitive disadvantages of registration discussed in 3.15-3.20?*
- 6.2 The responses in question 28 of our survey are broadly similar to those in question 8 and those set out on page 6 in the call for evidence. Our response in paragraph 4.6 above refers.
- 6.3 *Q13: In your view, do these financial costs and competitive disadvantages lead to businesses managing their turnover below the threshold? How significant is this effect on SME growth?*
- 6.4 Over 90% of respondents agreed that this was the case in question 29 of our survey. The financial burden of VAT registration for certain sectors of businesses referred to in paragraph 3.6 is the primary reason for businesses for managing turnover to remain below the threshold, as mentioned in paragraph 4.15 above (see Appendix response 29 freeform comments).

7 EU SME proposal [Q14-15]

- 7.1 *Q14: What in your view would be the likely impacts of the EU's proposal on the administration of VAT for SMEs, and how in particular will it help incentivise SME growth?*
- 7.2 37% of the respondents considered that the EU's proposals would be helpful, with 26% considering the proposals to be unhelpful and 26% as neither helpful nor unhelpful (see Appendix question 30). The following comments should recognise the relatively limited support for the proposals overall.
- 7.3 The UK has taken the decision to leave the EU with effect from 29 March 2019. A transitional period where the UK will adhere to EU legislation whilst being outside of the EU is anticipated to be in effect from 29 March 2019 until 31 December 2020. It is not yet certain whether the transitional period or other negotiated agreement impacting EU and UK VAT legislation could be subject to any extension beyond 31 December 2020.
- 7.4 The European Commission's proposal for a council directive to amend the Principal Directive sets out changes to make VAT simpler for smaller businesses and member states will be required to apply the provisions from 1 July 2022. The three changes and our comments about the benefits or drawbacks are set out in paragraphs 7.5 to 7.7 below.
- 7.5 *Simplification 1: €85,000 maximum national exemption threshold (a domestic threshold of approximately £75,000 maximum)*

UK businesses already have a high VAT registration threshold compared to other member states so many small businesses are already benefitting from the simplification. Depending on what agreements are made in the political negotiations between the UK and the EU for the UK's departure and it becoming a future third country trading partner, if the UK must adhere to or mirror the VAT position in the EU as part of its trade deal, this simplification must also be enacted in the UK. If so, there would be a negative impact on unregistered UK businesses trading with a turnover of £75,000 to £84,999 (or future VAT threshold minus £1) primarily if affected financially by the cliff edge and also administratively with VAT reporting obligations (albeit simplified as set out in paragraph 6.7 below).

7.6 *Simplification 2: €100,000 of annual turnover in the EU eligibility condition for small businesses established in another EU Member State*

As the UK is leaving the EU, the current position is understood to be that a UK business would not be able to benefit from this simplification in 2022, unless it had an establishment in a member state. Having an establishment in the EU to take advantage of this simplification is likely to be prohibitively expensive for small UK businesses. We have received feedback that this measure also increases administration for small businesses with cross border sales as they will have to monitor multi-territory turnovers.

7.7 *Simplification 3: €2,000,000 of annual turnover in the EU threshold defining small business*

These simplifications include simplified registration, simplified record keeping and longer tax periods (optional), resulting in less frequent filing of VAT return. As one of the CIOT's objectives is to see greater simplicity in tax, we would urge the UK government to consider the administrative simplifications available to EU SME businesses to ensure that UK businesses are not disadvantaged by the UK leaving the EU. As already stated, as the terms of the trade agreement between the UK and the EU are not finalised it remains to be seen to what extent the UK must mirror the EU's VAT legislation after the transitional period ends.

7.8 *Q15: Are there constituent parts of the proposal which are particularly attractive or unattractive? If so, what are they and why?*

7.9 The proposal for a smoothing mechanism that allows a business to go over the VAT registration threshold by 50% was the most popular proposal with 58% of respondents selecting this option. There were many comments left in the freeform comments about the benefits of flexibility in turnover for businesses and that it prevents accidental registration where turnover has increased just above the threshold and avoiding the cliff edge approach (see Appendix question 31 and freeform comments), although we recognise that this flexibility is available to some extent already in the UK (Schedule 1, paragraph 1(3), VAT Act 1994). As set out in this response already, the financial burden for certain sectors of business is the primary reason for managing turnover to avoid VAT registration (see Appendix question 31 and freeform comments).

7.10 The next popular proposal was the administrative simplifications, with 46% of respondents selecting this option (respondents could select more than one option) (see Appendix question 31 and freeform comments).

7.11 There were a number of comments from respondents stating that they do not see the proposals as relevant for a lot of unregistered businesses either due to Brexit or the limited number of businesses of this size with cross border trading in the EU. Several

respondees thought that the proposals brought added complications for business (see Appendix question 31 freeform comments).

- 7.12 The European Commission has set out that administrative simplifications for VAT should be available for EU businesses with a turnover less than €2,000,000 from 1 July 2022. Please refer to comments made at paragraph 7.7.

8 Administrative smoothing [Q16-18]

- 8.1 *Q16: Do you think the mechanisms described in paragraph 4.8 would help businesses better manage the administration of VAT, upon registration? If so, would the positive effect be significant?*
- 8.2 The first administrative smoothing mechanism suggested is the extension of the first VAT return period to 6 months.
- 8.3 51% of respondents thought that it would not assist, mentioning that this was a cashflow mechanism rather than addressing the administrative issues. Other respondents had concerns about the ability for small businesses to pay six months' VAT, preferring the current three months (see Appendix questions 33 and 34 freeform comments). Some comments suggest that the proposal does not provide any smoothing and it ignores the main reason why businesses do not want to be registered, which is the financial impact where the VAT charged becomes an actual cost to the business where prices cannot absorb the 20% VAT rate.
- 8.4 Of the 35% of respondents that agreed that the proposal would assist businesses, comments included that the proposal gave businesses some time to adjust to the record keeping requirements as well as managing cashflow (see Appendix questions 33 and 34 freeform comments). 14% of respondents neither agreed nor disagreed with the proposal.
- 8.5 The second proposal was to apply the threshold test over two years rather than one.
- 8.6 49% of respondents agreed that this mechanism would assist businesses (see Appendix question 35) although in the freeform comments in question 36, many comments suggest that it will assist with better management of fluctuations in turnover whilst still remaining under the VAT registration threshold, which is not meeting the aim of better managing the administration of VAT upon registration.
- 8.7 *Q17: Would any of these solutions be sufficient to change the behaviour of businesses that take measures to remain under the threshold?*
- 8.8 For the first proposal that extends the first VAT return to 6 months, we received few free form comments around expectations on whether this could impact behaviour. 74% of respondents thought that it would not impact behaviour (see Appendix questions 33 and 34).
- 8.9 For the second proposal for the two year threshold test, 53% respondents thought that it would not change behaviour. However, amongst the 27% that thought that it would, several respondents commented that it could encourage businesses to test whether increasing turnover could work for the business, including taking on staff. If this proved successful, these businesses would go on to register for VAT and continue to grow (see Appendix question 36 freeform comments). However, we

would recommend that the impact of this measure was modelled more thoroughly. For example, the financial impact on a business of becoming VAT registered at an effective ‘cliff-edge’ of £170,000 could be twice as harsh as that for a business with a turnover of £85,000?

- 8.10 *Q18: Are you aware of any simplification schemes from around the world that work particularly well? If so what are they?*
- 8.11 The majority of respondents to the survey did not have an awareness of simplification schemes in other countries that work particularly well (see Appendix question 37 and freeform answers). Where suggestions were made, the information provided was limited as to the experience of that system.
- 8.12 In broader feedback, suggestions include:
- Very high threshold (Singapore/Jersey)
 - Low threshold (EU countries)

9 Financial smoothing [Q19-22]

- 9.1 *Q19: What is your experience of the type of mechanisms outlined in paragraphs 4.10-4.15? Would they be effective in incentivising business growth in the UK? If so, how and why?*
- 9.2 The mechanisms set out in the call for evidence were listed in question 39 of our survey and respondents could select those that they thought could be helpful for financial smoothing. It was possible to choose more than one answer.
- 9.3 The results in descending order are as follows:
- Introducing bands of lower VAT rates for small businesses just above the threshold - 54%
 - Reducing the flat rate scheme rate payable for the first few years after registration – 39%
 - Allowing small businesses to keep some of the VAT they collect when first registered – 34%
 - Applying a lower threshold for businesses supplying services than those supplying goods - 18%
 - Applying different thresholds to different industries or sectors - 10%

23% of respondents thought none of the mechanisms would be helpful.

- 9.4 Respondees have raised the point throughout the survey freeform comments that the financial impact of the cliff edge is the primary factor why businesses, mainly those listed on page 6 of the call for evidence document and the craft sector, want to remain under the VAT registration threshold. If a business is not able to raise its prices by 20% due to competition or because the current price is all that the market will bear, also combined with incurring minimal costs bearing input VAT, it can lose up to £14,166 per year just by going £1 over the VAT registration threshold. If prices are raised, the income can still reduce due to falling sales. A business sensitive to the cliff edge impact must rapidly increase its turnover to at least £96,000 just to receive the same level of income as pre-registration (even before considering the administrative costs of VAT registration). If a sole proprietor can work for 5 days a week and achieve £80,000 sales per year, what is the incentive (say) to work for 6

days a week to achieve £96,000 in sales and receive the identical amount of income, plus having additional administration and competition and penalty risks?

- 9.5 The proposal of lower VAT rates for small businesses just above the threshold was the most selected option, whether this was by means of a reduced VAT rate or achieved using an updated flat rate scheme to create the same effect (see Appendix question 39 freeform comments). Equally, there were concerns in the comments about simplicity for the taxpayer for the lower rate option.
- 9.6 There were many concerns expressed in the freeform about the proposals adding to complexity of the VAT system, not only for businesses taking advantage of a financial smoothing mechanism, but also for those businesses that had increased in size and have to come out of the smoothing mechanism and become a 'normal' VAT registered business. Respondees want a financial smoothing mechanism to also bring simplification to VAT administration.
- 9.7 *Q20: In your view, are there any other solutions that could work? What are they and why would they work?*
- 9.8 No respondents provided details of any financial smoothing simplification schemes in other countries (see Appendix question 40 and freeform answers).
- 9.9 Several respondents have made comments throughout the survey that having a lower VAT threshold, like other EU countries, would remove competitive disadvantage as well as changing the culture and expectation around paying VAT. However, it is uncertain if any member states will opt to significantly increase their domestic VAT thresholds (to a maximum of €85,000) when the SME simplification package comes into effect on 1 July 2022.
- 9.10 Other respondents have commented in the survey that the VAT registration threshold should be higher, for example £150,000, as the majority of businesses would have to employ staff at this point and would need to continue to grow. Again, it is uncertain whether the UK will be impacted by any future trade agreement with the EU to mirror the maximum domestic VAT threshold on 1 July 2022. In the short term we would, therefore, caution against substantial changes in the VAT threshold.
- 9.11 The UK Government should consider the VAT simplification measures set out in the European Commission's SME VAT package (see also our comments in section 6 above), and if free to do so under any future trade deal, enact similar simplifications that would be beneficial for UK businesses. It is uncertain currently whether the UK must enact such simplifications as the terms of trade deal with the EU are not yet finalised.
- 9.12 Other suggestions received in the survey are:
- Reduce the standard rate of VAT, this reduces the cliff edge;
 - Revisit the changes made to the flat rate scheme; a blanket approach on the limited cost rules to tackle specific avoidance by the few, has had major impacts to the compliant majority and is another barrier for the cliff edge;
 - As set out in paragraph 8.5 above, lower VAT rates for small businesses just above the threshold either by means of a reduced VAT rate or achieved using an updated flat rate scheme to create the same effect.
- 9.13 *Q21: The EU Commission SME proposal introduces the idea of essentially two thresholds. The first, lower threshold exempts small businesses from the financial*

obligations of VAT. The second, higher threshold exempts slightly larger businesses from some of the administration of VAT. What do you think about this proposal?

- 9.14 Please refer to our feedback in respect of the European Commission SME simplifications in section 6 of this document.
- 9.15 *Q22: Assuming the UK has the freedom to do so, would increasing or decreasing the threshold simply move the threshold problems or alleviate them?*
- 9.16 In question 38 of the survey, 51% of respondents disagree that reducing the current VAT threshold would alleviate the cliff edge for small businesses. 35% of respondents agree.
- 9.17 As a measure taken in isolation, we feel that this would simply move the threshold problems for businesses particularly impacted financially by the cliff edge.

10 Other comments / suggestions

- 10.1 Our comments above are predominantly reflect the results of our survey. We have set out below some further thoughts and recommendations on areas for possible future research:
- Becoming VAT registered in just one of the ‘barriers’ faced by businesses who wish to grow. There are also costs and complexities involved in taking on an employee for the first time, moving into new premises, incorporating a business, and so on. We would recommend that wider research is undertaken into the barriers to growth that businesses perceive to exist, and for the government to consider how this might be overcome.
 - The call for evidence indicates a number of potential financial smoothing mechanisms. We would recommend that a number of different mechanisms are ‘modelled’ to evaluate the potential impact on businesses. We would be happy to work with HMT to develop and evaluate these mechanisms.
 - There is more than a fleeting correlation between the sectors primarily affected by crossing the VAT registration threshold and the reduced rates for ‘labour intensive’ businesses as set out in Annex III to the VAT Directive. The government may wish to consider the impact of introducing these reduced rates as a means of easing some of the financial barriers outlined above, recognising of course the broader economic impact of introducing such a measure for all VAT registered businesses.

11 Acknowledgement of submission

- 11.1 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.

12 The Chartered Institute of Taxation

12.1 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.

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