

Further written evidence submitted by the Chartered Institute of Taxation (Clauses 50-52) (FB02d)

VAT

Clauses 50-52

Executive Summary

Clause 50 is designed to give the government the flexibility to amend certain anti-fraud legislation so it does not have an unduly burdensome effect on small business. The immediate beneficiaries will be businesses in the building and construction sector who it will save from being pushed above the VAT threshold. We welcome the clause but are concerned that the Order extending this provision to the construction sector creates further complexity in an already complex area.

Clause 51 and Schedule 16 implement the EU Vouchers Directive into UK law, changing the way vouchers are treated for VAT purposes. We are broadly supportive of the changes though have some concerns around the transition to the new rules, which will take place at the busiest time of year for retailers.

Clause 52 and Schedule 17 widen the entry criteria to VAT groups, allowing individuals and partnerships to join a VAT group if they meet certain tests. Again we are broadly supportive, but a number of questions remain for the government to answer.

1 Clause 50 – VAT: Duty of customers to account for VAT on supplies

1.1 Background

1.1.1 This clause is designed to give the government the flexibility to amend certain anti-fraud legislation so it does not have an unduly burdensome effect on small business. The immediate beneficiaries will be small businesses in the building and construction sector who it will save from being pushed above the VAT threshold.

1.1.2 Section 55A of the VAT Act 1994 (s.55A VATA94) is anti-fraud legislation aimed at preventing organised criminals from attacking the VAT system for fraud – known as ‘missing trader’ fraud. This legislation works by deeming the business customer, rather than the supplier, to be responsible for declaring the VAT on its purchase of certain goods or services (known as ‘relevant supplies’), which are of a kind used in missing trader fraud. This is known as a ‘reverse charge’. By having the purchaser account for the VAT, the seller does not gain the benefit of VAT charged, which would be undeclared by the seller (‘missing trader’) but deducted by the purchaser.

- 1.1.3 Subsection 9 of s.55A VATA94 states that 'relevant supplies' are goods or services of a description specified in an order made by the Treasury; examples include qualifying supplies of mobile phones, computer chips, emission allowances, gas/electricity and telecommunications. From 1 October 2019, construction services and works on existing buildings will also be added. This is being done by government in response to the spread of missing trader fraud to supply chains for large projects in the construction sector.
- 1.1.4 Subsection 3 of s.55A states that the value of any 'relevant supplies' purchased by the customer over £1,000 must be aggregated along with its turnover from its own business supplies for the purposes of the VAT registration threshold test (currently £85k of taxable supplies in a rolling 12 month period). Note that when construction and building works supplies are included in s.55A, the Order amends the default position so that the £1,000 small value supplies limit will not apply (i.e. nil threshold).
- 1.1.5 To give an example, if a customer buys £30k of 'relevant supplies' in a 12 month period (each over £1,000) and also makes £60k of their own onward taxable supplies, the VAT registration turnover test in subsection 3 of s.55A VATA 94 applies to £90k (60+30) not just to the £60k turnover, so (if an exception is not made) a VAT registration obligation for the customer occurs.
- 1.1.6 Clause 50 creates a power for the Treasury to modify the position on the inclusion of 'relevant supplies' (subsection 9) in the turnover test for the VAT registration threshold (subsection 3). In effect this means that a decision can be made on whether the customer may exclude relevant supplies from the turnover test. The aim of the measure is to prevent the anti-fraud provision from unintentionally pushing a small business over the VAT threshold.
- 1.1.7 It is the bringing of construction services and works on existing buildings into the 'relevant supplies' rules that has prompted this clause. It would be an unintended consequence to have small businesses in the sector that would otherwise be below the VAT threshold having to register for VAT because of the requirement to aggregate the value of purchases of relevant supplies to turnover, when the fraud that the legislation is seeking to tackle is much further up the supply chain.
- 1.1.8 For the example in 1.1.5, clause 50 and the accompanying Order (see below) mean that for the construction and building works services, the VAT threshold test would only apply to the £60k of turnover. Consequently the business would not be pushed over the VAT threshold.
- 1.2 **Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019**
- 1.2.1 This Order extends the VAT 'reverse charge' set out in s.55A VATA94 to construction services, with effect from 1 October 2019. It was published on 7 November. While separate from the Finance (No.3) Bill, article 10 of the Order (see 1.2.5, below) would not have been possible without clause 50 of the Bill and the two are closely interrelated.
- 1.2.2 The reverse charge in this sector applies for business to business transactions where the supply is subject to a positive VAT rate, the customer is registered for UK VAT and is required to report through the Construction Industry Scheme (CIS). There is a nil threshold on sales, meaning all qualifying transactions are impacted. The rules do not apply to zero-rated supplies of construction services (e.g. works on new dwellings, certain residential and charitable buildings, certain adaptations for the disabled).
- 1.2.3 For this sector, the missing trader would also benefit from unpaid CIS deductions, making fraud more financially attractive.

1.2.4 The long period to introduce this measure for the construction sector has been due to the changes for business with Brexit and Making Tax Digital in March/April 2019 and the complexity of VAT liability in the construction and building works sector. The time period is designed to allow businesses to review their working capital position, as they will no longer receive VAT receipts for transactions subject to the anti-fraud measure.

1.2.5 Enabled by clause 50, article 10 of the Order states that reverse charge supplies will not count as supplies for the purposes of calculating whether a construction business is over the VAT registration limit.

1.3 **CIOT comments**

1.3.1 We welcome the introduction of clause 50 which, combined with article 10 of the Order, removes the unintended consequence that small businesses in the construction sector would be unnecessarily brought into the scope of VAT registration by having to aggregate the values of their purchases of relevant supplies with the value of their sales, when the particular fraud that s.55A VATA94 is aimed at is not carried out by unregistered businesses. It provides certainty on the VAT registration threshold for these small businesses.

1.3.2 The CIOT welcomes that clause 50 is the result of ongoing and regular consultation between HMRC and representatives from the construction sector, professional bodies (including the CIOT), and others. This is a good example of effective and productive engagement by HMRC.

1.3.3 The CIOT supports HMRC taking action to combat VAT abuse and non-compliance. Missing trader fraud in the construction sector alone is estimated to be costing taxpayers £100 million annually. We recognise the resource constraints HMRC face in the current economic and political climate.

1.3.4 The CIOT welcomes that the final supply, i.e. the supply to a person who does not make any further supplies of such specified services, is excluded from the reverse charge requirements, as set out in Article 8(b)(i) of the Order. This prevents customers, who may not operate in the construction sector, from bearing the responsibility for calculating what could be complex VAT liabilities on projects with multiple VAT rates.

1.3.5 However the CIOT has a number of broad concerns around the complexities of the practical application of the anti-fraud measure itself for taxpayers within the construction and building works sector. These are set out in paragraphs 1.3.6 to 1.3.8 below. While these concerns relate to the extension of s.55A VATA94 to the construction sector, which is being implemented by the Order rather than by clause 50, we hope there will be an opportunity to raise some of them in this debate.

1.3.6 The CIOT is concerned about the complexity of the application of the reverse charge in the construction sector, particularly for small businesses. VAT and property is already a complex subject and as the consultation process has illustrated, the VAT position in large infrastructure projects is highly sophisticated, raising many questions.

1.3.7 Article 8 of the Order confirms that supplies are excepted (not subject to the reverse charge), if they are not subject to the Construction Industry Scheme rules, if you supply an 'end user', or if you supply an 'intermediary supplier' that has relevant connections to an end user, either via normal connected party rules or a mutual relevant interest in land. Whilst the definition of 'end user' in article 2(1) of the Order is a VAT registered recipient of specified supplies who does not make onward supplies of such services, the guidance states: *If the end user does not provide its supplier with confirmation of its end user status it will still be responsible for accounting for the reverse charge.* It will be

important for buyers of specified supplies to ensure that the supplier is aware of the end user status. The CIOT would like to see this confirmation of end user status clarified in the legislation so responsibilities for VAT accounting are clear to both parties; the CIOT will raise this in ongoing consultation.

- 1.3.8 Although the CIOT cautiously welcomes that the anti-fraud measure was given a longer lead time of 1 October 2019, due to the unknown position for the UK exiting the EU on 29 March 2019 and the introduction of Making Tax Digital (MTD) for VAT returns starting on or after 1 April 2019, it should be noted that certain businesses have now been deferred for MTD to 1 October 2019. These businesses are going to have to cope with new MTD rules on digital record keeping at the same time as having to adjust their VAT accounting software to correctly calculate the DRC on affected sales and/or purchases, increasing complexity for business.
- 1.3.9 A secondary reason for delaying the introduction of the scheme was to ease the impact of VAT cashflow for businesses who may be using VAT receipts as working capital between VAT return quarterly payments. The CIOT welcomes that there has been time for business to arrange alternative finance should this be necessary.

2 Clause 51 and Schedule 16 - Treatment of vouchers

2.1 Background

- 2.1.1 The EU Vouchers Directive (Council Directive (EU) 2016/1065), agreed on 27 June 2017, standardises the VAT rules for vouchers in all member states, including providing standard definitions of vouchers. Due to member states having different VAT rules on vouchers, it was resulting in cases of double taxation or non-taxation arising for cross border transactions, with non-taxation scenarios being used for cross border VAT planning schemes.
- 2.1.2 Clause 51 and Schedule 16 implement the directive into the UK's VAT rules, with effect from 1 January 2019.
- 2.1.3 The rules regarding vouchers have always been a complex area for VAT. Originally the VAT treatment for vouchers was that the purchase was disregarded for VAT purposes and VAT was due at the time of redemption. However, the types of vouchers available have evolved, such as acquiring the ability to be used in other countries or bulk discounts for intermediary resellers, with the VAT rules also updated so that different types of voucher had specific VAT treatment. The use of different voucher rules used in VAT planning schemes led to case law shaping differing VAT treatment.
- 2.1.4 For vouchers issued on or after 1 January 2019, rules in the new Schedule 10B of the VATA94 (published in Schedule 16 of the current bill) for either single-purpose vouchers (SPV) or multi-purpose vouchers (MPV) will apply. 'Single purpose' means that the goods/services purchased are known to be at a single VAT rate; 'multi-purpose' means goods/services purchased could be subject to different VAT rates or territories. The existing UK VAT rules in Schedule 10A of the VATA94 for 'credit vouchers', 'retailer vouchers', 'other kinds of vouchers' and 'single purpose voucher' (different scope to new definition) will still apply to vouchers issued on or before 31 December 2018.
- 2.1.5 The definition of a voucher will change from 'the right' to receive goods and services (para 1(1) of Schedule 10A of the VATA94), to representing the goods or services that can be obtained (para 3 of Schedule 10B VATA94). For SPVs, this means that although the amount of VAT to be declared will not change, the time that VAT must be declared will be brought forward to when the voucher is sold rather than redeemed (para 4(3)

Sch 10B VATA94). This is the same time that VAT would be declared if goods or services, rather than an SPV, were purchased. For MPVs, VAT will be accounted for at the time of redemption.

- 2.1.6 Most credit vouchers and retailer vouchers will fall into the MPV description, so the time when VAT should be accounted for would be unchanged. For most businesses changing to the MPV rules, the VAT treatment of the voucher should be unaffected.
- 2.1.7 There are changes for MPV intermediaries' business arrangements where MPVs are purchased in bulk and resold; as these supplies are disregarded under para 7 Sch10B VATA94 this could impact the right to recover input tax for some businesses. It is anticipated that most businesses in this sector will make changes to the trading terms in the supply chain to mitigate any VAT loss. MPV intermediaries may need to monitor two sets of voucher rules where purchases have been made in 2018 and 2019.

2.2 **Single and Multi-Purpose Vouchers**

- 2.2.1 The current VAT treatment of a single purpose voucher is that VAT is due at the time of purchase of the voucher where the supply of goods or services is of one type subject to a single rate of VAT. In practice, few vouchers met this definition as retailers sell a variety of products so won't know what will be supplied even where all of the products on sale are standard rated e.g. a fashion store may sell clothes, shoes, bags and accessories. An example where the single purpose rules would apply would be the purchase of a telephone card that only provides standard rated telephone calls.
- 2.2.2 The new definition of an SPV applies to sales of vouchers where it is known that the goods or services that can be purchased are of the same VAT liability. It will not matter if a variety of goods or services can be purchased, only that the VAT liability is the same. In the above example of a fashion store, if all product is standard rated, future sales of vouchers will be under the SPV VAT rules. The impact of this is that the timing of the VAT declaration will change to the point of purchase of the voucher rather than at the time of redemption but the amount of VAT charged will not change.
- 2.2.3 A multi-purpose voucher is a voucher that can be redeemed for goods or services with different VAT liabilities or in different countries. The initial sale is disregarded for VAT purposes and VAT is accounted for at the time of redemption when the VAT liability of the supply is known.
- 2.2.4 In practice, most retailers and other businesses selling vouchers sell a variety of products with different VAT liabilities; stores selling computer games and game accessories will normally also sell some zero-rated children's clothes with gaming branding and zero-rated books about playing the game; food outlets may sell some zero-rated takeaway food, so these businesses will issue MPVs, and the VAT treatment at the time of redemption is similar to the current VAT rules.

2.3 **CIOT comments**

- 2.4 The CIOT welcomes that the draft legislation went through a consultation process and feedback from industry, practice and professional bodies, including the CIOT, was obtained. We also welcome that standardised rules for vouchers in the EU simplifies voucher definitions and reduces the risk of double taxation or non-taxation for intra-EU cross border transactions.
- 2.5 We consider the new definitions of Single-Purpose Voucher (SPV) and Multi-Purpose Voucher (MPV) to be more intuitive compared to the current rules, although vouchers will still be a complex area of tax where taxpayers need clear guidance with many

examples. The legislation published in the Finance Bill is unchanged from the draft which assists certainty, although we would like to see clarity for taxpayers in HMRC's new guidance, which we are concerned is still to be published at this late stage when the implementation is effective from 1 January 2019.

2.6 Businesses that only sell product at one VAT liability will need to review their position and make changes to their VAT accounting accordingly. There is a risk of not declaring VAT on the redemption of vouchers purchased in 2018, so it will be critical that the business can identify the date of purchase, adding complexity to the administration of vouchers. These rules are being implemented at the busiest time of year for retailers which is unfortunate and raises the risk of errors with the pressure of the January sales period and the redemption of Christmas vouchers.

2.7 We anticipate that most businesses issuing MPVs will be broadly unaffected. However the changes to some MPV voucher intermediary resellers will introduce new complexity that particularly small enterprises may not have the understanding or access to advisers to adopt correctly or without risk. Some intermediaries will have to monitor two sets of voucher rules for purchases in 2018 and 2019, as MPVs are taxed at the redemption date rather than sale date. Affected businesses may also need to revise their supply chain arrangements as the onward supply of MPVs are disregarded for VAT purposes which could result in an impact to input VAT recovery. It is anticipated that changed terms should mitigate the VAT position, however this will result in costs of professional advice and internal resource to implement changes.

3 Clause 52 and Schedule 17 – Groups

3.1 Background

3.1.1 Schedule 17 contains provision about the eligibility of individuals and partnerships to be treated as members of a group for the purposes of VAT.

3.1.2 The existing VAT rules allow corporate bodies (companies of all types and limited liability partnerships) to form a VAT group providing the eligibility tests are met: each has an establishment in the UK and they are under common control. There are additional eligibility rules for 'specified bodies' that are larger businesses (VAT group turnover >£10m) with more complex ownership structures and specific benefits accruing to third parties. The specified bodies' rules are an anti-avoidance measure.

3.1.3 VAT grouping is an administrative simplification measure where the VAT group's members account for VAT on a single VAT return and intra-group supplies are disregarded for VAT purposes. However, the VAT group members each take on the joint and several liability for each other's VAT obligations

3.1.4 Part 1 of Schedule 17 amends section 43A VATA94 to widen the eligibility rules to join a VAT group for individuals and partnerships, and inserts a new section 43AZA which amends the control test to include individuals and partnerships. The amendments are required due to the decisions in the joined Court of Justice of the European Union cases, Larentia + Minerva (C-108/14) and Marenave (C-109/14). The legislation in Schedule 17 is the UK's implementation of the findings of those cases, which is that non-corporates can join a VAT group providing they meet the control test entry criteria.

3.1.5 Individuals and partnerships who want to join a VAT group must be undertaking business activities; those who are not undertaking business activities will be unable to join.

3.1.6 Part 2 of Schedule 17 FB3 lists the amendments to the VATA94, substituting the terms 'body corporate/bodies corporate/body which' for 'person/persons/person who/persons who/P'. These substitutions allow VAT groups with changed memberships that include individuals and/or partnerships, and unchanged VAT groups to continue to operate in the same manner for VAT purposes. There are no other impacts to businesses.

3.1.7 The date from which these measures take effect has not yet been announced; it will be after Royal Assent appointed by Treasury regulations. The guidance has not yet been published.

3.2 **CIOT comments**

3.2.1 The CIOT welcomes that the draft legislation was subject to consultation and HMRC held consultation meetings with representatives from professional bodies, including the CIOT, practice and industry. The consultation raised several challenges that we would like to see addressed in the VAT guidance. These are set out below.

3.2.2 The meaning of 'established or has a fixed business establishment in the UK' in the amended s.43(1)(b) VATA94 raises questions such as:

- Whether partnerships could have partners that were both UK and non-UK resident; would a partnership that had UK business premises with entirely non-resident partners be eligible?
- Would the VAT grouping rules in other member states where establishment is less important as opposed to closer economic and fiscal links be considered?
- How would the ongoing challenge of how the physical presence test be monitored and policed?

3.2.3 Where an individual or partnership satisfies the entry criteria from the date of application to join the UK VAT group, it raises questions by what means HMRC or the individual/partnership know that they remained compliant:

- Should there be an annual declaration or tick box on the VAT return to encourage regular self-assessment?
- Would HMRC cross reference the VAT grouping establishment position with the partnership or sole trader tax return?
- For a non-resident individual holding a UK Unique Tax Reference (UTR), would HMRC monitor the tax return to see if they remained eligible?
- Could the partnership and sole trader tax registration details be used to tag and monitor which partnerships or sole traders were within a VAT group (both for HMRC administration and for taxpayers' reference when dealing with such entities and checking VAT registration)?

3.2.4 The position on joint and several liability on personal assets for individuals was discussed, particularly around residential property and whether it could be held in a private capacity outside the economic activity and the VAT group. Would the scope of joint and several liability be a barrier to most individuals wishing to join a VAT group?

3.2.5 We would like to see the draft guidance form part of the ongoing consultation prior to publication so that as many of the above questions can be clearly explained for taxpayers.

3.2.6 We would also like to see further focus on limited partnerships and VAT groups in the consultation.

4 The Chartered Institute of Taxation

4.1 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 18,400 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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