



# VAT REGISTRATION THRESHOLD: CALL FOR EVIDENCE

## Response by Association of Taxation Technicians

### 1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HM Treasury call for evidence *VAT registration threshold: call for evidence* ('the Call') issued on 13 March 2018.<sup>1</sup>

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 Our response is set out below. Section 2 outlines our approach in responding to the Call, and in Sections 3 to 8 we address the specific questions posed by the Call in each of the following areas:

- Section 3: The current VAT threshold and the impact on business growth
- Section 4: Administrative burdens
- Section 5: Financial and competitive burdens
- Section 6: EU SME proposals
- Section 7: Administrative smoothing
- Section 8: Financial smoothing

In Section 9 we draw together our summary conclusions based on the above.

1.4 We would be pleased to discuss any aspect of this response further and contact details can be found in Section 10.

### 2 Our approach in responding to the Call

2.1 The ATT and CIOT jointly invited members to respond to a survey based on the questions posed by the Call. In total 429 responses were received. Of those responding, 83% were agents and 45% were ATT members.

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<sup>1</sup> The Call can be found at <https://www.gov.uk/government/consultations/vat-registration-threshold-call-for-evidence>

- 2.2 Our survey covered the same topics addressed in the Call, but with some additional and alternative questions to gather further information and evidence where we felt this was required.
- 2.3 A summary of the survey questions and responses is attached as an appendix to this response. These should be considered in conjunction with this response.
- 2.4 Some members provided evidence directly to us, and this has also been factored into this response where appropriate.

### 3 The current VAT Threshold and the impact on business growth

*Question 1) What experience or knowledge do you have of small businesses managing their turnover to remain below the VAT threshold?*

3.1 Our survey asked the following questions:

- *How common is it, in your experience, for small businesses to manage their turnover in order to stay below the VAT threshold? (Q6)*
- *What methods have you seen businesses apply in practice to stay below the VAT threshold? (Q12)*

Full details of the answers received to these questions can be found in the Appendix.

3.2 In summary, our survey results indicate that it is common for small businesses to manage their turnover to stay below the VAT threshold, with 45% of those answering saying this was fairly common, and 21% that it was very common.

3.3 The most common methods of managing turnover seen by those responding to Question 12 were:

- turning down work (73%);
- asking customers to purchase raw materials and/or supplies (63%);
- closing the business for a season or period (39%);
- restricting opening hours (35%); and
- splitting up the business (32%).

Only 15% of those responding had ever heard of deliberate under-declaration of income or evasion being used to stay below the VAT threshold.

3.4 Other methods of managing turnover reported by respondents included invoicing at different times, deferring work and quoting high to ensure they were not given work.

*Question 2) Are there, in your experience, particular types, regions or sectors of businesses where this is particularly relevant?*

3.5 Our survey asked the following questions:

- *In your experience, is managing turnover to stay below the threshold (Q7)?:*
  - *More common in businesses supplying mainly goods*
  - *More common in businesses supplying mainly services*

- *Not affected by whether businesses supply goods or services*
- *Not applicable*
- *Have you come across one or more sectors where it is common to manage turnover to stay below the VAT threshold? (Q8)*

Full details of the answers received to these questions can be found in the Appendix.

- 3.6 Our survey results indicate that, on balance, it is more common for businesses supplying mainly services to manage their turnover to stay below the VAT threshold, with 48% of those responding selecting this option. This result is perhaps not surprising, given that services businesses often have relatively low levels of input tax which they could reclaim, exacerbating the financial impact of becoming VAT registered.
- 3.7 Responses were divided as to whether managing turnover is more common in any specific sector(s), with 52% indicating this was not the case, and 48% indicating it was. Common examples cited of specific sectors where it is common to manage turnover included:
- construction and building trades;
  - hairdressers and beauticians;
  - catering and hospitality businesses such as takeaways and cafes; and
  - individual tradesmen such as plumbers, gardeners and handymen.

A common theme of all of these businesses is that they mainly supply goods and/or services to the general public who cannot recover any VAT charged. This leads to increased competition with unregistered businesses, who are not required to charge VAT and therefore may have lower prices.

*Question 3) 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?*

- 3.8 Our survey asked the following questions:
- *What do you believe is/are the main reason(s) for businesses wanting to stay below the VAT threshold? (Q9 and Q10)*
  - *Are there any other challenges faced by VAT registered traders compared to unregistered businesses? How do these affect the ability of the registered business to grow? (Q13)*

Full details of the answers received to these questions can be found in the Appendix.

- 3.9 Our survey results indicate that concerns over being able to compete with non-VAT registered businesses are a key reason why businesses may want to stay below the VAT threshold, with 60% identifying this as being the most important issue.
- 3.10 The importance of competition with non-registered businesses is further underlined in the comments received in response to Questions 10 and 13 in our survey which highlight the difficulty businesses face in terms of passing on the VAT charge to customers in a competitive market, or covering the cost themselves.

*Question 4) As the OTS suggest, does the current threshold contribute to the size of the hidden economy, and how?*

3.11 Our survey asked the following questions:

- *Do you believe the current level of the VAT threshold? (Q14):*
  - *Is too high and affects the growth and/or productivity of small businesses*
  - *Is too high and contributes to the size of the hidden economy*
  - *Is too low and imposes excessive administrative burdens on smaller businesses*
  - *Is too low and leads to increased costs for consumers*
  - *Is about right*
  - *Other (please specify)*
- *If you think the current level of the VAT threshold contributes to the size of the hidden economy, please provide reasons (Q15)*

Full details of the answers received to these questions can be found in the Appendix.

3.12 Of those responding, only 22% believed that the current VAT threshold is too high and contributes to the hidden economy.

3.13 Responses to Question 15 indicated that the main way in which the level of the VAT threshold influences the size of the hidden economy is that some businesses are incentivised to under-declare income in order to stay below the threshold. This includes, for example, cash in hand sales which are kept off the books. This behaviour is exacerbated by the 'cliff edge' effect of passing over the threshold, which means that VAT has to be charged on all turnover once the threshold is passed. Some businesses may also believe that, by avoiding VAT registration, they can stay off HMRC's radar.

3.14 There did not appear to be any clear consensus amongst those responding as to whether lowering the VAT threshold would reduce the size of the hidden economy. Some actually indicated that, in their opinion, lowering the threshold could increase hidden economy activity. The current high level of the threshold means that many individuals can earn sufficient amounts to live on without crossing the VAT threshold. Significantly lowering this threshold could result in more businesses (ie those trading comfortably below the current threshold) having an incentive to under-declare earnings.

*Question 5) In your experience, does the current threshold have any effect on growth and/or productivity? If so, how significant is that effect?*

3.15 Our survey asked the following questions:

- *Do you believe the current level of the VAT threshold? (Q14):*
  - *Is too high and affects the growth and/or productivity of small businesses*
  - *Is too high and contributes to the size of the hidden economy*
  - *Is too low and imposes excessive administrative burdens on smaller businesses*
  - *Is too low and leads to increased costs for consumers*
  - *Is about right*
  - *Other (please specify)*

- *If you think the current level of the VAT threshold affects growth/productivity, how significant is this effect? (Q16)*

Full details of the answers received to these questions can be found in the Appendix.

- 3.16 Of those responding, only 19% felt that the current VAT threshold is too high and affects the growth and/or productivity of small businesses.
- 3.17 Comments received from those responding were mixed, with some indicating that there was a substantial impact for those businesses trading at or around the VAT threshold, whilst others queried whether the effect on growth and productivity was as significant as believed. Some responses stressed that whatever the level of the threshold there would be some distortion, with businesses trying to stay below that threshold. Others stressed that it is not VAT alone that deters businesses from growing, and that issues such as employment taxes, auto-enrolment and general administrative requirements also play an important role.

#### 4 Administrative burdens

*Question 6) Does the administration of VAT discourage businesses from registering?*

- 4.1 Our survey asked the following questions:

- *What do you believe is/are the main reason(s) for businesses wanting to stay below the VAT threshold? (Q9 and Q10)*
- *In your experience, does the administration of VAT discourage businesses from registering? (Q17)*
- *Do you agree that the perceived administrative burdens of the VAT regime are a key reason why some small businesses may manage their turnover in order to stay below the VAT threshold? (Q20)*

Full details of the answers received to these questions can be found in the Appendix.

- 4.2 The survey responses confirm that the administrative burdens of becoming VAT registered are a key concern for businesses:

- Administrative burdens were identified as being the second most important reason (after concerns over being able to compete with non-VAT registered businesses) for businesses wanting to stay below the VAT threshold.
- 70% of those responding felt that the administration of VAT discourages businesses from registering.
- 45% agreed, and 30% *strongly* agreed, that the perceived administrative burdens of the VAT regime are a key reason why some small businesses may manage their turnover to stay below the VAT threshold.

*Question 7) If so, what are the main aspects of VAT administration that are putting businesses off registering?*

#### 4.3 Our survey asked the following questions:

- *Which aspects of VAT administration do you believe to be the most onerous for businesses? (Q18 and Q19)*
- *In your experience, what would be the typical fee for preparing and filing a standard VAT registration application (excluding any additional forms such as option to tax)? (Q24)*
- *In your experience, what would be the typical fee for preparing and filing a single quarterly VAT return for a newly registered business? (a 'simple' business for VAT purposes with no more than 20 sales invoices and 20 purchase invoices; sales are single VAT liability with no other complications such as TOMS or partial exemption, and the business maintains its own records) (Q25)*
- *Are there any other standard charges for professional costs incurred by clients for a VAT registration (client meeting, VAT liability advice etc.)? (Q26)*

Full details of the answers received to these questions can be found in the Appendix.

#### 4.4 Survey responses indicate that the most onerous aspects of VAT administration for small businesses are:

- additional record keeping requirements;
- gathering the information to complete VAT returns;
- determining the VAT liability of supplies;
- preparing and submitting VAT returns; and
- the costs of obtaining technical VAT advice.

#### 4.5 Comments received in response to Question 19 also highlight the complexity of the VAT regime as being an issue for many small businesses.

#### 4.6 Many small businesses are unlikely to have dedicated finance staff and their owners are often already very busy with the day to day running of the business. They may therefore prefer to outsource administrative tasks in order to free up their time to concentrate on developing and growing the business. In Questions 24 to 26 of our survey, we therefore sought to understand the professional costs which a typical straightforward business which has just passed the VAT threshold may incur if they wished to outsource their VAT compliance. These indicated typical costs of:

- £100 - £249 for preparing and filing a standard VAT registration application.
- £100 - £249 for preparing and filing a single quarterly VAT return.

This suggests that a typical small business would incur professional fees of between £500 and £1,245 in their first year of registration, and potentially much more were they to need specialist VAT advice regarding the treatment of their supplies. For a business with a turnover which may only just exceed £85,000 (and may have a much lower profit), this is a significant sum.

*Question 8) 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?*

4.7 Our survey asked the following question:

- *When businesses register for VAT, how do they find the administrative burdens compared to their expectations? (Q21)*

4.8 Of those responding to this question, 45% felt that the administrative burden was about the same as anticipated, and 31% that it was higher than anticipated. There therefore appears to be limited support for the notion that apprehension over administrative burdens is excessive compared to the reality.

*Question 9) How well do current simplification schemes address these issues?*

4.9 Our survey asked the following questions:

- *Do you agree that special VAT accounting schemes such as the cash accounting scheme, flat rate scheme, annual accounting scheme etc. help to alleviate the administrative requirements of small businesses? (Q22)*
- *Please specify whether you believe any one accounting scheme is particularly useful in alleviating administrative requirements. (Q23)*

Full details of the answers received to these questions can be found in the Appendix.

4.10 Survey responses showed support for current simplification schemes, with 41% agreeing that these helped to alleviate administrative requirements and 12% *strongly* agreeing.

4.11 Of the current simplification schemes, the flat rate scheme (FRS) and cash accounting schemes were particularly popular, with 46% believing that FRS alleviated administrative requirements and 37% believing that cash accounting did.

4.12 There was limited support amongst those responding for annual accounting, with only 9% believing this scheme alleviates administrative burdens. From discussions with members outside of the survey, we understand that this may be because annual accounting does not necessarily alleviate record keeping requirements or the necessity to collect information and categorise supplies accurately. Businesses may also be uncomfortable with the requirement for payments on account to be based on prior year figures, and believe traditional VAT accounting is less likely to lead to cash flow problems.

4.13 Several respondents noted that recent changes made to the FRS, in particular the introduction of the limited cost trader rules in April 2017, have made the scheme less attractive to small businesses. The limited cost trader rules were introduced to tackle abuse of the FRS, which we understand was particularly prevalent amongst a subset of voluntarily registered businesses. However, the new rules apply much more widely, and are complex in nature, causing many businesses who were not acting in an abusive manner to revert to traditional VAT accounting and the extra administrative burdens this brings. In Section 9.14 below we address potential alternative approaches to the limited cost trader rules which would allow the FRS scheme to act as an administrative simplification for the majority of small businesses, whilst targeting abuse by the minority.

*Question 10) Ipsos MORI research suggests that dealing with VAT returns is likely to be the most time consuming aspect of VAT administration. What is it about VAT returns that is particularly time consuming for small businesses?*

4.14 Our survey asked the following question:

- *Which aspects of VAT administration do you believe to be the most onerous for businesses? (Q18 and Q19)*

Full details of the answers received to this question can be found in the Appendix.

4.15 With respect to VAT returns in particular, our survey indicates that the most onerous aspects are:

- gathering the information to complete VAT returns;
- preparing and submitting VAT returns;
- determining the VAT liability of supplies;
- keeping abreast with VAT changes; and
- understanding guidance.

*Question 11) 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?*

4.16 Our survey asked the following questions:

- *Do you believe that Making Tax Digital for VAT is a further reason for small businesses to want to remain below the VAT threshold? (Q11)*
- *Do you agree that Making Tax Digital is likely, in the long term, to lessen the administrative burdens associated with VAT compliance? (Q27)*

Full details of the answers received to these questions can be found in the Appendix.

4.17 Survey responses in this area were quite clear:

- 74% believed that MTD was a further reason for small businesses to want to remain below the VAT threshold.
- 32% *strongly* disagreed, and 27% disagreed that MTD is likely to lessen administrative burdens in the long term.

4.18 These results indicate that many businesses and their advisers remain unconvinced of the benefits to them of MTD. They also raise questions as to whether mandation of MTD for VAT from April 2019 is appropriate given the current concerns over the effect of the VAT threshold on productivity and growth.

## **5 Financial and competitive burdens**

*Question 12) 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?*

5.1 Our survey asked the following question:

- *Are you aware of any particular sector, industry or business type that is particularly affected by the financial costs and competitive disadvantages of having to charge VAT? (Q28)*

Full details of the answers received can be found in the Appendix.

5.2 Responses to this question were evenly split, with 49% indicating they were not aware of any particular sector, industry or business type that was particularly affected, and 51% indicating that they were.

5.3 Comments received frequently identified the following sectors, industries or business types as being particularly affected:

- building and construction;
- catering and hospitality industries;
- service providers such as handymen, gardeners etc.;
- hairdressers and beauticians;
- charities;
- tourism and those subject to TOMS.

As noted in Section 3.7 above, a common theme of many of these businesses is that they mainly supply goods and/or services to the general public who are unable to recover any VAT charged. This leads to increased competition with unregistered businesses, who are not required to charge VAT and therefore may have lower prices. The same sectors are also likely to have limited recoverable input tax, leading to a larger financial burden of becoming VAT registered. In particular, catering and hospitality businesses commonly have predominantly zero-rated purchases, but make standard rated supplies to non-VAT registered customers.

*Question 13) 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?*

5.4 Our survey asked the following questions:

- *What do you believe is/are the main reason(s) for businesses wanting to stay below the VAT threshold? (Q9 and Q10)*
- *Do you agree that the requirement to charge VAT to customers once registered, and the problems this can cause in terms of pricing and competition with unregistered businesses, is a key reason why some small businesses may manage their turnover to remain below the VAT threshold? (Q29)*

Full details of the answers received to these questions can be found in the Appendix.

5.5 Responses to Question 9 in our survey indicate that concern over being able to compete with non-registered businesses is the most important reason why businesses may want to stay below the VAT threshold.

- 5.6 This was supported by responses to Question 29, with 61% *strongly* agreeing, and 30% agreeing, that the financial costs and competitive disadvantages of having to charge VAT once registered is a key reason why some small businesses may manage their turnover in order to stay below the VAT threshold.

## 6 EU SME Proposal

*Question 14) 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?*

- 6.1 Our survey asked the following question:

- *How helpful do you believe this package of EU measures is likely to be in terms of reducing the negative impacts for small businesses of becoming VAT registered? (Q30)*

- 6.2 Responses showed that there was some support for the EU proposals, with 32% believing they would be slightly helpful and 5% believing they would be very helpful. However, 26% felt they would be neither helpful nor unhelpful.

*Question 15) Are there constituent parts of the proposal which are particularly attractive or unattractive? If so, what are they and why?*

- 6.3 Our survey asked the following questions:

- *Which components of the package do you believe would be most helpful? (Q31)*
- *Which components of the package do you believe would be unhelpful? (Q32)*

Full details of the answers received to these questions can be found in the Appendix.

- 6.4 Responses showed the most support for the proposed smoothing mechanism which will allow businesses to exceed the threshold by up to 50% in any one year without having to register, with 58% indicating this would be helpful. Comments received indicate that this proposal would be helpful as many businesses do not initially realise they have exceeded the VAT threshold and, when they do, this is often not until after the year end when accounts are drawn up. The proposal would also avoid businesses having to register and then (potentially) de-register due to an unexpected profit increase in any one period. However, respondents noted that this proposal alone would not address the cliff edge effect of the VAT registration threshold, or prevent businesses from managing turnover to stay below the threshold.
- 6.5 Support was also expressed for proposed administrative simplifications to invoicing, returns, payments etc., with 46% of those responding believing these would be helpful to SMEs.
- 6.6 The part of the EU proposals which received the least support was capping the national VAT threshold, with 47% indicating this would be unhelpful. It was noted that this would be particularly unhelpful for SMEs who only trade within the UK, as they would be impacted by any reduction in the UK threshold whilst potentially not benefiting from other EU simplifications.

- 6.7 Some respondents expressed a concern that the EU proposals would introduce unwelcome extra complexity into the UK VAT regime. It was also unclear what, if any, effect the proposals would have given the UK's impending exit from the EU.

## 7 Administrative smoothing

*Question 16) 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?*

- 7.1 Our survey asked the following question for each of the mechanisms described in paragraph 4.8:

- *Do you agree that this option would help to reduce the administrative burdens for businesses? (Q33 for extending the VAT accounting period to six months, and Q35 for applying the threshold test over two years rather than one)*

Full details of the answers received to these questions can be found in the Appendix.

- 7.2 Overall, the survey results show only limited support for extending the VAT accounting period to six months, with 35% disagreeing that this would reduce administrative burdens, 25% neither agreeing nor disagreeing and 25% agreeing. This is perhaps unsurprising, given that record keeping requirements and identifying the correct VAT treatment of supplies (identified in Sections 4.4. and 4.15 above as being key areas of administrative complexity) would not be affected by this proposal.

- 7.3 More support was shown for extending the period over which the VAT threshold applies to two years, with 42% agreeing this would help to reduce administrative burdens, compared with 26% neither agreeing or disagreeing, and 21% disagreeing.

*Question 17) Would any of these solutions be sufficient to change the behaviour of businesses that take measures to remain under the threshold?*

- 7.4 Our survey asked the following question for each of the mechanisms described in paragraph 4.8:

- *Do you agree that this option could reduce the number of businesses who manage their turnover to stay below the VAT threshold? (Q34 for extending the VAT accounting period to six months, Q36 for applying the threshold test over two years rather than one)*

Full details of the answers received to these questions can be found in the Appendix.

- 7.5 The survey results show that 74% of those responding do not believe that extending the VAT accounting period to six months would reduce the number of businesses managing their turnover to stay below the VAT threshold. Comments received indicate that this is because, as noted at Section 7.2 above, there is limited reason to believe that this will ease administrative burdens and it will have no impact on the financial or competitive pressures of becoming VAT registered.

- 7.6 The survey results also show that 53% of respondents do not believe that extending the period over which the threshold test is applied to two years would reduce the number of businesses managing their turnover to stay below the VAT threshold. Respondents agreed that this proposal would ease burdens on businesses who go over the threshold due to a one-off peak in turnover. However, it may lead to more long term planning, with businesses merely managing their turnover over a two year, rather than one year, period.

*Question 18) Are you aware of any simplification schemes from around the world that work particularly well? If so what are they?*

- 7.7 Our survey asked the following question:

- *Are you aware of any other administrative simplification options that work well in other countries? (Q37)*

Full details of the answers received to this question can be found in the Appendix.

- 7.8 Very few positive responses were received to this question, but suggestions included:

- Having a single return that covers VAT, taxes on earnings and social security payments.
- Having a higher, or lower, VAT threshold.
- Improving HMRC online systems so that these clearly cover all taxes.
- Allowing online amendments to VAT returns which have been filed.
- Postponed import VAT accounting.
- Changes to the FRS so that businesses in certain sectors who exceed the threshold by a small amount are subject to a lower rate.

## **8 Financial smoothing**

*Question 19) What is your experience of the type of mechanism outlined in paragraphs 4.10 – 4.15? Would they be effective in incentivising businesses growth in the UK? If so, how and why?*

- 8.1 Our survey asked the following question:

- *Do you think any of the following options set out in the call for evidence could be helpful in smoothing the financial impact of becoming VAT registered? (Q39)*

Full details of the answers received can be found in the Appendix.

- 8.2 The option receiving the most support was introducing bands of lower VAT rates for small businesses just above the threshold, with 54% feeling that this would smooth the financial impact of being VAT registered. This was followed by reducing the FRS percentage payable for the first few years after registration (39% agree) and allowing small businesses to keep some of the VAT they collect when first registered (34% agree).

- 8.3 However, many respondents expressed concern that these suggestions, and in particular introducing bands of lower VAT rates, could be overly complex and difficult for small businesses to both understand and administer. Many expressed a preference for any smoothing mechanism to be kept as simple as possible.

*Question 20) In your view, are there any other solutions that could work? What are they and why would they work?*

- 8.4 Our survey asked the following question:

- *Are you aware of any other financial smoothing options that work well in other countries? (Q40)*

- 8.5 Respondents did not identify any particular options.

*Question 21) 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?*

- 8.6 Please refer to Section 6 above for a summary of survey responses in relation to the EU SME proposals.

- 8.7 Whilst we would welcome proposals to reduce the administrative and financial burdens of VAT registration for small businesses, we would stress the importance of not introducing any further complexity into the VAT system. The introduction of two different thresholds could lead to businesses being unsure as to their obligations, and potentially also create two separate cliff edges around which turnover is managed.

*Question 22) Assuming the UK has the freedom to do so, would increasing or decreasing the threshold simply move the threshold problems or alleviate them?*

- 8.8 Our survey asked the following question:

- *Do you agree that decreasing the VAT threshold would reduce the 'cliff edge' nature of the VAT threshold? (Q38)*

- 8.9 Responses to this question were mixed, with 29% disagreeing and 22% *strongly* disagreeing that decreasing the threshold would reduce the cliff edge nature of the VAT threshold, but 24% agreeing and 11% *strongly* agreeing.

- 8.10 This mixture of responses may reflect the fact that any reduction in the cliff edge nature of the threshold would depend upon the magnitude of the change. Small increases or decreases are likely to merely move the point around which businesses manage their turnover. Only a very large increase or decrease would be sufficient to reduce the cliff edge nature significantly.

## 9 Summary and conclusions

9.1 In this section we draw together our summary conclusions based upon the survey results set out above and our discussions with members.

### *Link between the level of the VAT threshold and business growth and productivity*

9.2 We welcome the aim of the Call to address any negative impacts on growth and productivity of the current level and design of the VAT threshold. However, we question whether this impact is as significant as may be believed.

9.3 As set out in Sections 3.15 to 3.17 above, only 19% of those responding to our survey felt that the current VAT threshold is too high and affects the growth and/or productivity of small businesses.

9.4 Whilst some small businesses may manage their turnover to stay below the VAT threshold, it should not be assumed that in the absence of this behaviour those businesses would grow significantly. Many small businesses have no intention of growing into large companies, and are merely set-up to provide their owners with sufficient income to support them and their families. This is especially the case since the financial crisis, which resulted in some of those who lost their jobs deciding to set up in business on their own account. In many cases this will have been as a traditional employment role was not available to them.

9.5 We would further note that there are many reasons beyond VAT why a business may seek to limit its size. Key among these are concerns over employing additional staff, which as well as resulting in increased tax burdens and the requirement to operate PAYE, also introduces issues such as auto-enrolment, national living wage compliance and security issues.

9.6 We therefore do not believe that VAT should be considered in isolation when it comes to business growth and productivity in the UK. The broader tax and regulatory landscape should be considered.

### *Approach to reform of the VAT threshold*

9.7 We believe that the most appropriate way to address concerns that the current VAT threshold distorts taxpayer behaviour is to smooth the impact on businesses of crossing the threshold for the first time. Although reducing the VAT threshold may appear to be a simpler solution, it would result in unwelcome added costs and burdens for small businesses who suddenly find themselves above the VAT threshold, as well as adding to the tax burden on households in the form of additional VAT.

9.8 We also note that, following the introduction of MTD for VAT in April 2019, any future reduction in the VAT threshold would mean that many businesses with lower turnovers would have to cope not only with VAT but also the burdens and costs of MTD. As noted in Sections 4.16 to 4.18 above, there is limited belief that the introduction of MTD for VAT will relieve administrative burdens, and many of those responding to our survey indicated that this would actually provide further incentive to businesses to manage their turnover.

9.9 The imminent introduction of MTD for VAT together with the current uncertainty surrounding Brexit further reinforce our belief that it is not appropriate to bring more small businesses into the

scope of VAT by lowering the threshold. As a result, we welcome the focus in the Call on identifying potential smoothing mechanisms.

*Potential smoothing mechanisms*

- 9.10 Our survey results indicate that, in order to address any distortion of taxpayer behaviour, potential smoothing mechanisms must address the administrative, the financial and the competitive burdens of becoming VAT registered. Focusing on one of these areas alone is unlikely to have significant impact.
- 9.11 However, we would urge the need to keep any new smoothing mechanisms as simple as possible in order to avoid introducing extra complexity into the VAT system. Members have already identified applying VAT law correctly to supplies and understanding the wider VAT implications of transactions as key areas of complexity, and these complications are a factor in businesses wishing to stay below the VAT threshold.
- 9.12 Whilst the introduction of new, lower bands of VAT for those just above the threshold, or allowing businesses to keep a certain proportion of the VAT they collect based on their turnover may sound appealing, we are concerned that these would be overly complex both for small businesses to apply and for HMRC to monitor.
- 9.13 Instead, we would prefer to see much simpler solutions considered. This could include an extension of the FRS, a scheme which is already familiar to small businesses and their advisers, and has the potential to deliver both administrative and financial benefits. It may be possible to, for example, expand this scheme by introducing lower FRS rates for small businesses who are just over the threshold, or only making domestic sales (subject of course to State Aid issues).
- 9.14 As noted in Section 4.13 above, recent changes to the FRS, and in particular the introduction of the limited cost trader rules in April 2017, have limited the benefits of the FRS to many businesses and introduced unwelcome complexity. The limited cost trader rules have a wider application than the abuse they seek to address, and we would recommend that the scope of these is revisited as part of any reform. Possible ways to address the abuse of the FRS, whilst maintaining its administrative and financial benefits for the majority of small companies could include:
- Abolishing the limited cost trader rules, but limiting access to the FRS to those businesses who are above the VAT threshold (ie removing access for the voluntarily registered); or
  - Keeping the limited cost trader rules, but only applying them to those businesses that are *voluntarily* registered.
- 9.15 As set out in Sections 3.7 and 5.3 above, respondents to our survey commonly identified service sector businesses who deal predominantly with the public as being most affected by the financial and competitive burdens of VAT registration. One potential way of addressing these may be to consider implementing the EU 'labour intensive services' scheme<sup>2</sup> in the UK. This scheme gives Member States the option, should they so wish, to apply a reduced rate of VAT to certain 'labour intensive' services, including small repair and renovation services, window and household cleaning, domestic care services and hairdressing. Several countries have made use of this scheme, although to date the UK Government has shown only limited interest. However, now may be an

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<sup>2</sup> These rules were introduced in October 1999 by an amendment under Directive 1999/85/EC  
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appropriate time to revisit it, particularly as the imminent exit of the UK from the EU may provide scope for the services covered by such a scheme to be expanded.

## 10 Contact details

- 10.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson, on 07773 087111 or at [erawson@att.org.uk](mailto:erawson@att.org.uk)

## The Association of Taxation Technicians

### 11 Note

- 11.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,500 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.