

**HM Treasury Call for Evidence:  
VAT Registration Threshold  
Response from the Low Incomes Tax Reform Group (LITRG)**

**1 Executive Summary**

- 1.1 We agree with the findings of the OTS report to a large extent and so support this review of the VAT threshold. We believe the focus of further work should be on the potential smoothing mechanisms to ease the 'cliff edge' aspect of the threshold.
- 1.2 There are so many fundamental changes on the horizon for small businesses to get to grips with in the next few years, such as Brexit and HMRC's Making Tax Digital programme, we strongly urge caution when considering introducing any further substantial changes to the business landscape which will simply just add to further complexity and burdens.
- 1.3 In view of the economic uncertainty that could attend the UK's exit from the European Union, we are concerned that any lowering of the VAT threshold at this time could seriously threaten a small business' ability to remain competitive in its marketplace if its trade is mainly with non-VAT registered customers. In our view, lowering the registration threshold should only be considered if a smoothing mechanism can be incorporated into the VAT system to ease the tax cost and competition issues on crossing the threshold. Ideally, this should be in tandem with simpler VAT accounting and compliance requirements so that the additional administration a business must carry out on a day-to-day basis when it becomes VAT registered does not become too burdensome.
- 1.4 We strongly believe that the prospect of a small business becoming a VAT registered trader is a daunting one for many and so may have the impact of stunting growth for some businesses. But on the other hand, if the threshold is set too low, this may entice some smaller businesses which might otherwise be compliant into the hidden economy due to the overwhelming burden that they perceive VAT compliance to be and because they do not feel they can be competitive in their industry if they have to charge VAT.

- 1.5 VAT compliance can be complicated, daunting and time-consuming for a business of any size and lowering the threshold to bring more small businesses with low turnover within the VAT net may prompt many to seek professional help with their VAT affairs and so drive up their costs for professional services.

## **2 About Us**

- 2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

## **3 Introduction**

- 3.1 We welcome this opportunity to respond to the call for evidence in relation to the VAT registration threshold following the Chancellor's announcement of a review of the threshold and the recent report by the Office for Tax Simplification (OTS).
- 3.2 There are many self-employed traders with turnover at or near the VAT threshold but who make very modest profits and our comments below are made with this taxpayer base in mind, based on our extensive knowledge of this sector.

## **4 Response to consultation questions**

- 4.1 ***Question 1: What experience or knowledge do you have of small businesses managing their turnover to remain below the VAT threshold?***  
***Question 2: Are there, in your experience, particular types, regions or sectors of businesses where this is particularly prevalent?***
- 4.1.1 We are aware that some businesses do legitimately manipulate turnover to stay below the VAT threshold, for example, seasonal businesses such as cafes and restaurants where they

may reduce their opening hours. These are often businesses that have low profits even though their turnover is approaching the VAT registration threshold, who feel they cannot pass the VAT onto their clients by increasing their own prices if they were to exceed the threshold because it would make them uncompetitive. Therefore becoming VAT registered would mean they would need to absorb the VAT as a business expense and so be less profitable, or possibly not a viable business at all.

- 4.1.2 Also tradespeople commonly ask customers to acquire the materials required for a job rather than purchasing them through their own business to manage their business turnover. Sometimes this leads to problems when inferior or inappropriate goods are bought by customers, causing delays and additional work that cannot always be invoiced, thus reducing the profitability of the business.
- 4.1.3 It is also known that a desire to remain below the VAT threshold can lead a business to use casual labour when they need assistance rather than taking on an employee. For example, a joiner may be operating below the VAT threshold. If he takes on an employee (an apprentice perhaps) to help with his work, he will incur the salary and other employment costs that he needs to recover from his customers – as well as hoping to make a profit on that staff member's work. That additional 'income' to cover the costs could easily push them over the VAT threshold limit.
- 4.1.4 We also understand that some businesses deliberately depress turnover to stay below the VAT threshold. Anecdotal evidence suggests this often seems to be the case for domestic trades in particular, where there is huge pressure to quote the cheapest price possible to homeowners to win work. This pressure has increased in recent years following the influx of migrant workers, who have expanded the pool of tradespeople competing for work but who have lower cost bases and so are driving prices down further. In competitive market places such as the home improvement arena, it is not uncommon for jobs to be lost where a quotation is only £50 or £100 higher. Adding VAT could push the price beyond the threshold where the business could make money in their local area. Travelling further afield might yield more work, for example in cities, but that work comes with added pressures, travelling for example, and many tradespeople want to avoid those pressures, if possible.
- 4.2 ***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?***  
***Question 4: As the OTS suggest, does the current threshold contribute to the size of the hidden economy, and how?***
- 4.2.1 There are competition challenges for business-to-consumer traders just over the threshold who cannot pass the VAT onto their customers by increasing their prices. They are therefore forced to absorb the cost. This has a disproportionate impact on those businesses which are already struggling on low profits and may even make them not commercially viable. If this seems likely to be the case, it can lead to businesses ignoring their VAT obligations and not registering, or under-declaring turnover.

4.2.2 However, if the VAT threshold was lowered substantially, we are concerned that some small businesses (maybe those around the £25,000-£50,000 turnover range) may find compliance with all the extra paperwork that VAT entails, plus the added cost of professional assistance to help with the complications of being VAT registered, too burdensome given the size of their profits and therefore end up in the hidden economy. It is possible that a low threshold may act as a disincentive to trade altogether for some who may be considering setting up a small business.

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

4.3.1 See comments above.

4.4 ***Question 6: Does the administration of VAT discourage businesses from registering? Question 7: If so, what are the main aspects of VAT administration that are putting businesses off registering?***

4.4.1 In our view, it is inevitable that the prospect of additional administration arising from being VAT registered will discourage some businesses from registering and so they will manage their business so that they stay below the threshold. The quarterly VAT return process is viewed as time consuming for sole traders, with complex rules to understand or additional professional fees to pay. Many business with turnover around the current registration threshold will be low profit businesses who cannot afford additional expenses such as accountancy fees, but as they fear making mistakes they feel they have to incur them.

4.5 ***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?***

4.5.1 We think there may be a perception that VAT is harder than it really is. While VAT is no doubt complicated, we think concerns about VAT may also be heightened by the amounts of tax involved (often large), the likelihood of a visit from the VAT man (quite likely) and the potential costs of getting calculations and submissions wrong (significant). We suggest that HMRC carry out some research to establish what the main issues are. They could also do more by way of outreach work to reassure businesses about the help available/their compliance approach, etc.

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

4.6.1 We think the current simplification schemes are useful as they can save businesses time and money and improve cashflow. The Flat Rate Scheme in particular is attractive to many, partly due to the simplicity and partly due to the fact that traders could be 'in pocket' when applying the scheme, although this has been largely curtailed by the 'limited cost trader' rules introduced in April 2017. (As an aside, it is worth noting that the Flat Rate Scheme has encouraged some traders to register voluntarily, but this is now less common due to the introduction of the 'limited cost trader' rules. Indeed, some voluntarily registered traders are now de-registering!)

- 4.6.2 However some simplification schemes have been designed for specific trade sectors. Others have been designed to deal with general businesses. Some of the schemes can be used together. They often have different qualifying conditions. For example, cash accounting and annual accounting can be used by businesses with turnover of no more than £1.35 million but flat rate accounting (which can also be used with annual accounting but not cash accounting) can only be used by businesses with turnover of no more than £150k.
- 4.6.3 This creates complexity for people trying to navigate the system and choose the right scheme for their specific business and needs. It would be useful if HMRC could offer more by the way of support and guidance to businesses to help them choose the right scheme for their business. For example, we understand some traders have been put off using the Flat Rate Scheme as they assumed the simplified charge would always overestimate the VAT and so be weighted in HMRC's favour. Better guidance with more examples of the benefits of the scheme would help overcome such perceptions.
- 4.7 ***Question 10: 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?***
- 4.7.1 Anecdotal evidence suggests it is the frequency of the returns that are particularly burdensome. Recent research published by the Federation of Small Businesses shows that calculating the correct amount of VAT is the most time consuming aspect of compliance, so having to do this four times each year exacerbates this. Even though there are relatively few entries to make on a VAT return, the data gathering, analysis and calculation work to arrive at the relevant figures can be considerable. Many small businesses are fully occupied developing and running their business on a day-to-day basis and so do not always keep on top of their paperwork as they go along, which makes the VAT return completion process that much more tricky each quarter. The compulsory compliance with the 'Making Tax Digital for VAT' regime may address some of these issues in due course.
- 4.8 ***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?***
- 4.8.1 It is to be hoped that the compulsion to use digital technology to be compliant with Making Tax Digital for VAT will make the VAT return process more straightforward and less time-consuming once it is bedded in, however there are significant challenges to overcome to get to that point in the meantime.
- 4.8.2 But new technology in itself will not ease the process significantly for those who are not digitally competent or confident, or for those that are digitally excluded (which could be for a variety of reasons such as disability, remoteness of location, etc.) and so exempt from Making Tax Digital for VAT. It would still be necessary to simplify the underlying administration to ease the compliance process for these groups of taxpayers.

4.9 **Question 12: In your experience, what are the sectors, if any, that are particularly affected by the financial costs and competitive disadvantages of registration discussed in paras 3.15-3.20?**

**Question 13: In your view, do these financial costs and competitive disadvantages lead to businesses managing their turnover to remain below the threshold? How significant is this effect on SME growth?**

4.9.1 See comments above.

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

4.10.1 Any proposals which further complicate the rules which determine when you exceed the VAT registration threshold and so are required to register for VAT would almost certainly cause more confusion; education and guidance would be key if these proposals were to be taken forward. A large number of traders do not understand the current registration rules as they think the threshold only needs to be considered at the end of their annual accounting period, rather than in any 12-month period.

4.10.2 On the other hand, any genuine simplifications for those with lower turnover such as those suggested at paragraph 4.7 would be welcomed.

4.10.3 Any significant changes made will need an investment by HMRC in help and support by way of guidance, telephone support, etc. when they are first introduced.

4.11 **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?**

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

4.11.1 We think that both suggestions put forward by the OTS have merit and would like to see further research carried out into the potential effects – both good and bad – on small businesses.

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

4.12.1 No comment.

4.13 **Question 19 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?**

4.13.1 We do not have specific experience of the mechanisms described in paragraphs 4.10-4.15, however on the face of it, graduated VAT rates as per 4.14 could be attractive as they would ease the cliff edge costs to newly registered traders and cushion the initial financial hit

suffered by businesses who cannot pass on the VAT to their clients. Graduated rates of tax are a concept that most traders are familiar with from the income tax regime and so it should be more easily understood than perhaps some other options for change.

- 4.13.2 However there would be numerous practical issues that would need to be addressed in such a system, for example what rate of VAT would be shown on invoices? An invoice showing a lower rate of VAT than the standard rate would indicate to others the level of the business' turnover which may give the business a trading disadvantage. Or would it work more like the Flat Rate Scheme, whereby you charge the standard rate of VAT to customers and pay over a lower rate? How would you get relief for the VAT suffered on expenses, if at all?
- 4.13.3 The introduction of any new system would need to be properly resourced by Government/HMRC to implement the change.
- 4.14 ***Question 20: In your view, are there any other solutions that could work? What are they and why would they work?***
- 4.14.1 No comment.
- 4.15 ***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?***
- 4.15.1 See comments above. It is essential that any changes to the rules regarding the registration threshold are straightforward and clear to all.
- 4.16 ***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?***
- 4.16.1 We agree with the comments made by the OTS if there was to be a substantial increase in the threshold, in that the higher the threshold the more likely it is that a business will be able to cope with being VAT-registered once they cross it (and also the more likely they will want to be VAT-registered in any event).
- 4.16.2 However we believe that lowering the threshold without introducing any other measures is likely just to move the associated threshold problems.