



**CALL FOR EVIDENCE
SIMPLIFICATION OF PARTIAL EXEMPTION & CAPITAL
GOODS SCHEME**

RESPONSE FROM ICAS TO HMRC

25 September 2019

Background

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to the call for evidence 'Simplification of Partial Exemption and Capital Goods scheme', issued by HMRC on 18 July 2018, to explore how changes could be used to reduce the administrative burden on businesses.
3. We are concerned that Partial Exemption Special Methods (PESMs) are overly difficult to agree, with the process sometimes taking many months or even years. Whilst this would be understandable when a taxpayer is seeking to achieve significant VAT savings, our members report major delays where this is not the case. HMRC seem to take a 'tax avoidance' approach to PESH discussions, whilst lacking a sense of materiality. Therefore, in addition to the comments we make on the proposals for change, we believe it would be helpful to improve PE awareness amongst HMRC officers generally and move away from the current situation where PE expertise lies with too small a group within HMRC.

Specific questions

4. Our responses to the specific questions in the consultation, where we have comment to make, are detailed below.

Partial Exemption Special Methods

Question 4: Would allowing businesses to apply PESMs without seeking approval improve the system? Please give reasons for your answer.

5. It is self-evident that removing the requirement for taxpayers to negotiate and obtain approval from HMRC to use a PESH spares individual traders the time required for those negotiations. From HMRC's perspective, their time saving should be considerably greater because of the cumulative effect of being freed from multiple negotiations. However, this change would diminish the protection for the trader from subsequent assessment and penalties if HMRC eventually examine and dispute that it is fair and reasonable.
6. ICAS does not oppose a change which would permit those traders who wish to apply a PESH without the requirement to negotiate an agreement with HMRC. However, we want to see HMRC accommodate traders who require greater certainty by continuing to negotiate and sign agreed PESMs when desired.

Question 5: Would there be issues created by removing the requirement to seek approval of a PESM?

7. As discussed in our response to Question 4, the uncertainty created by risk of subsequent assessment and penalties will be the key concern for traders in using a PESM which is not negotiated with and agreed by HMRC. In our experience, this uncertainty will not be confined to fear of financial consequences, but will extend to the burden of time spent responding to a dispute with HMRC which can be a great distraction from running their business. That is why we want to retain the facility to have a PESM approved by HMRC where that is what the trader desires.

Question 6: Would an increased focus on the use of sectoral frameworks be of benefit, particularly if approvals were removed?

8. An increased focus on the use of sectoral frameworks is attractive. ICAS recognizes the desirability of offering a route which minimizes the time and cost burden on both sides by offering a sectoral method which has been arrived at by HMRC and sector representative bodies in a spirit of fairness. In addition, we want sectoral frameworks to be arrived at pragmatically, with sufficient flexibility to recognize that fellow members of a sector are not identical.
9. If focus on sectoral frameworks is to deliver on its potential to simplify matters for both traders and HMRC, ICAS takes the view that HMRC's resourcing must be addressed. We believe it is important that HMRC engage with traders as they tackle the inevitable issues which will arise as they try to make a sector wide framework operate within their individual business. Not to acknowledge traders' concerns and to leave them struggling unsupported would undermine the prospect of maximizing sectoral framework use.
10. ICAS does not want the use of sectoral frameworks to be mandatory. Those businesses which want to use a bespoke PESM should still be able to do so. It is important that an increased use of sectoral methods does not create a new hurdle for traders who seek to establish a fair and reasonable bespoke method. It would be unfair for HMRC to attack a bespoke method merely on the basis that it differs from the sectoral framework. HMRC should acknowledge that businesses within a sector are not homogeneous.

Increasing the de minimis limit

Question 10: What would the advantages and disadvantages of increasing the de minimis threshold be to business?

11. Since businesses already have the opportunity to ignore the de minimis provisions, those who spend time on de minimis calculations must do so willingly. ICAS takes the view that provided that it is well publicised that businesses do not have to spend time on de minimis calculations if they do not wish to do so, then an uprated limit will be welcomed.
12. Additionally, we think consideration should be given to making de minimis amount a universal allowance so that all businesses can reclaim exempt input VAT up to the limit. Another suggestion is that very small businesses with turnover below £150,000 which is more than 80% taxable should simply be accepted as de minimis.

Question 12: What would be the advantages and disadvantages of removing the de minimis test?

13. The removal of the de minimis test would cut out the time spent by traders in tackling these calculations and the time spent by HMRC in checking these calculations. However, this would be at the expense of those businesses, most likely small businesses, which currently benefit. The attraction of tax regime simplification is undermined when it is at the expense of the small taxpayer.

The Capital Goods Scheme

Question 17: To what extent does the CGS help to prevent cases of tax avoidance and unfair competition?

14. ICAS believes that the CGS plays a role in preventing of tax avoidance and unfair competition, but our members encounter situations where a disproportionate amount of effort is required for the adjustment involved. To illustrate this point, we have been told that the record keeping involved, where there are only marginal changes in the use of a building, is disproportionate to the VAT at stake. The current rules can see a lot of time spent calculating an insignificant adjustment of a few pounds. We also have feedback that a multinational financial services enterprise has to devote considerable time to working out an annual CGS adjustment, which is of little benefit to anyone because the residual recovery rate is relatively static. A reform which might reduce this problem would be only to require a CGS adjustment if the movement in taxable use of a CGS asset was 5% either way – with the option for the taxpayer to opt to make an adjustment for smaller movements.

Question 18: What would be the advantages and disadvantages of increasing the threshold for land and property for businesses?

15. The capital expenditure threshold for land and property was set at £250,000 in 1990. It is now too low, particularly in light of the significant inflation on in property prices since this date. If CGS remains in its present form the threshold for land and property should be brought up to date using an appropriate index– and then regularly reviewed (at a specified interval, say, five years). This would mean that many taxpayers would no longer need to consider CGS.

Question 23: Would removing computers from the CGS be a simplification for business?

16. We do not have any reports indicating that much time is spent deciding if any computer assets require annual adjustment under CGS. The downward movement in cost of computers over the years has seen to this. Therefore, removing mention of computers from CGS will not have a big impact, but it is a logical, and simple, tidy up of the provisions.

Question 25: Would a change in the number of intervals help businesses with their administration of VAT? Why?

17. The disparity in the adjustment period for property and non-property expenditure introduces a complexity which should be avoided. In preparing this response, we have had input from members advocating standardization to a five-year adjustment period for both. We have also received the suggestion of a six-year adjustment period for both to reflect the statutory record keeping requirements for VAT.