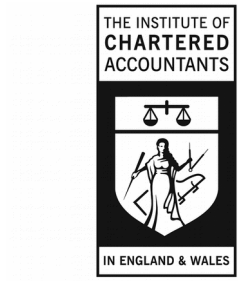

Faculty of Taxation

TAXREP 30/03

VAT: MAKING INPUT TAX RECOVERY FAIRER

Memorandum submitted in September 2003 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document issued in April 2003 by Customs

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VAT: MAKING INPUT TAX RECOVERY FAIRER

GENERAL COMMENTS

1. We welcome the opportunity to comment on the issues described in Customs' consultation document issued on 9 April 2003 and published on their website at www.hmce.gov.uk/forms/budgetnotices/bud-2003/input-tax-recovery.htm.

2. It is important to make the recovery of VAT fairer and simpler for businesses, especially smaller businesses registering for VAT for the first time. We applaud Customs for their proactive approach in putting forward the practical ideas in their paper to improve the efficiency and fairness of the VAT system. It is our belief that if the proposals are introduced the objectives could well be achieved.

3. We note that para 1.5 of the consultation document excludes from the remit of the consultation businesses making exempt supplies, charities making non-business supplies and partial exemption calculation methods. In the interests of simplicity, if the proposals are brought into effect, we would prefer the same rule for all businesses.

DETAILED COMMENTS

VAT on purchases prior to VAT registration

4. We welcome and support the proposed measures relating to an extension of the time limit in respect of the recovery of VAT incurred on services received prior to registration. Extending the time limit to three years, in line with that for goods, would provide consistency of treatment and negate the requirement for the practical solution described in paragraph 3.6 of the paper. This should reduce the administrative burden for all parties.

5. With regard to the proposed amendments to the recovery of pre-registration VAT to take into consideration any pre-registration usage, we agree with the justification for an alteration to the current rules. It is important that both registered and non-registered businesses are treated equally and that both should be entitled to recover VAT incurred in respect of taxable supplies. However, care should be taken to minimise the inevitable additional administrative burden of the apportionment calculations to both the taxpayer and Customs.

6. In respect of the proposal to allow taxpayers to use a fair and reasonable method we note and support the recognition that what is a fair and reasonable method for one business may be wholly inappropriate to another. With regard to the proposed methods detailed in Annex A of the consultation paper, we agree that methods 1, 3, 4 and 5 may produce fair results. However, method 2 appears simply to be a reversal of the current rules, whereby VAT may only be recovered if it is wholly consumed after registration. It seems likely that there will be few instances where this will produce a reasonable outcome. We feel that it is important not to be prescriptive about apportionment methods to be adopted by taxpayers. Perhaps the published guidance in relation to this could make it clear that *any* method that produces a fair and reasonable result would be acceptable and, perhaps list some options that might

be considered. Additionally, we suggest that consideration be given to whether newly-registered businesses will be permitted to use different methods for different assets or will be restricted to one method. For example, a mileage-based method could be used for a vehicle, a time-based method for fixed assets and an income or expenditure-based method for stock. Again, we would suggest that this be made clear in published guidance.

7. As a more general point, the recovery of input VAT incurred by companies pre-incorporation and pre-registration will need to take account of the eventual judgement in the Faxworld case (C-137/02) currently pending in the European Court.

VAT recovery following a change of intention about the use of a purchase

8. There has always been a stark contrast between the clawback and payback legislation in Regulations 108 and 109, VAT Regulations 1995. We welcome the proposed changes to Regulation 109 to enable taxpayers to simply recover by way of adjustment to the VAT return VAT incurred on goods and services where there is a change of intention in respect of the use of that good or service to taxable on their VAT returns.

VAT on purchases and the option to tax buildings

9. We agree that the proposed changes to the restrictive conditions associated with automatic permission to opt to tax would reduce the administrative burden for Customs and a significant number of taxpayers. The proposed conditions will widen the availability of the automatic permission thus reducing the circumstances where correspondence with Customs is required. However, it is of note that this is a complex area of VAT law and a genuine error could prove costly to the taxpayer. Thus Customs may continue to receive disclosures and requests for confirmation of treatment from taxpayers when the sums in question are significant.

10. We are aware that some local offices have been declining to respond to requests for confirmation of the VAT position in relation to, for example, transfers of let property on a "going concern" basis. Of itself, this is of concern and we would welcome confirmation that this does not reflect a move by Customs away from the Charter commitments to be accessible and to assist traders to pay the right amount of tax.

11. We also support the proposed changes to allow a proportion of input tax incurred on building-related costs below £250,000 to be recovered. Our preferred method of enabling this is Option B. Option A involves making amendments to the capital goods scheme legislation. It is worth noting that this legislation is already complex and further amendments may increase the scope for taxpayers to be confused, increasing the chance of errors being made. Creating a new and separate scheme, as proposed in Option B, would appear to present a more readily accessible method, particularly for small businesses. In respect of the threshold suggested in Option A, this appears to be an arbitrary reduction from the £250,000 capital goods scheme (CGS) threshold and a reduction to £nil (as suggested in Option B) may be more sensible.

12. We agree with the observations regarding the disparity between entitlement to VAT recovery by newly-registered businesses and registered businesses and with regard to the differing CGS adjustment periods for each. We support the plans to amend this. The proposed alterations would appear to resolve the issue without placing a further administrative burden on businesses. The amendments to the rules regarding a change from exempt to taxable use would avoid any further disparity being created. Although these changes will inevitably increase or decrease VAT recovery (compared to the recovery which would have been achieved under current rules) for different taxpayers in different circumstances, they would bring the general advantage of clarity and consistency of the treatment of VAT recovery in relation to property.

13. Overriding any simplification in the UK rules governing the obtaining of permission is the question of whether it is necessary under European law to seek permission. This is currently being considered by the European Court. The Official Journal C200 of 23 August 2003 records a referral from the Court of Appeal from the Grand Duchy of Luxembourg (Case C-2669/03: civil proceedings between 1. Administration de l'Enregistrement et des Domaines and 2. Etat du Grand-Duche de Luxembourg and Vermietungsgesellschaft Objekt Kirchberg) in which the question is asked whether sub-paragraph (a) of Article 13C of the Sixth Directive permits a Member State that has exercised the power to allow taxpayers a right of option for taxation in cases of leasing and letting of immovable property to make full deduction of the input tax conditional upon non-retroactive approval of the tax authorities first being obtained.

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