

ICAEW TAX FACULTY REPRESENTATION

TAXREP 16/11

DRAFT FINANCE BILL 2011: VAT – SPLITTING OF SUPPLIES, AND ACADEMIES

Comments submitted on 9 February 2011 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales on the proposed legislation on 'VAT: splitting of supplies' and 'VAT: academies' published as part of the draft Finance Bill 2011 on 9 December 2010.

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DRAFT FINANCE BILL 2011: VAT – SPLITTING OF SUPPLIES, AND ACADEMIES

INTRODUCTION

1. This document sets out the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) on the proposed legislation on **VAT: academics** and **VAT: splitting of supplies** published as part of the draft Finance Bill 2011 on 9 December 2010.
2. These comments were sent to the HMRC officer responsible for this topic on 9 February 2011.
3. They are also included in our comprehensive response to the draft Finance Bill 2011, which is published as TAXREP 5/11 and was submitted to the Exchequer Secretary to the Treasury and to the Permanent Secretary for Tax at HMRC on 9 February 2011.
4. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's ten tenets for a better tax system, by which we benchmark proposals to change the tax system.

WHO WE ARE

5. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
6. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
7. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

KEY POINTS

VAT: splitting of supplies

8. We recommend changes to the legislation so that zero-rated supplies of printed material are only treated as standard rated in appropriate circumstances. Under our suggestion standard rating would only apply if both suppliers are connected and the value of the supply is artificial and not at arm's length.

VAT: academics

9. We believe the current legislation gives too much discretion to HMRC and that the extent of this discretion should be more closely defined so that Parliament can scrutinise the proposals to determine whether they are reasonable. We believe Academies should be put on the same footing as local authorities in relation to the recovery of input tax relating to exempt income.

COMMENTS ON THE DRAFT PROVISIONS – VAT: SPLITTING OF SUPPLIES

10. The legislation regarding the proposed VAT treatment of the splitting of supplies in relation to printed matter is drafted too widely. As it stands, it would require many zero-rated supplies to be standard rated where the supplier had no way of knowing that this should be done.
11. We do not believe that it is the intention of this clause to remove zero-rating from a wide range of books and other printed matter and instead subject them to 20% VAT or convert them into exempt supplies. But it risks starting that effect unless the draft is amended to make it more targeted.
12. The Tax Information and Impact Note (TIIN) in relation to this clause states

‘Policy objective

This measure supports the Government’s objective of making the tax system fairer by closing a VAT avoidance scheme that is being used to reduce the amount of VAT due where a business supplies a service together with printed matter that is ancillary to that service.

‘Proposed revisions

This measure covers, for example, the following situations:

- where the consumer is contractually obliged to purchase the printed matter from one company in order to obtain the service from another; and
- where the price of the printed matter is discounted against the price of the service but if the customer chooses not to take the printed matter they are charged the undiscounted price for the service.’

‘Summary of impacts

This measure will only impact on the small number of businesses taking part in this VAT avoidance scheme.’

13. We can understand why HMRC decided to change the law, but the draft legislation amending the zero-rating provisions in Group 3, Schedule 8 VAT Act 1994 goes far wider than HMRC’s stated intentions. It states:

‘... (2) Items 1 to 6 do not include goods in circumstances where.
(a) the supply of the goods is connected with a supply of services, and
(b) those connected supplies are made by different suppliers.

(3) For the purposes of Note (2) a supply of goods is connected with a supply of services if, had those two supplies been made by a single supplier.
(a) they would have been treated as a single supply of services,
and
(b) that single supply would have been a taxable supply (other than a zero-rated supply) or an exempt supply ...’

14. There is no requirement for the two suppliers to be connected (in the sense of under common ownership), nor that they are even aware of the other’s existence. There is not even a requirement on HMRC to demonstrate that there has been any tax advantage or that there has been any artificial value-shifting.

15. Supplies that would be caught by the draft legislation include the following.
- A newspaper promotional coupon offering a 10% reduction on a restaurant meal.
 - Someone hiring an electrical item from one supplier decides to purchase a book on how to use it from an independent retailer.
 - Someone having their car serviced decides to buy a servicing manual to check that the job has been done properly.
 - A tutor gives a reading list to a group of fee-paying students, who then buy the books from various independent booksellers. The booksellers would not necessarily know that the purchase was linked to an exempt supply of education.
 - Educational course books being purchased by students from a third party distributor. This is a common arrangement which applies to, for example, the supply of ACA and other ICAEW course materials. These are commercial and practical arrangements to make it easier for the distribution of reference material to students. There is no requirement for students to purchase the materials available.
16. In each case the retailer of the zero-rated printing matter would not know, nor have any means of knowing, that there had been a supply of services by a third party to the same customer. It is even difficult to see how HMRC could discover this without identifying and speaking with the purchaser.
17. It would not be acceptable for government and/or HMRC to say that the law would not be applied in such cases. There would still be considerable uncertainty. Taxation by law and relief by concession is not a satisfactory tax policy.
18. If a retailer were assessed, then it would be difficult for him to contest the assessment properly unless HMRC were to provide him with the information on the third party supplier of services. HMRC would presumably not be prepared to do this because of taxpayer confidentiality. But without that information, how could the third party retailer know to what supplies of services his sales of books etc HMRC considered were connected?
19. We consider that the draft legislation should be amended to require, in each case that
- both suppliers are connected (in the sense of common ownership); and
 - that the values for each supply are artificial and not at arm's length.
20. There is also the question of whether the UK would need a derogation under Article 395 of Directive 2006/112/EC before it could introduce the clause.

COMMENTS ON THE DRAFT PROVISIONS – VAT: ACADEMIES

21. We are concerned that the draft legislation gives HMRC too much discretion to make changes.
22. There is no definition of the format or frequency of the claims. The legislation merely states that claims shall be made 'at such time and in such form and manner as the Commissioners may determine'.
23. In addition subsection (1)(3) states that claims should be submitted within four years of the supply being made but subsection (1)(4) then gives HMRC the right to determine a shorter period.
24. We consider that in the interests of certainty the legislation should specify what HMRC is permitted to determine so that parliament can scrutinise its reasonableness.

25. It seems that if an Academy is not VAT registered and makes a claim under section 33B, then it cannot recover any input VAT relating to exempt business activities, whereas section 33 does allow local authorities to recover input Vat relating to exempt income in certain situations. We believe that the legislation should be amended so that Academies can benefit from the same VAT treatment as local authorities.

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APPENDIX 1

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99.