TAXREP 41/14
(ICAEW REPRESENTATION 110/14)

VAT: PROMPT PAYMENT DISCOUNTS

ICAEW welcomes the opportunity to comment on the consultation paper *VAT: Prompt Payment Discounts* published by HMRC on 17 June 2014.

This response of 4 September 2014 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

1. The proposed change in the VAT treatment of prompt payment discounts is likely to significantly increase the administrative burden of dealing with them. We believe that this is likely to lead to many businesses deciding to cease offering prompt payment discounts.

2. It is more likely that purchasers will fail to reduce their input VAT after taking advantage of a prompt payment discount than it is for sellers to fail to reduce their output VAT. The change is therefore likely to result in an overall loss of revenue to HMRC.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Are there particular issues or difficulties in raising and issuing credit notes or revised invoices where a PPD is taken up after an invoice is issued? If so what are they?

3. Businesses that offer prompt payment discounts will quickly become familiar with the new legislation and act upon it, despite a considerable administrative burden in many cases. We would ultimately expect such businesses to make a correct reduction to the output tax declared and issue a credit note if required.

4. A business that takes advantage of a prompt payment discount offered to it is much less likely to be familiar with the new legislation, as it will probably only receive such discounts from a very small proportion of its suppliers. It is therefore much more likely that affected transactions will be accounted for incorrectly. This may result in any credit note not being properly processed, with the consequence that the input tax originally claimed will not be reduced.

Q2: If you have answered yes to Question 1 have you identified any solutions which still ensure that output tax is declared by the supplier on the consideration received and that the customer can only claim the corresponding input tax?

5. A possible solution to reduce the number of omissions might be for any customer taking advantage of a prompt payment to be required to issue a debit note to its supplier as a condition of the discount being allowed. The customer would then be the originator of the adjusting document and much more likely to process it correctly.

6. To ease the burden on its customer, the supplier could produce the debit note, either in hard copy or electronically, and send it to the customer with the original invoice. The customer could then return the debit note with the payment, confirming to the supplier that it had reduced its input VAT by the amount of VAT shown on the debit note. Such a document could effectively be a combined debit note and remittance advice.

7. Alternatively, the supplier could include both the pre discount net and VAT and the post discount net and VAT on the invoice. The purchaser could then post the invoice according to whether or not they were taking up the prompt payment discount and the supplier issue a credit note, where applicable, after receiving payment.

Q3: Are there any particular challenges involved in processing payments and adjusting VAT when discounts are taken up? If so what are they? How might they be overcome?

8. In many cases, the amounts involved are likely to be small and easily overlooked.

9. Prompt payment discounts are correctly accounted for as a selling expense, as opposed to a price reduction. The correct method of dealing with them is to post the full VAT amount when the invoice is raised and to post the discount in full when payment is received.

10. Rather than post each transaction separately, a simplification could be to produce a single journal entry at the end of each VAT accounting period to debit VAT and credit discounts given. Similarly, the purchaser's accounting records could be adjusted by a journal entry to credit VAT and debit discounts received. This treatment should be optional, as it would depend upon how the accounting system was set up as to whether or not individual entries would be required.

Q4: Are there any particular types of supply or arrangements, e.g. self-billing, which may result in other implementation issues? If so what are they? How might they be overcome?

11. We believe that it would be very rare for prompt payment discounts to be offered in relation to transactions that were subject to self-billing arrangements. In such cases, it would probably be normal for the payment to accompany the self-billed invoice, in which case the self-billed invoice would be issued for the discounted price, with no subsequent adjustment being necessary.

Q5: Are there any other implementation issues that may cause businesses difficulties? If so what are they? How might they be overcome?

12. Paragraph 18.2.1 of Notice 700 states:

> *"When you allow a credit or contingent discount to a customer who can reclaim all the tax on your supply as input tax, you do not have to adjust the original VAT charge* ***provided both you and your customer agree not to do so****. Otherwise, you should both adjust the original VAT charge. You should issue a credit note to your customer and keep a copy.*
>
> *If both parties agree, the customer may issue a tax debit note instead of the supplier issuing a credit note. A valid debit note places the same legal obligations on both parties as a valid credit note and must fulfil the same conditions."*

13. If the above facilitation measure continues to be available, clear guidance will be required as to its impact on the new legislation for prompt payment discounts.

14. Ideally, we would like to see this optional measure extended to prompt payment discounts, so that adjustments would not be required to the VAT amounts where prompt payment discounts were offered to fully taxable customers and where both supplier and customer agree. In such circumstances, the purchaser would need to pay the discounted net amount but full invoiced VAT amount to the supplier.

15. Paragraph 18.2.5 of Notice 700 states:

> *"The tax point for credit or debit notes issued by - or on behalf of - insolvent traders, is the date on which the supply was originally made or received."*

16. Given the above, it would appear that where a business offering prompt payment discounts has become insolvent, there will be an additional burden of having to adjust previous VAT returns for any credit note issued as a consequence of customers taking up a prompt payment discount. We recommend that the issue of credit notes and making of corresponding retrospective adjustments should not be required in cases where a supplier has become insolvent.

17. Paragraph 18.2.6 of Notice 700 states:

> *"The tax point for any credit or debit note you issue or receive after the date of cancellation of your registration is the date of the original supply. If this happens after you have already rendered your final VAT return you should contact the VAT Written Enquiries Team to arrange for any adjustments to be made."*

18. Where a business offering prompt payment discounts has deregistered between the date of the original invoice and the discount being taken up by the customer, we recommend that no adjustment should be required. This would eliminate an unnecessary administrative burden for the supplier, customer and HMRC. Otherwise, affected businesses may need to submit repayment claims to HMRC after deregistration for the amount of output VAT on the credit notes issued in relation to the prompt payment discounts offered prior to deregistration. It is also questionable whether such a business should be entitled to issue VAT credit notes after it has deregistered.

APPENDIX 1

ICAEW 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 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)