

Simplification of Partial Exemption & Capital Goods Scheme Call for evidence

Date: 7 October 2019

Sent to: operation.ofPE@hmrc.gsi.gov.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities.

We welcome the opportunity to comment on this 'Call for evidence'.

General Comments

As HMRC will be aware, UK Finance's members have a particular interest in this call for evidence, given that banks and other financial institutions make a mixture of exempt and taxable supplies for VAT purposes and are required to charge VAT, and recover input VAT, on their services accordingly. In practice this is a complex and time-consuming process. For instance, under the Partial Exemption Special Method (PESM) regime, UK Finance members report facing significant uncertainty regarding their VAT recovery position and spend considerable time and resource in getting their PESH agreed with HMRC. For some, the process has taken a number of years, meaning having to file VAT returns on a 'provisional' basis, with risk of challenge continuing for an indefinite period.

The Capital Good Scheme is also of interest to the UK Finance membership. The current thresholds (which have not been updated for approximately 25 years) are considered to warrant urgent attention, whilst the administration of the scheme is thought to merit a more proportionate approach, which is appropriate to the tax risk.

Consequently, UK Finance welcomes this review, and hopes that it may result in reforms to improve the efficiency and administration of both regimes whilst still ensuring that the correct overall amount of tax is collected.

Specific Questions

Partial Exemption Special Methods

1. Does your business use a PESH? If so, what was your experience in getting the PESH approved?

No comments.

2. How long did the approval process take?

No comments.

3. Do you find the administration involved with PESMs challenging?

UK Finance members describe the administration involved with PESMs as 'extremely challenging', 'excessive' and 'unnecessarily onerous'. Particular criticism relates to the lack of a clear process and the inability to set a reasonable timeframe.

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

Yes. UK Finance believes that allowing businesses to apply a new PESH without the need to go through the current approval process would improve the overall process and provide certainty of treatment, allowing organisations the ability to be more responsive to, and change methods to meet, the current circumstances of their businesses. The approach would almost certainly reduce costs for businesses and HMRC alike.

We would suggest that each taxpayer be required to formally notify its PESH to HMRC, with a "fair and reasonable declaration" signed by an authorised signatory. The change could be supported by rules to ensure full disclosure of the method. As with the process in place for approval of the transfer of a business as a going concern (TOGC), where HMRC are given 90 days in which to raise questions on the transaction, there could be a 90-day period to challenge the PESH. HMRC would retain VAT audit powers, which would mean 4 years' worth of PESH calculations could be challenged if determined not to be fair and reasonable. This could run alongside the current approval process for those taxpayers with PESMs already approved or who prefer more certainty.

5. Would there be issues created by removing the requirement to seek approval of a PESH?

A potential issue for taxpayers relates to the imposition of penalties, should HMRC conclude that the method for VAT recovery has not been appropriately applied. For the banking industry, where the bank is an adopter of the Code of Practice on Taxation for Banks, and the 'fair and reasonable' declaration is made, it would be reasonable to assume that error arose despite the bank taking reasonable care.

The 90-day challenge process, HMRC's audit power and HMRC's statutory powers to remove members from the VAT group and issue a Special Method override for the Protection of the Revenue should mitigate risks for HMRC. The current approval process could remain as an option rather than requirement for those taxpayers with PESMs already approved or who prefer more certainty.

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

Sectoral frameworks may be of assistance to small and not particularly complex organisations, to give support to 'fair and reasonable' assumptions where tax advice resource of the taxpayer/PESH experience of tax offices may be more limited. The financial services sector is not homogeneous, so it may be challenging to develop a framework that can successfully cover the breadth of the industry.

To be effective sectoral frameworks should reflect the use of residual input tax by the sector. The current draft Banking Framework is too general and, for the most part, refers financial institutions back to the HMRC internal manual rather than providing an industry specific solution for business to use in PESM discussions with HMRC.

7. Do you have other suggestions to improve or simplify the application of the PE regime?

No comments.

8. Do you have other suggestions on how the way in which HMRC interacts with partly exempt businesses could be improved?

HMRC could provide more training and empowerment to local officers on PESM, or include PESM specialists at an earlier stage in negotiations. Additionally, one of the major factors causing delays is the constantly changing team of experts within HMRC on a particular account. This translates into repetitive and lengthy discussions around business basics, rather than cultivating specific technical tax discussions/decisions that business requires.

To simplify and improve the PE regime, HMRC would have to work closer with trade associations and businesses, to improve the knowledge transfer to HMRC. Lack of sector expertise is also causing delays. The onus is on business to demonstrate why standard values-based method is distortive and the proposed method is fair and reasonable. Therefore, the volume of business information shared with HMRC is significant. It is difficult for an HMRC expert to interpret this information without specific industry knowledge and it falls on the in-house tax team to fill in the, often, material gaps in HMRC's business knowledge.

Adopting a more practical approach that focuses on key material risks would also help with in-house resource allocation. Often the discussions are just as detailed around matters with a maximum amount at stake of £1,000 as they are where the potential liability is in the millions. Given that the industry is under material cost pressures, HMRC could really make a difference by focusing on issues that are material to both parties.

Increasing the de minimis limit

9. What is your experience of carrying out the de minimis test?

No comments.

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

No comments.

11. Are you aware of the existing simplification, and do you make use of it?

No comments.

Removal of the de minimis limit

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

Some members consider that this would be a disadvantage. This is because they rely on the de minimis in operating s43(2A) calculations, which would otherwise be a time consuming piece of work that they would struggle to accommodate on an annual basis.

13. Do you have other suggestions to improve or simplify the application of the de minimis regime?

No comments.

14. Do you have any suggestions on how to determine what can be considered as 'insignificant' that would be different to the current de minimis tests?

No comments.

CGS Thresholds

15. What is your experience of the CGS?

The experience of the CGS varies for UK Finance members. Commonly members have indicated that the process is "convoluted", "time consuming" and necessitates "a largely manual invoice review". Others have suggested that the "annual calculations are relatively straightforward". All members are, however, agreed that the requirement to retain information for numerous assets over 10 years seems unnecessarily onerous.

16. How much time and resource do you allocate to carrying out CGS calculations? Does this have an impact on your business?

The general complaint of the UK finance membership relates to the resource intensiveness of the CGS calculation which isn't proportionate to the tax at stake. For instance, a member notes that "The computer element of the CGS, last year, took our organisation's VAT accountant approx 36 hours and resulted in an adjustment of less than £10. This diverted time from more value-adding assurance and governance work."

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

UK Finance can only comment on its own members' experiences, and a great number of the UK Finance membership are governed by the Code of Practice on Taxation for Banks.

We are doubtful that the computer element of the CGS helps prevent any cases of tax avoidance or unfair competition. While it may have done so when first introduced, given the dramatic fall in the value of computer hardware and the rise of cloud storage since the implementation of the CGS scheme it seems less probable now.

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

It would be beneficial for HMRC and taxpayers in terms of time saved for more valuable work, if the trigger points could be increased to reflect inflation since they were introduced. The main advantage is that there would be fewer qualifying assets and therefore the number of properties in

the CGS would reduce. There would also be a benefit in limiting taxpayers' information retention obligations. We see no disadvantages in raising the trigger points for land and property: it would simply allow HMRC and taxpayers to concentrate on the higher value transactions.

19. Would there be any other issues involved with increasing the land and property threshold?

No comments.

20. If the threshold for land and property is increased, do you think we should consider having a different threshold for alterations, extensions, annexes and refurbishments, (i.e. retain the current threshold) or would it increase complexity?

No – such an amendment would only add complexity to a process that is already complex. It would be preferable for the limits to be increased for all property CGS items, including annexes, alterations, extensions and refurbishments to the same value, otherwise the scheme would be more complex to administer for no obvious advantage to HMRC or taxpayers.

21. Are there other ways in which the CGS can be improved?

A number of options have been proposed by UK Finance members, including:

- The CGS could be removed and replaced with an anti-avoidance measure.
- A de minimus rule could be introduced so that businesses only have to carry out the CGS calculation if their VAT recovery rate moves more than 10% in the period.
- The CGS threshold could be increased to £250k VAT cost, from its existing £250k net cost.
- Reduction in the number of intervals for refurbishment/fit out works and the number of the intervals alignment to UEL according to accounting standards. For example, capitalised refurbishment works are likely to have 5 years UEL for the accounting purposes but still have 10 intervals for CGS adjustments.

Categories

22. Do you have experience of computers being included in the CGS?

Some members have experience of this, to the extent that servers are included in the definition of the computer and could cost more than £50k.

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

Yes. Given the short lifespan of such equipment and importance of software (rather than hardware), the 5-year adjustment period seems excessively long.

Intervals

24. What do you think of the current interval length?

Having to prepare the time consuming CGS calculation each year for 5 years, for immaterial VAT movements, is an ineffective and inefficient use of business resource.

For property, it seems inconsistent that records need to be kept for 10 years, when all other tax records are only required to be held for 6 years. As such, we would propose a 5-year adjustment period for property, to align with the tax records retention obligations and to keep the CGS calculations straightforward.

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

Potentially reducing the number of periods would help businesses. However, unless the CGS was removed entirely for computers, this would still be a time-consuming exercise for businesses.

Other possible areas to review

26. Do you have other suggestions to improve and simplify the application of the PE and CGS regime?

No comments.

27. Do you have any experience of the operation of PE and the CGS in other countries? How does the UK compare?

No comments.

28. Do you have any other comments?

N/A

If you have any questions relating to this response, please contact Sarah Wulff-Cochrane at sarah.wulff-cochrane@ukfinance.org.uk.

Sarah Wulff-Cochrane
Principal, Tax Policy