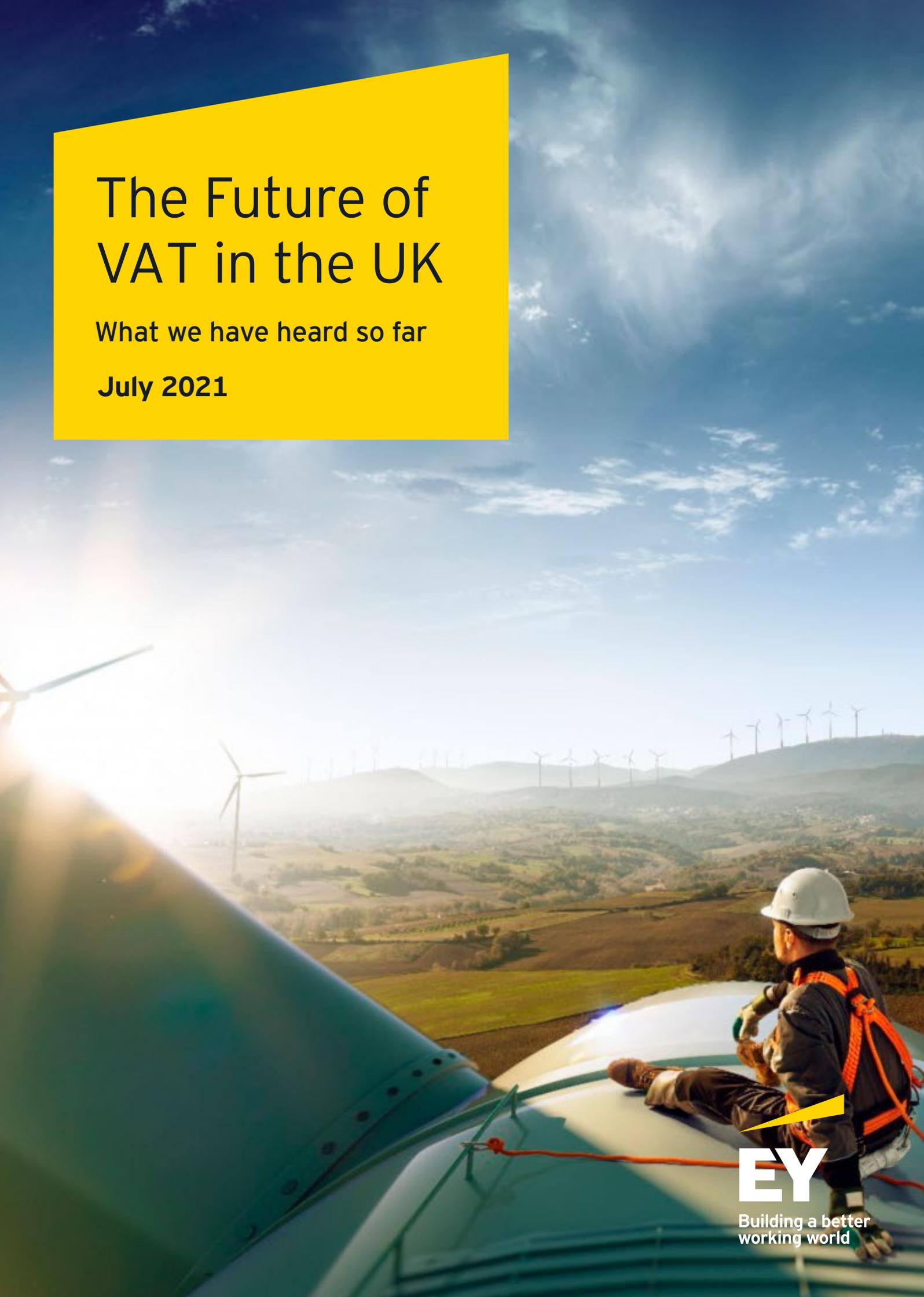


The Future of VAT in the UK

What we have heard so far

July 2021



EY

Building a better
working world

Welcome to the Future of VAT

I am excited to share an update on our work on the Future of VAT in the UK. This interim report provides an update on what we've heard through our Future of VAT in the UK survey, conversations with clients, discussions with sector groups, and at an EY Leaders in Indirect Tax event with HMRC.

I am delighted to have had positive engagement from such a range of business sizes and sectors, and this has given us a really rich picture of the challenges and opportunities in the VAT regime. It has also shaped our next steps in the Future of VAT in the UK campaign and this report outlines the deep-dives we are embarking on and how you might get involved.

The breadth of engagement underlines the importance of VAT for business and reflects the interest in VAT when the UK stands at a crossroads: COVID-19 has brought unprecedented challenges to the economy; the end of the Brexit transition period brings new opportunities to change the regime; and HMRC's aspiration to move towards real-time reporting by 2030 provides a possible vision for the future of tax. In addition, governments across the world are seeing the opportunity to use indirect taxes to accelerate behavioural change, with an increased focus on sustainability.

By bringing together the views of over 340 organisations across a wide-range of sectors, our aim is to influence policy in relation to the future of VAT in a way that reflects the needs of businesses, whilst recognising the regime must deliver the Government's policy objectives. VAT has a crucial part to play, from supporting vital public services to smoothing the path for digital tax compliance and encouraging sustainable consumer and business behaviours.

More exciting still is that we are only at the beginning. We will be engaging further with business and HMRC to delve deeper into the feedback we have heard, and solidify thoughts before we share our proposals. Our hope is our final report could help shape the future of VAT in the UK, contribute to making the UK a successful and competitive economy and deliver our purpose of *Building a better working world*.

Together, let's make the future of VAT one that delivers for business and society.



Jamie Ratcliffe

EY UK&I Indirect Tax Leader

Our key findings

The Future of VAT in the UK survey was live between April and May 2021 and we received 346 responses. These came from small not-for-profit organisations through to large multi-national businesses across sectors, ranging from financial services to agri-food to consumer products. During this period, we also conducted wide ranging conversations with clients, sector groups and held a Leaders in Indirect Tax event, involving 35 of our largest clients with HMRC in attendance.

Headlines from our survey

Survey respondents had strong views on some of our key questions. We have summarised some headline statistics below. (Percentages are based on total responses to each question which varies by question).

VAT remains the preferred option



Only 6% would support replacing VAT with another indirect tax.

Making Tax Digital has made compliance more costly



72% found that the cost of UK VAT reporting has increased over the past five years.

Brexit can unlock opportunity



75% agree that Brexit is an opportunity to reform the UK's VAT system.

Real-time reporting takes time



60% think that it will take at least two years to prepare their business for real-time VAT reporting, with 22% indicating that it may take more than four years.

HMRC compares favourably



62% found HMRC more accessible than overseas tax authorities.

VAT can be a force for good



54% support the wider use of temporary zero-rating and many see its potential for driving sustainability.

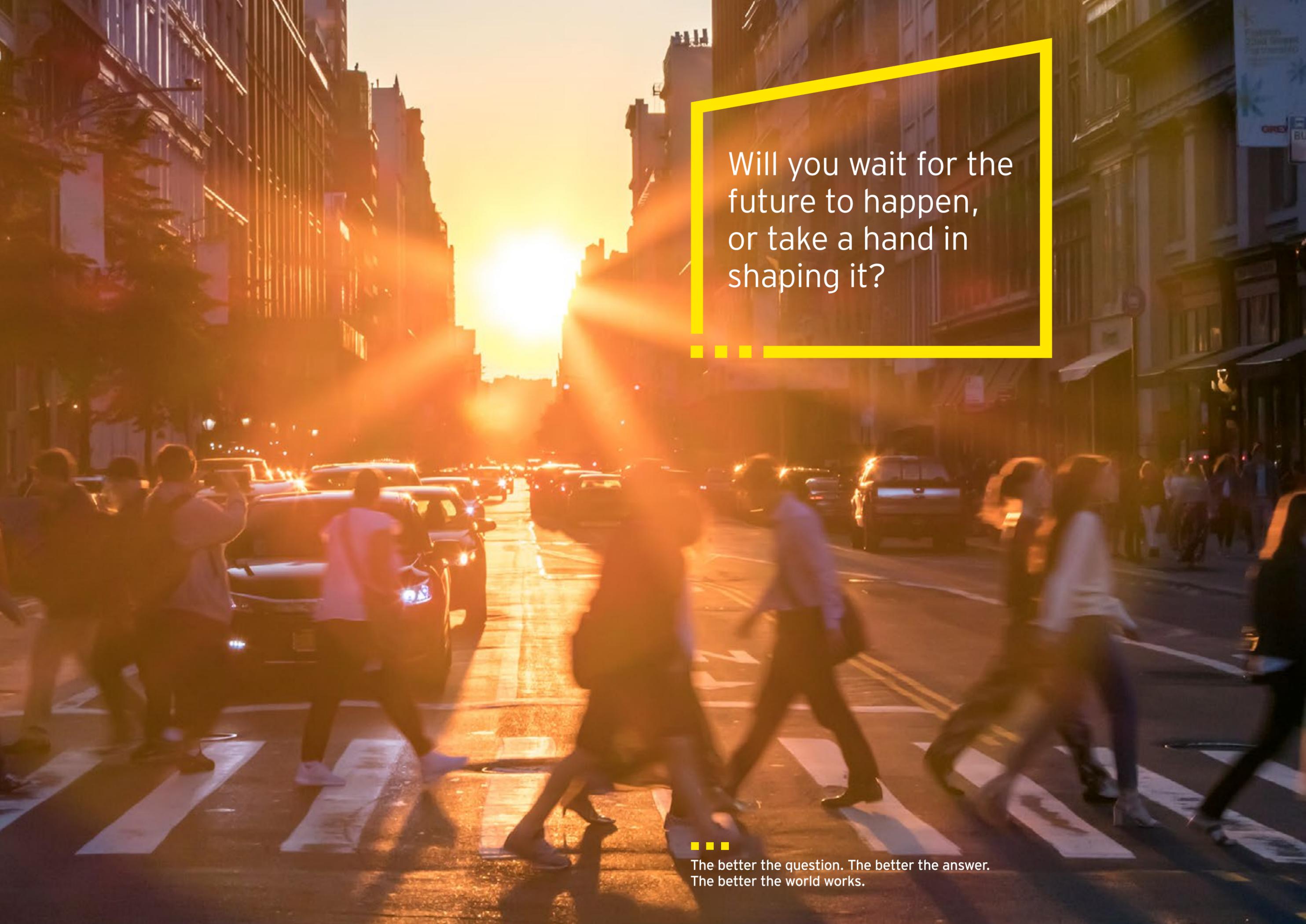
Scope of survey reach



Ripe for reform

We asked respondents to indicate their support for reform in a list of areas of the tax. Based on these responses the top five areas for reform are as follows:

- 1 Partial exemption
- 2 Land and property
- 3 Capital Goods Scheme
- 4 VAT exemptions
- 5 VAT recovery

A photograph of a busy city street at sunset. The sun is low on the horizon, creating a strong orange and yellow glow that silhouettes the buildings and people. Pedestrians are crossing the street, and cars are visible in the background. A yellow rectangular text box is overlaid on the right side of the image.

Will you wait for the future to happen, or take a hand in shaping it?



The better the question. The better the answer.
The better the world works.

In more detail

From written responses and client feedback, four clear themes emerged:

1 The UK as a digital tax administration

In July 2020, HMRC made a clear statement that it aspires to deliver a fully digital tax system. A move to some form of real-time reporting for VAT by 2030 is highlighted as a key element of this aspiration.

Steps towards this digital future have included Making Tax Digital (MTD) for VAT and whilst there have been some positives, such as better data quality, automation and time savings, respondents believe that the MTD rules are relatively 'light-touch' compared to other jurisdictions which have moved to or are moving towards real-time reporting.

MTD has increased the cost of VAT compliance and, looking further afield, the different approaches taken by tax authorities across the globe is making the future proofing of enterprise resource planning (ERP) systems and processes difficult and costly for businesses.

Businesses are currently unsure whether HMRC's target of real-time reporting by 2030 is an achievable aim. They are concerned that HMRC have not yet provided a roadmap or clear milestones to meet this ambition. Two of the biggest challenges are technology constraints and the timeframe required to bring systems in line with expectations.

A number of businesses have encouraged HMRC to be ambitious in their plans for digitisation but cautioned that HMRC must give certainty well in advance to give businesses enough time to prepare, which will include securing internal budget for changes and implementing and testing changes.

Continuing the debate

In preparation for our final report, we will undertake a deep dive into **the future of UK VAT as a digital tax**, including consideration of:

- ▶ The future of Making Tax Digital
- ▶ Preparing for real-time reporting by 2030
- ▶ Exploring the introduction of split payments



“
To do this HMRC need to set out a clear plan with clear milestones.

Survey respondent

“
The post-COVID environment is much more well-aligned to online and automated reporting/working.

Survey respondent

2 VAT as a driver of change

Throughout its history, VAT has been used as a lever for social and other objectives, in particular with the use of zero and reduced rates. In recent times we've had some reminders of what is possible, but it feels like so much more could be achieved.

The response to the COVID-19 pandemic included the introduction of a temporary VAT reduction for hospitality and leisure and the temporary zero-rating of certain personal protective equipment (PPE). We also saw the zero-rating of women's sanitary products from 1 January 2021.

This use of VAT as a driver for positive change may become more commonplace, particularly in relation to sustainability. Our survey responses indicate a support for the use of zero and reduced rates in the right circumstances and a widespread recognition that VAT has a role to play in driving positive change. This is a fact that HMRC also acknowledges: in a presentation as part of the Leaders in Indirect Tax event in June, HMRC stated that "VAT can respond to policy challenges" and support "wider government priorities such as carbon net zero and health".

Our work to date shows that businesses are well aware of this shift and are very positive in encouraging HM Treasury to consider using the VAT system to accelerate behavioural changes from businesses and consumers in relation to sustainability, as well as wider issues such as wellbeing.

Businesses also indicated that they would be open to seeing VAT being used to support specific sectors with temporary VAT rates. However, there were concerns that temporary rates may create additional complexity for systems and administration, and as a result these changes would need to be introduced in a targeted and proportionate way, with appropriate consultation. The complexity in this area was also recognised by the Office of Tax Simplification (OTS). Changes in this area should consider the complexity and potential for distortions of competition.

Continuing the debate

In preparation for our final report, we will undertake a deep dive into **how UK VAT can be used to promote sustainability**, including:

- ▶ The use of input tax provisions
- ▶ The use of zero and reduced rates for specific purposes



“
I would have no issue with a higher rate of VAT for products/services that are bad for the environment.

Survey respondent

“
Complexity might outweigh benefits.

Survey respondent

3 UK VAT in the international context

Whilst three-quarters of respondents agreed that Brexit represents an opportunity to reform the UK VAT system, a common concern from responses was the extent to which it is desirable to diverge from the EU VAT system, particularly in relation to cross-border rules, where there are clear advantages to remaining aligned to the EU rules. Divergence from the EU system should be carefully planned to avoid mismatches which lead to potential double taxation and undue system complexities.

In addition to considering issues around divergence from the EU system, many businesses are increasingly viewing VAT from a global perspective, especially from a data point of view. Some suggest the UK should work at a global level, for example through the Organisation for Economic Co-operation and Development (OECD), to advocate for global alignment of data requirements for indirect tax reporting. The tax landscape is becoming increasingly global and therefore it is essential that the global perspective is appropriately considered as the UK moves to change its VAT system. Clearly, there is much room for discussion and further consultation, perhaps on a scale unseen to date with domestic changes, to ensure any changes do not come with unforeseen consequences.

Continuing the debate

In preparation for our final report, we will undertake a deep dive to consider the optimum **alignment of the UK VAT system with other global tax regimes** with a view to making the UK more competitive. This will include:

- ▶ The impact of divergence from the EU VAT system and the potential for mismatches and double taxation
- ▶ Global alignment, including data requirements



“ Now the UK is no longer burdened by having to comply with the VAT Directive; the UK can simplify the tax and reduce cost to business.

Survey respondent

“ I would not want to see the UK VAT rules diverge significantly away from the EU VAT system to avoid additional complexity and mismatches.

Survey respondent

4 Clarity, consistency and certainty

Whilst there is currently very little support from respondents for replacing VAT with another indirect form of taxation such as a sales tax, there are clear concerns that the system is overly complex and outdated. In particular, in relation to certain domestic areas such as VAT exemptions, which figured highly in our survey in terms of the areas most in need of reform.

Our respondents would like to see changes in these areas but want change to be carefully targeted at removing uncertainty and inconsistency. Concerns were expressed by a number of respondents that blanket simplifications, for example the removal of an aspect of the tax, like an option to tax, could create an unintended adverse impact.

Our survey and associated conversations also considered the role of HMRC and the relationship between HMRC and business. Measured against tax authorities across the world HMRC compared favourably in most areas, in particular where a business has a Customer Compliance Manager in place. Respondents did highlight that HMRC's guidance and other communication could be improved and that uncertainty around the application of MTD, including related compliance activity, is currently a challenge.

Continuing the debate

In preparation for our final report, we will undertake a deep dive to consider **HMRC relationships, communication and collaborative policy development**.

We will also undertake a deep dive to explore **specific technical areas and potential reform**, for example partial exemption, Capital Goods Scheme, land and property and financial services. Our deep dives will build on existing HMRC consultations and calls for evidence, where relevant.



“ The current system works but is too complicated and subsequent developments have made it more and more complicated.

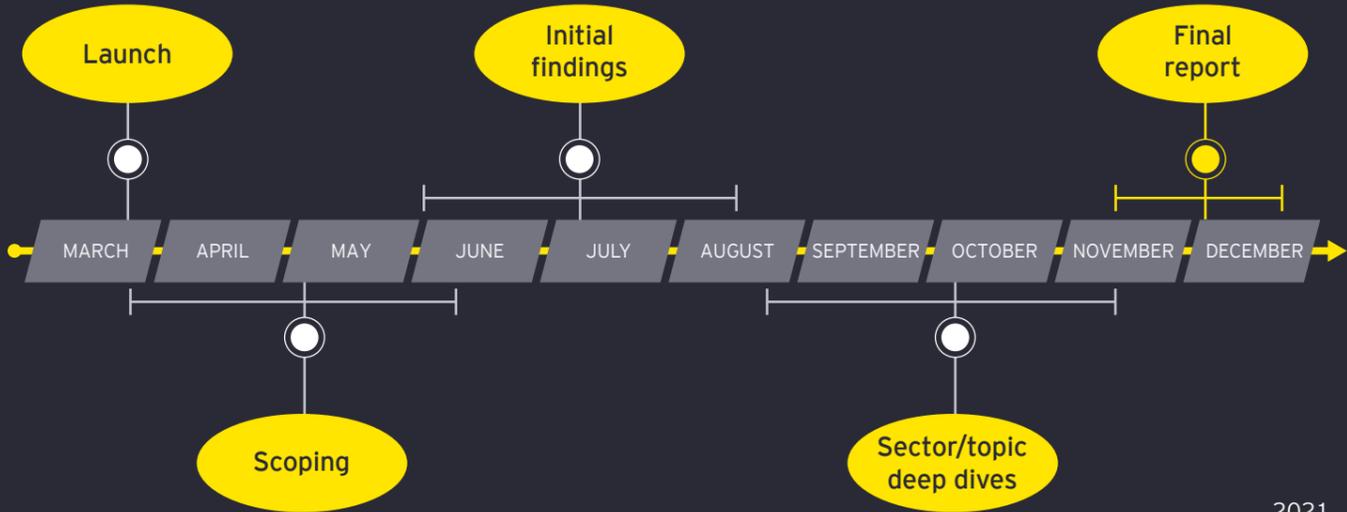
Survey respondent

“ The UK could get a significant competitive advantage from having a straightforward VAT system for the (financial) sector.

Survey respondent

Next steps

As we reach this point in our work on the Future of VAT in the UK we are really encouraged by the interest shown by businesses, and HMRC, and have high hopes for positive change in the regime. Our deep dives will take place during late Summer and into the Autumn and by the end of the year we will publish a final report that summarises the concerns, challenges and opportunities we have heard; articulates our view of the priorities for the regime into the future based on the feedback that we hear from our respondents; and considers short- and long-term changes that could help the VAT regime play its part in the future of the country and how these priorities can be achieved. As our work develops over coming months we may also publish articles on specific priority issues in advance of the final report.



2021

Get involved, get in touch

We would love for you to be involved in the next stage of this conversation.

Our deep dives will include further one-to-one conversations, focus groups, workshops and sector meetups and may also include targeted surveys.

If you would like to be involved in one or more of the deep dives, please indicate your interest through our [response form](#).

Deep dives summary

1. The future of UK VAT as a digital tax
2. How UK VAT can be used to promote sustainability
3. The alignment of the UK VAT system with other global tax regimes
4. HMRC relationships, communication and collaborative policy development
5. Specific technical areas and potential reform

If you have already been involved, we will stay in touch with the latest developments as we move through the rest of the year. If you have not been involved yet or want to add further insights, please get in touch with your usual EY contact or the Future of VAT in the UK team at futureofvat@uk.ey.com.

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