Office of Tax Simplification (OTS) VAT Review

Charity Tax Group response to the Call for Evidence

26 June 2017

Overview

1. The Charity Tax Group (CTG) has over 500 members of all sizes representing all types of charitable activity. It was set up in 1982 to make representations to Government on charity taxation and it has since become the leading voice for the sector on this issue.

2. CTG welcomed the opportunity to meet members of the Review team during the consultation period and would be very happy to arrange additional meetings to discuss this response.

3. CTG welcomes the efforts being made to reduce unnecessary bureaucracy and to simplify the VAT system. This is long overdue and reform would have a positive impact in terms of administrative costs for charities. However, this support is contingent on reforms helping charities and not resulting in additional costs, or the loss of special privileges such as zero rating. In our view, it is crucial that, in considering the direction of reform, the OTS and HMRC take into account the fact that the differing needs of different types of charity have to be considered – there may not be a "one-size-fits-all" solution.

4. At our meeting with the Review team we welcomed the confirmation that the project had evolved since its inception and was now very much intended to contribute to the Government's thinking on VAT in the post-Brexit landscape. This provides the Review with an important opportunity to look at long-standing policy issues as well as pure administrative simplifications, and, in particular, the structural obstacles facing charities in the VAT system.

Charities and VAT

5. The VAT system treats charities differently depending on the types of service they provide and whether or not they charge for their services. Those that do not charge are treated as the final consumer even when they are not. As a result, they are unable to recover VAT on purchases (input VAT) made to support their activities. Most of the charities that charge for their services also suffer from irrecoverable VAT because their services are exempt.

6. According to estimates by CTG, charities in the UK lose approximately £1.5bn a year in irrecoverable VAT. This would be even higher were it not for reduced and zero VAT rates and the limited s33 refund schemes. Although these reliefs and refund schemes are vital, they are unsatisfactory in that they create a more complex VAT system, which has made limited progress in reforms and simplifications

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due to the need for unanimity on tax issues at a European level. Full exemption with refund for charities would be fairer, easier to understand and simpler to administer.

7. The current VAT system has a detrimental effect on the work of charities in the UK. The economic crisis, recent increases in VAT, and funding difficulties have put the sector under significant financial strain. This is all the more important because, in the UK, we observe growing pressure on charities to play a greater role in providing social welfare services and on foundations to help support such work. The current system massively disadvantages charities as it favours the provision of these services by public bodies that are entitled to a refund of VAT while charities cannot recover VAT costs where the service is VAT exempt or financed by grants. The current VAT system is distortive for charities to the extent that there are differing impacts on the different types of charities, depending on how they operate and the activities they undertake (including whether their supplies are exempt or non-business and whether their activities are staff-intensive or require supplies to be bought in). This results in an uneven playing field, particularly when compared to public bodies or commercial enterprises.

Charity Output Rate

8. In an ideal world, the aim should be for VAT to be charged on everything (whether at 0%, 5%, 20% or other rates) so that all VAT can be recovered by VAT-registered businesses and all the complicated schemes such as partial exemption, options to tax, capital goods schemes, tour operators margin schemes etc could be abolished. There could then be a special refund scheme for charities in relation to their non-business activities. It would be limited to the charity's primary purpose activities and would satisfy other requirements e.g. public benefit. Many charities which undertake exempt activities as part of their primary purpose (e.g. welfare) could have a reduced rate of VAT charged on their services (e.g. 5% or less) to make these into taxable business activities for VAT purposes and allow full VAT recovery. Other exempt income e.g. domestic lettings would probably need to remain exempt.

Charity Input Rate

9. Another reform option would be to extend the existing reduced and zero rates on supplies to charities to cover all supplies to charities in addition to the reduced rate for supplies by charities (and the European Commission proposed such a reduced rate in the early 1990s which only narrowly got defeated by the Council of Ministers). To avoid market distortion, this should only apply to costs incurred by the charity on its charitable purposes, and not for trading with a view to generating resources, or property investment. This would have to be referenced against a charity's objects. Given that this would help reduce the structural anomalies in the system that affect the work of charities, we urge the Government to consider introducing this important reduced rate as it would significantly reduce the complexity of the present system as refund schemes would not be needed as there would be relief at the point of access. We recognise that there is some potential for complexity (because, for example, every charity would have to provide a certificate to every supplier it dealt with, and there would be a burden on every supplier to check whether they were supplying to a legitimate charity) but we strongly believe this is worthy of further consideration and modelling.

Refund Scheme

10. If the proposals in sections 8 and 9 above could not be introduced, an alternative could be a refund scheme to remove the irrecoverable VAT burden from charities. This has been one of CTG's long-

standing proposals. Almost all the other simplification issues discussed elsewhere in this consultation response would be irrelevant if charities were taken out of the VAT system in this way. What would this look like in practice?

11. There is an important precedent for refund schemes within s33 of the VAT Act 1994 and CTG believes that relieving the VAT burden on charities would ultimately lead to savings in respect of Government funding, which is often required to fund irrecoverable VAT somewhere down the line. Previous research by CTG has indicated that up to 92% of expenditure by charities relates to areas in which Government has responsibility (and this has probably increased further given the amount of outsourcing of services to charities by local and central Government) and that there would be a considerable additional financial burden for Government if these services were not being provided by charities. Such a refund scheme would be relatively easy to administer – suppliers would charge VAT in the normal way and charities would then submit their own claims for a refund of VAT through their normal quarterly VAT returns. This would also allow HMRC to verify the legitimacy of the claims made by each charity. If there were an issue about VAT reliefs for certain charity sectors this could be dealt with by introducing a positive rate of VAT e.g. 5% rate whilst allowing full input VAT recovery. It is important to note that a VAT refund scheme would not necessarily need to be a refund of 100% of the VAT, if this were felt to be too costly. The refund could be reduced to a lower percentage based on affordability. While charities would prefer a full refund any mitigation of the current irrecoverable VAT burden would be extremely helpful.

Consultation Questions

12. As outlined in the introduction to this response we think the aim should be for wider structural reform of the VAT system to minimise the range of services which are exempt from VAT, so that the need for complicated partial exemption methods and special schemes is removed (with limited exceptions where still useful).

13. The comments on the existing VAT system are included to inform the current debate, but should be read in the context of improvements to the existing rules, rather than an endorsement of the current system *per se.*

14. Please note that we have only responded to those questions that we feel are most directly relevant to charities.

1. Identifying the implications of the level of the registration threshold

Question a: no comment

b) What would be the impact of raising the threshold significantly? With and without the option for voluntary registration?

- CTG believes that charities would generally prefer a higher threshold (as many do carry out taxable supplies but, in many cases, fall below the registration threshold comfortably), but would probably be happy with the status quo too.

- Increasing the threshold reduces administrative costs and complexities for charities as it could relieve them of the need to be registered.

c) What would be the impact of reducing the threshold significantly? How would HMRC and businesses who were brought into the VAT net manage?

- Were a lower threshold to be introduced, it would be very helpful if charities were allowed to share resources, such as staff and IT, with their trading subsidiaries, without any charges for this counting towards the VAT registration threshold. This would be a helpful step regardless of the VAT registration threshold.

- In general, it would be useful to apply a higher registration threshold for wholly-owned charity trading subsidiaries that, for administrative reasons and function, exist only to support the charity. This is because charity law requires certain activities not to be carried out by the charity, which creates an extra burden for charities that should be recognised in VAT law.

- Another solution would be to change the rules so that zero rated supplies do not contribute to the VAT registration threshold, with only positive rated supplies included. This would have a material impact on charities, owing to taxable supplies often being of books and other printed materials.

- At our meeting with the Review team it was understood that consideration could be given to charities enjoying a higher threshold than commercial businesses. We therefore request consideration of the possibility of a special charity registration rate at a higher level (perhaps at £150,000 in line with the VAT flat rate scheme).

d) In both cases what would be the impact on economic activity?

- Charities do use small traders and in practical terms benefit marginally from higher thresholds that allow their suppliers not to charge to charities. We acknowledge however that this does distort the market.

Question e: no comment

2. Multiple VAT rates: causes of complexity?

Questions a – f: no comment

At our meeting with the Review team there was a request for feedback on any existing reduced and zero rates.

Zero Rates and unwarranted complexity

- We acknowledge that, while the UK is a member of the EU, the scope of the zero rates cannot be changed. This explains the often piecemeal nature of the zero rate provisions. Following the UK's departure from the EU we anticipate that it will be possible to tidy up these provisions. CTG hopes

that they would be tidied up in a generous spirit, and believes that this would be unlikely to give rise to significant or meaningful reductions in government revenues.

- We should point out that CTG has considerably higher ambitions for more general zero rate reliefs than mentioned here, but we offer this as a 'stand-alone' item which can be reviewed on its own merits. The sections of Schedule 8 VAT Act 1994 falling under this heading are Groups 4, 5, 12, and 15.

Group 4 – Talking books for the blind and handicapped and wireless sets for the blind

- Item 1 refers to 'magnetic tape', which is somewhat akin to referring to transport on a steam train. The references should be changed to any device or apparatus which has design features only made necessary for those suffering from conditions which necessitate the use of sound recording as a substitute for reading. This would obviate the need for all the detail currently featured in item 1(a)-(i). It would also allow the removal of the ambiguous word 'blind' (the meaning of which has shifted over the decades) and of the tainted phrase 'severely handicapped', which is not only socially unacceptable, but ambiguous. We also see no functionality in mentioning the Royal Institute for the Blind or the National Listening Library, as exemplars of the kind of charity that could benefit. It should be assumed that any charity that buys such equipment has a legitimate interest in the product.

- Item 2 suffers from the same defects as item 1. Our suggested formula for item 1 would appear to remove the need for item 2, since it would then be subsumed.

- Having said this, our proposed reforms for Group 12 would almost certainly remove the need for Group 4 entirely.

Group 5 – Construction of Buildings etc

- We acknowledge that the charitable aspects of Group 5 are part of a much wider review that could be carried out, and which covers all non-commercial classes of building (within a social relief). We do not wish to attempt, in this response, to suggest any entirely new scheme. However, the questions that are particular to charities are the definition of 'relevant charitable purpose' and the definition of 'annexe'.

- Relevant charitable purpose (RCP) has caused great confusion over the years and is often used by charities only to determine this relief (but including the disapplication of the option to tax) and the reduced rate for fuel. Up to the Court of Appeal decision in *Longridge on the Thames,* there was much uncertainty, but at least a useable degree of latitude in its meaning, when considering the limb relating to activity 'otherwise than for business'. The current position, which equates 'business' with the EU definition of 'economic activity' restricts its use very severely. We believe that there is scope for a definition of 'non-business' which is decoupled from the concept of 'economic activity' for the purposes of whether an activity is generally within the scope of VAT.

- The simplest approach would be to move to the concept that RCP will include any primary purpose activity or trade (PPT), also incorporating activities that are ancillary to primary purpose. This will align the VAT relief to the direct tax exemption. This reflects the common misunderstanding in

charities that RCP and PPT are the same thing. If they were made to be the same, that would solve this problem, and produce a more logical tax policy. We acknowledge that it would make the relief more 'generous', but it would be considerably more logical.

- If that is not acceptable, we believe that principles along the lines of the 'Lord Fisher' tests could be incorporated specifically into the legislation. These would not be any easier to interpret than before but they would have the beneficial result of reviving a now substantial corpus of case precedent that has been effectively marooned by the *Longridge* decision. We would be happy to discuss any practical ideas to make this suggestion work.

- The 'village hall' limb is in need of modernisation but would be obviated if the PPT definition of RCP were adopted. Otherwise, we believe that there is a need to refer to a 'community centre' rather than 'village hall' (which essentially requires the user consciously to decide that their property is covered by the relief, despite not being what anyone would refer to as a 'village hall'). Furthermore, we believe that the errors into which HMRC has fallen in interpreting 'village hall' (see *Caithness* and *New Deer*) have arisen from this nomenclature. If the category covered any charity-run facility operating mainly or solely as a local community facility, (irrespective of its governance, the exact range of activities arising therein, or its exact layout and facilities), this would be much more useable, at relatively little cost to the government.

- The definition of 'annexe' given in note 17 has caused problems over the years. How is one to determine whether the annexe has separate functionality (which, notoriously, has often appeared to be determined by reference to whether it incorporates its own lavatories)? One has to consider whether the main entrance is through the existing building or by its own separate door (an issue that is often impossible to determine since paths people take to various locations depend on quirks of human and herd behaviour). Such things over-complicate the definition and lead to no real benefit to charities or government. We assume that the restriction of the relief to annexes was intended to make this compliant with EU VAT law. After Brexit, this will no longer be a concern and the relief can be made available for extensions as well as annexes and new build. This will greatly simplify the arrangements.

Group 12 – Drugs, medicines, aids for the handicapped, etc.

- This group has the greatest incidence of piecemeal and out of date application, insofar as it relates to equipment or adaptations for disability. It is also high time that the word 'handicapped' was removed from the legislation.

- Its main defect is that it mentions specific kinds of adaptation and then limits these, in some cases, to specific kinds of location. This inevitably causes the legislation to fail to move with trends in assisting disabled people. The group is very long and is often seen as being designed as much to deny relief as to grant it.

- We suggest that there should be a statutory definition of 'disabled'. We understand that the DDA defines this as *"a physical or mental impairment which has a substantial and long-term adverse effect on a person's ability to carry out normal day-to-day activities".* This could be adopted as the VAT definition. The zero rate could then be made to apply to any adaptation or equipment supplied to a charity (or a disabled user as defined), the design features of which only arise owing

to the disability that is addressed by the functions of the equipment or adaptation. This simple definition would allow a reasonable rule of thumb to be adopted, namely that zero rating should apply when a charity incurs an expense in order to address disability access or use.

- We acknowledge the problems that HMRC has faced with the relief for adapted cars being misued to benefit able bodied people. We acknowledge that as wide definition as above might be open to abuse in regard to supplies to individuals. But that would not be true of supplies to charities, which cannot legally abuse their ownership of the facilities.

- We would only add that the current restrictions on the reliefs appear to us to mean that mental disability is more or less ignored, which we doubt is an acceptable bias in the modern world.

- CTG and the British University Finance Directors' Group (BUFDG) have met HMRC officials to discuss possible updates and improvements to HMRC's Public Notice 701/6 and guidance regarding charity-funded equipment for medical and veterinary uses. A number of updates were agreed but due to resource constraints no changes have yet been made to the formal HMRC guidance. Instead, CTG and BUFDG were asked to share details of the updates agreed with their networks, as outlined in this note. These updates should be shared more widely through official guidance.

Group 15 – Charities etc

- The rules relating to the sale of donated goods (item 1) include many traps for the unwary. We are concerned that the need to offer goods to the 'general public' (Note (1)(a) can preclude worthy cases where the charity has bona fide reasons for limiting the customer base (such as where it is concerned that touts and 'investors' will become involved or the product is deemed unsuitable for wider consumption). The reference in Note (1)(b) to the preclusion of 'arrangements' has caused significant doubt as to its scope and has caused charities to incur professional fees or obtain clearances from HMRC for relatively uncontroversial scenarios. Given that the direct tax treatment of donated goods sales is simply that they are not a 'trade', it is difficult to see why the VAT provisions have to be so highly engineered alongside the relatively relaxed direct tax treatment.

- We also think that limiting the zero rate to the sale of 'goods' is out of date. The sale of donated services should also be included. This removes a common confusion that donated services are bound to be treated as the same as goods, and removes the need to consider whether an item is a 'good' or a service.

- The charity advertising relief (items 8 – 8C) generally works well. However, we recommend that consideration be given to removing the restriction that it relates to 'a right to promulgate an advertisement by means of medium of communication with the public' as this excludes web site and social media services, which have increasing importance. Recent examples included an attempt by an officer to dis-apply the zero rate for modern charity advertising mechanisms (Facebook adverts etc), which were targeted automatically at users based on their online preferences, on the basis that it did not fall within the original broadcast advertising definitions. There have also been issues with e-books, medical supplies and assistive technology. The relief should apply to all advertising or publicity services and we believe that it should be extended to

advertising consultants and PR services, even though we acknowledge that defining these may present difficulties.

- We also think that items 8B and 8C are best covered by a catch-all description that any services wholly or mainly relating to the advertisement or publicity of a charity is included. This would also allow the grey borderline between corporate image design services and advertisement creative services to be removed, since corporate design would also fall within the zero rate, as it would be a publicity service.

3. Partial exemption methodologies, option to tax and capital goods scheme simplification

Partial exemption

a) Where does partial exemption arise in practice unexpectedly? What is the impact on the businesses concerned?

- CTG welcomes the useful points made in the interim report about partial exemption, particularly in relation to standard and special methods. The two 2012 *de minimis* tests catch only the very smallest businesses and having three tests is confusing. Because of the way exempt input tax is defined, a trader with limited exempt activity and very small amount of direct costs which are under the £7500 threshold is often caught in the partial exemption net because of overheads. Often the overheads may have very little link to the exempt activity but the *de minimis* limits generally do not relieve the burden of performing a calculation.

Question b: no comment

c) What alternatives methods would you recommend – or recommend avoiding?

- We note that one possible reform measure could be to increase the Partial Exemption rules *de minimis* limit, which it could be argued is too low and in need of indexation. Such an approach could be helpful (particularly for smaller charities) but, given the nature of charities' activities, a more helpful and meaningful simplification would be to extend the *de minimis* limit to all non-taxable income (thus extending its impact to non-business activity).

- In most cases charities have less than 50% recovery, so any *de minimis* limit that helped them would not be particularly '*de minimis*' in nature and would need to be very generous.

d) What alternatives or improvements could be put in place to make the process of agreeing a partial exemption special method with HMRC simpler, easier and quicker? Would a flat rate or sector-specific methodology for PE calculations be better than the flexibility of agreeing a bespoke method?

- We suggest that HMRC develops a suite of simple standard methods (ie off-the-peg solutions) that would apply to different types of activities. For example, for venue charities a floor area approach to all property costs or automatic default to direct costs basis where overheads were below a certain percentage and outputs could not work properly. We would also suggest that the override should be set at a higher level of difference in response to this new suite of simple standard methods. While there is no way of forcing organisations to use the standard methods,

this would give a choice where applicable. We are aware that other jurisdictions allow this type of practice so long as organisations can justify what they are doing. This in turn should remove the need to go to HMRC with a special method request. Overall, there needs to be a better relationship between the tax office and taxpayers and an increased level of trust where methods are concerned.

- CTG believes that further thought is needed about any flat rate methodology but we caution that, in general, "one-size-fits-all" solutions do not work very well for charities, owing to the diversity of the sector, which could result in winners and losers unless the rate were very generous. There is a special method for cathedrals but any attempt to read across from that is likely to result in greater complexity and, overall, such an approach is better suited to the insurance and financial services industries.

Option to tax

e) Could the process of Opting to Tax be simplified? How?

- It would be very helpful to have the option to make exempt supplies into taxable supplies. This would be particularly helpful in the context of cultural charities, which would often like the flexibility to opt to tax but it would also be useful for those charities that are exempt when providing non-profit education and physical recreation services. In addition, there are occasions where it would be useful for charities to opt to tax in relation to the fundraising events exemption. We are aware that there could be concerns about an adverse response from the public if VAT were charged, particularly at lower price points or on exempt services such as welfare, although in general there is a very limited awareness of how VAT operates and such a mechanism could work very effectively for these types of activity. In most cases the VAT is paid by the supplier out of the income received and is dealt with in the supplier's relationship with HMRC rather than the individual customer.

- The option to tax would allow charities to operate on a more level playing field when dealing with organisations that can recover their VAT and would give the charity's trustees the discretion to make an informed decision and manage charity finances and cashflow, particularly in respect of capital projects. Given that charities generally work on a break-even basis this should not create any major distortions.

- We also think that there could be a 0% rate for all lettings of charity buildings used for a primary purpose, with 20% VAT on all commercial lettings and domestic lettings remaining exempt. There would be no need for any option to tax, which would be a huge simplification. As noted above, if there were a s33 style refund scheme for charities, there would be no need for a 0% rate on the letting of property to charities.

f) Could a system where, say, all commercial property is considered as opted by default work? Would this cause complexities with awareness?

- We think that this would 'work' but we would wish to retain the rule whereby a charity may require exempt supplies to be made to it to override this taxable treatment. As this could cause the landlord to suffer irrecoverable VAT, this should perhaps be subject to agreement between the

charity and the landlord. Where charities act as landlords the assumption that the rent is automatically taxable would probably be seen as a simplification, as charities that sublet often fail to notify options to tax on the false assumption that the supply is automatically taxable.

Question g: no comment

h) Can the notification process be improved? Does this require confirmation from HMRC?

- We believe that HMRC should allow broader charity disapplication criteria for the option to tax on an agreed basis with a landlord, such as an extension to office use and where use is solely non-taxable. Any increase on the current disapplication position should require landlord consent to avoid unfair distortion for landlords. We also believe that the disapplication should be extended to land as well as property, as charities can incur irrecoverable VAT on land which they acquire for non-business purposes where the land has been opted to tax by the vendor.

- Another way to address this inflexibility would be to deal with the option to tax on an individual transaction basis, so long as this does not cause additional complexity. We are aware that other jurisdictions do not require opting-in to be on a 10/20-year basis, with taxpayers able to opt in and out so long as reasonable notice is given. The current process is cumbersome and has often led to timing issues and litigation, with the anti-avoidance rules being particularly difficult to navigate. We support the wholesale withdrawal of the schedule 10 anti-avoidance provisions as they do not work as intended and do not create the fiscal outcomes which Government intended.

Capital Goods Scheme (CGS)

i) What burdens does the CGS create in practice?

- We agree with the OTS that there has been a need for some time for capital goods thresholds to be reviewed, not least because some of the assets are irrelevant or need updating to reflect technological changes and modern valuations. We are aware that other jurisdictions have widened the definition of capital goods to include buildings, which would be relevant for charities if implemented in the UK. We would welcome a significant increase in the £250,000 threshold, especially as the record keeping/accounting procedures can be quite onerous.

- We are aware that the concept of a *de minimis* test for CGS has been mooted. This could be helpful, although clearly this would have to work both ways and taxpayers would not simply be able to cherry pick when to apply it or not. Some form of cumulative adjustment, based on real time use and information could result in a more logical fiscal impact, although we recognise that this is not possible under current EU law and would need to be introduced after the UK has exited the EU.

- Additionally, it can be difficult for charities to monitor changes of use in buildings as this may change fairly regularly (eg where a tenanted cottage on charity land becomes a holiday cottage and then changes back again). CTG representatives have suggested that formal change of use should only be recognised when there are actual physical changes of use, not just "paper changes".

Questions j – k: no comment

4. Special Accounting Schemes

Flat Rate Accounting Schemes

Questions a – i: no comment

Tour Operators Margin Scheme (TOMS)

j) Does TOMS still help the sort of tour operators originally targeted?

- Charities often get caught by TOMS despite not being tour operators. Most charities would benefit from it being abolished (eg by allowing registered Tour Operators to reclaim the foreign VAT charged and to charge 20% VAT on their services as normal) but, in particular, its removal from the criteria of the fundraising event exemption would be very helpful as this creates unnecessary restrictions and additional disproportionate accounting requirements. As TOMS was only introduced owing to concerns arising from EU law, this should hopefully be possible – removing conferences and events would be a good start. Overall, we think the scope should be considerably narrowed so that it applies only to organisations which are in the holiday business and not any other taxpayer who happens to buy in services for a package e.g. a conference.

Questions k – r: no comment

5. VAT administration, penalties and appeals processes

Administration

a) We would be interested in your experience in relation to VAT guidance. Are there particular types of guidance that cause issues? Or issues about accessing guidance?

- VAT legislation and guidance not keeping up with commercial and technological developments is a recurring issue. When HMRC has identified a need to update guidance, there have often been insufficient resources available to undertake this work (which has been regarded as a lower priority).

- We welcomed the update from the Review team that there are plans in place to outsource responsibility for identifying necessary updates to professional bodies which could then be reviewed and approved by HMRC. We have seen this start to happen and have ourselves provided suggested guidance but have found that it remains a lengthy process due to HMRC resource constraints.

b) Would it help if there was a search function or site map for guidance?

- Yes. CTG has regularly expressed concerns to Treasury Ministers about the quality of guidance available on the Gov.uk website. This has included a lack of detailed guidance for practitioners on important VAT issues (and the difficulty in finding it through the search function), lack of new Business Briefs following case law developments and insufficient commentary/alerts to changes in guidance and what has actually changed in practice. Notices and Manuals commonly retain

policy statements that have been publicly changed by HMRC but no change is made to the primary source of public guidance. This situation often continues for years.

c) Would it be simpler if there was an automatic notification feature for all new and amended guidance that also told you precisely what the amendments were?

- Yes, this would be very helpful. At present, there is limited information available about the nature of changes (and sometimes it can appear that a whole guidance note has been updated when, in fact, it is just a contact number, which can be misleading, often leaving inaccurate policy guidance in place and seemingly shown as being of continuing relevance at a publication date that is far later than the actual policy change). The ability to compare with older versions of the guidance would also be very helpful too although we appreciate that this would need to be presented with considerable care to avoid random search engine enquiries picking up old and superseded guidance. Perhaps, this approach should be used solely on subscription publications used by professional advisers.

Questions d – e: no comment

Penalties

f) What are the major concerns with the penalties regime?

- We are concerned about the way in which negative rulings, once eventually secured (see below for further comment on rulings), are often accompanied with threats about tax linked penalties. As requested by the Review team, we have enclosed an anonymous copy of a sample penalty letter as an example.

- Unfortunately, HMRC's approach is often unfair, disproportionate and intimidating and this is likely to have a chilling effect on taxpayers seeking rulings, which increases the chance of errors being made.

g) How could we provide more clarity regarding the voluntary disclosure regime to encourage more compliance?

- We suggest that HMRC consider reintroducing penalty-free voluntary disclosures where there is no evidence of fraud etc. It should be possible to make a tax decision in good faith (and perhaps to tick an HMRC box to demonstrate this decision had been made) without HMRC automatically regarding any decision it disagrees with as "careless". Otherwise this would have a chilling effect on reasonable claims.

Question h: no comment

Appeals process

i) Would improvements to decision letters help improve understanding about the statutory review process?

- The charity sector has encountered the same level of difficulty with the statutory review process as is generally reported by commercial bodies. However, charities tend to be 'caught' in theoretical wranglings between government departments or local authorities and HMRC concerning specific VAT interpretations of funding arrangements. We have heard of cases where non-profit bodies have been told by HMRC officers that local authorities seek to manipulate the VAT system by the way they draft funding agreements. Such comments are inappropriate and cause charities to feel that they are 'caught in the middle'. A recent case where DFID and HMRC appeared unable to make a joint policy statement on important issues relating to DFID-funded services created significant barriers to compliance by charities and caused suspicion that officer decisions will be confirmed by the review officer simply because they have access to policy "secrets" which the charity knows nothing about.

Question j: no comment

k) Should anything be done to encourage greater use of ADR in VAT?

- We hear of cases where we would have expected ADR to be used where it has been refused by HMRC for no declared reasons.

l) In general, are there any simple routes to making the dispute resolution process, including the Tribunal stage, less time consuming and costly? Would lowering barriers risk encouraging too many appeals? Could anything be done to make a tribunal less time consuming and costly? And would lowering these barriers help or simply result in more appeals that could congest the system?

- For charities, there is an additional reputational risk in being seen to be penalised by HMRC, with litigation often not a feasible option due to the need for charity reserves to be used to fund it as costs are not reclaimable at the First-Tier Tribunal.

- Full consideration should be given to restoring the rule whereby HMRC meets reasonable costs of successful appeals and only seeks their own costs where appeals are vexatious. We are concerned that the costs regime is a particular disincentive to charities taking test cases where they might only obtain funding support if participating charities saw some prospect of getting back their share of costs. This would reduce the effect of HMRC's 'deep pockets' giving them an unjustifiable advantage.

6. Formal ruling system

a) What are the areas of the VAT system that most need rulings? Why are these needed – and how many would arise in a year?

- HMRC rulings are often a contentious issue and we are aware of serious frustrations among charities at the lack of clarity and certainty available from rulings and the difficulty in obtaining

them. As the tax system operates largely on a self-assessment basis, this is a significant issue – in such circumstances taxpayers need certainty that they are doing things correctly. We are aware that there are far fewer problems in other Commonwealth countries with rulings often made public (so others can rely on them or tax administrations preferring informal consultation with taxpayers and the use of accessible and understandable guidance.

- There is clearly an important role for guidance, but at present HMRC guidance is not always clear and comprehensive enough and is not accepted as authoritative by tax tribunals. It would therefore be helpful if tax tribunals or an independent ombudsman could adopt some form of judicial review role as current processes are impractical and too expensive for charities. The advantages of being able to appeal both tax law and HMRC conduct aspects as part of the same proceedings are obvious too.

- Our experience is that the statutory review procedure is not working and that there is, in practice, limited prospects of an appeal being successful where advice has been sought from the relevant policy unit, as there is usually no wish to rule against them. This can lead to litigation, which increasingly requires extensive representations at the First-Tier Tribunal level, resulting in very high costs and "access to justice" issues.

Questions b – c: no comment

d) What other routes could be used to achieve the needs of businesses for rulings without setting up a formal system?

- In our experience, if a charity has an HMRC Customer Relationship Manager (CRM) this greatly improves their chance of resolving an issue. Unfortunately, not all organisations are able to benefit from this service. We suggest that the UK might follow the example of other jurisdictions where helplines operate and help to resolve appeals and disputes, resulting in much less litigation.

7. VAT and Making Tax Digital (MTD) Alignment Opportunities

a) What are the areas of the VAT regime that require simplification to be compatible with MTD?

- The Government has announced that charities will be exempt from Making Tax Digital reporting requirements, but that this exemption will not extend to charity trading subsidiaries. CTG is still unclear exactly how Making Tax Digital is going to operate in practice, as well as expressing concerns about how VAT reporting will interplay with the other taxes.

- We are working with MTD officials as part of the pilot process but we have ongoing concerns about trading subsidiaries not being exempt as, in practice, this could mean charity exemption is undermined where there is VAT grouping, ultimately duplicating work.

- There will inevitably be additional costs for charities with subsidiaries, even if the associated accounting software were available for free. Making Tax Digital requirements will also cause additional complexity for volunteer charity treasurers, at least in the short term, and time and resources would need to be dedicated to training. We are therefore calling for a *de minimis*

threshold to protect those organisations that earn only very small amounts of income through their subsidiary.

Question b – d: no comment

CTG
26 June 2017