

## VAT and Value Shifting

### Response to the Consultation by the Charity Tax Group – 30 March 2021

#### Introduction and approach to the consultation

1. The Charity Tax Group (CTG) has over 800 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. CTG is an active participant in HMRC's Charity Tax Forum and sits as the charity representative on HMRC's Joint VAT Consultative Committee (JVCC).
2. CTG welcomes the opportunity to respond to this consultation. Since CTG is a representative/campaigning body for the charity sector as a whole, and does not charge VAT on any supplies, this response does not include any data or discussion of impacts of the proposals on our activities. However, the general theme raises issues for charities, so our response is based on our general knowledge of the position of many charities. For this reason, we have not approached this by answering the set questions.

#### The title of the consultation

3. We think it is unfortunate that HMRC gave the consultation what we regard as a pejorative title. Whereas a minority of organisations may have attempted to use product liability apportionment to weight the value of low or zero taxed elements, giving rise to what is described here as 'value shifting', we believe that the majority of organisations make a valid attempt to be 'fair and reasonable' in their approach. Whilst charities are not automatically immune from motivations to apply questionable values, the sector has a high sense of public responsibility, and is a risk averse sector, and therefore does not (except perhaps rarely) indulge in anything approaching 'value shifting'. Furthermore, the scope of the intended change goes far further than dealing with the small minority of such cases, and creates a more rigid framework for supply value apportionment.
4. In our view, the consultation should have been titled: 'VAT and Supply Value Apportionment for Multiple Supplies'. This would have started the consultation off on a more constructive basis.

#### Some points that are not strictly offered for discussion in the consultation

5. We are told that the consultation will not cover the scope of the legal changes *per se*. However, we point to the following.
6. We think it would have been more proportionate for HMRC to be given a power to direct the strict method discussed in the consultation, in cases where it suspected genuine value shifting, instead of removing the traditional 'fair and reasonable' approach for everyone. Given that this traditional

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approach has now subsisted for almost 50 years without serious criticism prior to 2020, it is difficult to see why it should be regarded as so dis-functional as to be removed entirely. If it is open to abuse, the proportionate response is to arm HMRC with powers to intervene in such cases, rather than to increase burdens on well-motivated and compliant taxpayers.

7. You note that the disclosure of avoidance schemes' provisions for 'value shifting' are not sufficiently clear to enable HMRC to receive disclosed information about value shifting, and this is the implied basis on which to change the law for all suppliers. The obvious solution to that difficulty is to change the scheme disclosure rules. It is illogical to use the frailty of that regime (which, we note, was only very recently introduced) to justify a complete change in the valuation basis applicable to all.
8. In other words, we believe that this device exceeds what is proportionate and necessary to deal with the perceived problem.
9. If the prompt for this change has been cases such as the *Marks & Spencer* 'free wine' package deal (see paragraphs 1.2 and 3.16), it is notable that this case has been easily won by HMRC, and in CTG's view stood little prospect of being successful. We cannot see why HMRC, having so easily won such a case, wishes to change the very law under which it won it. Furthermore, the point in that case did not relate to attributing values, but concerned whether a product was free.
10. If HMRC thinks that this is merely the most egregious example of a wide range of behaviour in the goods retail (high street and online) sector, it could limit the rules to such suppliers, without applying the same to service providers.
11. There could also be a case for determining a rule that is applicable based on size of organisation, thus relieving smaller suppliers from an unnecessary burden.

### **The proposed valuation basis**

12. Charities are more likely than other suppliers to provide benefits that are not sold individually by that charity. This will arise in cases where goods and services are made available to the charity expressly for the purpose of bundling into a multiple supply.
13. In 4.1.1 HMRC refers to the sale price of products, being the price applied by the supplier. This does not cover cases where the charity does not make such separate sales. This is a gap in the proposals as far as charities are concerned. We suggest that an alternative is allowed where, if the supplier does not supply them separately, but another supplies *the exact same product* at a separate price, that third party price be adopted by the charity. Where more than one high street price can be ascertained, the one selected by the charity should be accepted as the value, and should not be open to challenge by HMRC.
14. The costs basis (where no sale price is possible) causes difficulties for charities that may acquire goods and services for nothing (being donated to the charity for resale) or for a much reduced charge, which renders the valuation essentially unrealistic. For example, a package of benefits which include (amongst others) a zero rated e-magazine, and a standard rated ornament, may involve little or no cost for the e-magazine if the copy writing is all donated, and the type setting is pro bono, yet there may be a hard cost from the manufacturer of the ornament. This would not arise in the commercial

sector. Charities can currently use the fair and reasonable principle based on estimated market values to arrive at a realistic apportionment. This will not be available under your intended rules, unless an exception is made for charities.

15. The cost based approach will, in any event, be difficult to apply where, as is common with charities, the services in the bundle are derived from overhead costs, rather than direct costs. This is quite unlike bundles of consumer goods, where the direct stock cost is always a substantial proportion of the input cost. Where services are concerned, the components are often drawn from the same cost pool and can only be fairly valued by estimation. Even the keeping of timesheets (a practice usually rejected by HMRC in the context of input tax apportionment) would fail to give the full picture relating to use of such a pool of costs. It would also be excessively complicated to use, thus giving rise to barriers to activity for charities.

#### **Paragraph 4.1.2 mixed apportionment between price and cost**

16. We note that the drafting of this section was originally incorrect, and only corrected on 10 March. It is unfortunate that a consultation which has a fixed deadline for submission needs to be amended part way through the allowed response period. The fact that the clarification needed examples in order to make the meaning clear, even on the second attempt at explanation, does not bode well for application of the intended rule. It foreshadows problems which we believe will arise from the principles that are being proposed.
17. In particular, the principle under which the aggregate cost values, being greater than the residue of the full sales price, causes the fixed sale price to be treated as reduced, appears only to be explicable by reference to a worked example, and has not been explained in words. If the principle is too difficult to explain in words, or causes inaccuracy in its original drafting, we wonder whether comprehensible legislation can be drafted to deliver the proposal. We are concerned that this will increase uncertainty, complexity, and will generate disputes.
18. 4.1.2 does not explain the basis on which HMRC is prepared to have that residue value apportioned between multiple cost-valued items. The examples added on 10 March do not cover this, and it would be helpful if the legislation also made that clear.
19. Nonetheless, the above would still leave a problem with the cost valuation issues discussed further above.

#### **An example of a charity package**

20. The following is hypothetical and not based on any one particular charity offering, but attempts to replicate the kind of offering charities might provide.
21. Assume that the package, in return for an annual payment (or series of monthly payments) is as follows:
  - A. Magazine (also available alone for a fixed subscription price that relatively few people take up)
  - B. Access to an insurance scheme that is at a lower price than available from the same insurer individually

- C. Access to an advice line (phone or email) that is manned by staff of the charity
  - D. Annual lecture event invariably hosted by a corporate supporter of the charity and involving considerable internal administration time but no direct external costs
  - E. Access to password protected video content (produced using heavily discounted production charges but also using charity staff)
  - F. 'Thought for the month' email created by charity staff
  - G. Periodic surprise present, such as a toy or framed photograph
22. Item A has a fixed sale value since it is available for sale on its own, albeit few customers use this service. Does HMRC accept this value, as long as at least some customers exist for the product on a standalone basis, or is there a need to prove scale? If so, what would be the scale test (bearing in mind that it cannot be a vague target, as these provisions are supposed to remove soft or hazy borderlines)?
23. Item B has a third party fixed value at the usual price, and in this case the access price is paid additionally by the supporter, so the question is what the value really is here. Is it the gap between the usual price and the reduced price? If so, how does that fit into the scheme of valuation HMRC is proposing?
24. Item C has internal costs which could be valued by reference to any dedicated staff employed solely for that activity, but what if the staff have a variety of duties, one of which is to provide the advice line service?
25. Item D involves significant invisible costs arising for the external provider, but these costs are not calculated by that provider, and are not easy to calculate. As the new rules do not allow estimation, is this cost simply ignored (producing a definite inaccuracy in the valuation)? How do we value the internal administration part of the cost base?
26. Item E involves internal staff time, probably utilising the same staff as the ones giving advice. How can we acceptably measure the cost if, say, those staff also work on research and policy? Do we use the heavily discounted external charges, or a value that reflects a more realistic commercial price value?
27. Item F involves the same issues as item 5, minus the external value element.
28. Item G appears to have a hard cost value that can be attributed, and the charity never sells that product. However, if it is of a kind that is available on the high street (so let us assume it is not bespoke to the charity) would the third-party retailer value be used instead, or merely the cost at which the wholesaler sells to the charity, which may be much reduced from their usual prices?

#### Paragraph 4.2

29. This appears to postulate that, notwithstanding the foregoing provisions, where the supply would be regarded as 'free' (which, following *Marks & Spencer*, would appear not to arise) nonetheless it is taxed as per the rules in Schedule 6, 6 – 8. Is that intended to apply as a principle that excludes the business gift provisions of Schedule 4, 5(2)(a)? This is not clear.

### **The question of fairness**

30. Much is made, in the text of the consultation, of the increased fairness and thus reduction of burdens on the compliant part of the taxpayer population. We are not aware that anyone has been lobbying HMRC to rectify the perceived unfairness. However, it is clear to us that the introduction of a 'one size fits all' rigid system will unfairly increase burdens on charities and give rise to anomalous results. The purpose these proposed changes seek to fulfil could be achieved by better considered and more targeted proposals that leave the compliant and fair-minded taxpayers with the choice to use the 'fair and reasonable' approach which has served well for nearly fifty years.
31. We think the consultation is rooted in an over-reaction to some behaviours by a small number of businesses in the goods retail sector, and the proposals are therefore inappropriate.

**CTG**

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