The VAT Compliance Burden in the UK: A Comparative Assessment

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Abstract

This article explores the compliance burden imposed by the value added tax (VAT), which has traditionally been recognised as one of the more onerous taxes so far as compliance by business taxpayers is concerned. It compares the UK's VAT compliance burden with that experienced elsewhere in the EU, together with the experience of other Organisation for Economic Co-operation and Development and Forum on Tax Administration countries. Based upon the outcomes of a large-scale research project conducted in 2018–19 using an experimental diagnostic tool, the UK appears to have mixed results, comparing poorly on certain factors but outperforming many of its European and broader counterparts on other aspects of its VAT regime. The results are of particular interest to UK policy makers and practitioners as they establish that the most significant sources of compliance burden lie in the design of the underlying VAT law rather than in its administration. The UK's withdrawal from the EU may offer a once in a generation opportunity to effect real change and make meaningful reductions to the business compliance burden which could provide lasting improvements to the internationally competitive position of UK businesses. The importance of addressing the current causes of compliance costs becomes all the more pressing in the face of pending new costs UK businesses will face post-Brexit. The freedom created by Brexit in terms of VAT design should be exploited to achieve compliance cost reductions needed to offset new costs likely to arise in the post-Brexit era.

I. Introduction

Those involved in tax system design recognise—or at least purport to recognise—the importance of taking into account the compliance burden imposed on taxpayers in terms not only of the taxes themselves but also the manner in which those taxes are designed, administered and collected.[1] And yet, despite this recognition, most research indicates that tax

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[1] See, for example, OECD, *From red tape to smart tape: administrative simplifications in OECD countries* (Paris: OECD, 2003); OECD, *Cutting red tape: comparing administrative burdens across countries* (Paris: OECD, 2007); S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba (eds) for the Institute for Fiscal Studies, *Dimensions of tax design: The Mirrlees Review* (Oxford: OUP, 2010); and European Commission, *Europe can do better – best practices for reducing administrative burdens* (Brussels: European Commission, 2012).

compliance costs generally continue to rise.[2] This article explores the compliance burden resulting from the imposition of value added tax (VAT), a levy that has traditionally been recognised as one of the more onerous taxes so far as compliance by business taxpayers is concerned.[3] It compares the UK's VAT compliance burden with that experienced in other Organisation for Economic Co-operation and Development (OECD) member nations and in some instances, with EU Member States, drawing on a study that looked at VAT compliance burdens in the 47 Forum on Tax Administration (FTA) countries (an OECD sponsored forum comprising, at the time of the study, 50 OECD and non-OECD countries) that have a VAT.[4]

The basis for the comparison is a large-scale research project on the compliance burden conducted in 2018–19 by Australian and international universities working in collaboration with KPMG.[5] This is not the first study that has sought to identify or to evaluate relative complexity, tax compliance costs or the tax compliance burden.[6] Indeed, there have been a number of studies over the years that have developed composite indexes intended to evaluate and rank the tax systems of countries (or aspects of them) by reference to their complexity, compliance costs or compliance burden or combinations of these. These include the Paying Taxes Index,[7] the International Tax Competitiveness Index (for consumption taxes)[8] and the World Tax Index.[9] However, reviews of these indexes reveal that there are gaps in the literature in terms of two key issues: a systematic and comprehensive approach in identifying and quantifying factors that determine the compliance burden resulting from VAT and other taxes;

[2] See, for example, S. Eichfelder and F. Vaillancourt, "Tax compliance costs: a review of cost burdens and cost structures" (November 2014) Arqus discussion paper 178; P. Lignier, C. Evans and B. Tran-Nam, "Tangled up in tape: the continuing tax compliance plight of the small and medium enterprise business sector" (2014) 29(2) *Australian Tax Forum* 217; C. Evans, P. Lignier and B. Tran-Nam, "The tax compliance costs of large corporations: an empirical inquiry and comparative analysis" (2016) 64(4) *Canadian Tax Journal* 751; and European Commission, *Study on tax compliance costs for SMEs: Final report* (2018), where it was noted that "the burden of tax compliance is not significantly reducing over time" (xvi) and "tax compliance is perceived as more burdensome since 2010", (xviii). Note, however, that some studies indicate that tax compliance costs for some taxes, and particularly the corporate income tax, may be falling in some countries. See, for example, the annual *Paying Taxes* survey, part of the World Bank *Doing Business* series, available at *https://www.pwc.com/gx/en/services/tax/publications/paying-taxes-2020.html* [Accessed 1 July 2020]. Note also that some argue that the advent of technology may help to reduce tax compliance costs, although this suggestion is not always borne out by research. For example, the European Commission *Study on tax compliance costs for SMEs* noted that "e-filing is prevalent but does not necessarily reduce the compliance burden" (xvi).

[3] See, for example, C. Sandford, *Hidden costs of taxation* (London: Institute for Fiscal Studies, 1973); C. Evans, "Taxation compliance and administrative costs: an overview" in M. Lang, C. Obermair, J. Schuch, C. Staringer and P. Weninger (eds), *Tax compliance costs for companies in an enlarged European Community* (Vienna: Linde Verlag and London: Kluwer Law International, 2008), 447; and S. Smulders and C. Evans, "Mitigating VAT compliance costs – a developing country perspective" (2017) 32(2) *Australian Tax Forum* 283.

[4] Details of the jurisdictions in the FTA with a VAT regime in place at the time of the study are provided below at fn.14.

[5] R. Highfield, C. Evans, B. Tran-Nam and M. Walpole, *Diagnosing the VAT Compliance Burden: A Cross-Country Assessment—Amended Final Report* (Final Report) (October 2019), available at: *http://unsworks.unsw.edu.au/fapi/datastream/unsworks:59518/bincadefad3-a48f-4739-8ffe-71d6485a3628?view=true&xy=01* [Accessed 1 July 2020]. The universities involved in the study were UNSW Sydney, University of Sydney, University of Western Australia, Queensland University of Technology, University of Exeter, University of Qatar, University of Christchurch and University of Pretoria.

[6] See later in this section for a discussion of the subtle but important distinction between the terms "tax compliance costs" and "tax compliance burden".

[7] See *Paying Taxes*, above fn.2.

[8] See *https://taxfoundation.org/2019-international-index/* [Accessed 1 July 2020].

[9] See *http://www.eaco.eu/about-eaco/research/* [Accessed 1 July 2020].

and careful and thoughtful collection of reliable and justifiable data.[10] The study described in this article was designed to address these gaps.

In the literature, the terms "tax compliance costs" and "tax compliance burden" tend to be used interchangeably to refer to the burden borne by taxpayers in complying with the tax system (that is, tax policy, tax law, tax administration and tax tribunals or courts). There is, however, a subtle difference between the two. Tax compliance costs represent the economist's attempt to quantify or measure tax compliance burden in monetary terms. Basically, under this approach, tax researchers seek to obtain objective, reliable estimates of relevant vectors of quantities (for example, number of hours spent by business owners and employees on tax affairs, etc.) and prices (for example, business owners' imputed wages, employee wages, etc.) through means of surveys or case studies. Tax compliance costs are typically expressed in dollar terms or in relative terms (as a percentage of the corresponding tax revenue paid by the survey target group of taxpayers). These absolute and relative costs are defined at both individual or firm level or at the economy (aggregated) level. For aggregation, some knowledge of the distribution of taxpayers is typically required.

The tax compliance burden, by way of contrast, is somewhat broader, more multidimensional and qualitative. It is not a single numerical estimate of costs, but a vector of many qualitative and quantitative factors. It may include indicators that do not fit easily in the tax compliance cost quantification framework, for example, the psychological stresses experienced by individuals or sole traders in dealing with their tax requirements. Tax compliance burden, unlike aggregate tax compliance costs, is not concerned with such things as the number of taxpayers or the aggregate tax revenue collected. The tax compliance burden approach allows tax researchers to examine in greater depth many qualitative aspects of how the tax system may impact on taxpayers.

The focus of the current study is on the broader burden rather than the more specific costs, although there is considerable overlap between the two.

The study found the UK had mixed results in respect of four key factors that are considered to underpin the compliance burden endured by VAT-registered business taxpayers as a result of the imposition of the VAT: tax law complexity and burden resulting from core elements of VAT policy; the number and frequency of administrative requirements; revenue body capabilities in meeting taxpayers' service and compliance needs; and monetary costs and benefits associated with the act of complying.

The findings suggest that the UK VAT is more complex and burdensome than the VAT regimes of most OECD countries and the UK's European counterparts in respect of the first of these factors (identified, for example, by indicators such as the VAT rate structure, the availability of simplified methods for determining VAT liabilities, and the VAT registration threshold).

By way of contrast, the findings suggest that the UK out-performs comparator regimes in terms of minimising the compliance burden associated with administrative aspects of the VAT,

[10] See, for example, European Commission, "A review and evaluation of methodologies to calculate tax compliance costs" (2013) Working Paper N.40-2013 in EC's series of Taxation Papers, prepared by Ramboll Management Consulting, the Evaluation Partnership, and Europe Economic Research. Also see R. Highfield, M. Walpole and C. Evans, "A proposal for the development and testing of a diagnostic tool for assessing VAT compliance costs" (2017) 28(3) *International VAT Monitor* 228 for a discussion of the advantages and disadvantages of the various approaches.

the second factor examined. These include registration, filing, payment, record-keeping, audits, and disputes. However, the UK VAT does not compare so favourably with other countries when looking at the third factor reviewed—the revenue authority's capability to meet taxpayers' service and compliance needs. Examples of indicators considered when evaluating this factor include the quality of the revenue authority's website, the availability of telephone services and support for newly registered businesses.

Finally, the UK sits near the mid-point of the surveyed jurisdictions in terms of the fourth key factor underpinning the size and incidence of the VAT compliance burden—the monetary costs and benefits involved in complying with VAT laws (and more particularly the aggregate value of annual VAT refunds and provisions for the payment of interest to taxpayers for delayed refunds).

The results are of particular interest to UK policy makers and practitioners given the poor ranking of the UK on some indicators of complexity and the compliance burden.

The remainder of the article is structured as follows. The next section details the methodology that was used in the research project. This is followed by a more detailed explanation of the UK findings in a comparative context and—by way of concluding comments—a discussion of the challenges and opportunities that may arise for the UK as a result of these findings.

II. Methodology[11]

A. Design of the VAT diagnostic tool

Analysis of the literature, together with discussions with country officials conducted through the OECD and the conduct of a 13 country pilot study,[12] suggested that the design of the diagnostic tool should be based on the four factors mentioned above that are perceived to be the main drivers of the compliance burden facing VAT registered business taxpayers at the individual country level: tax law complexity and burden resulting from core elements of VAT policy (Factor A); the number and frequency of administrative requirements (Factor B); revenue body capabilities in meeting taxpayers' service and compliance needs (Factor C); and monetary costs and benefits associated with the act of complying (Factor D).

A comprehensive set of compliance burden indicators (27 in total) was then developed and categorised under Factors A–D. These indicators were largely, but not entirely, objective and aimed to maintain the consistency of scores used for cross-country comparisons.

It was recognised at the outset of the project that the four factors would impact unevenly in a compliance burden context and that, as a result, some form of weighting would be needed for the prototype diagnostic tool. The development of a total weighted score was seen as a prerequisite to the derivation of a composite indicator that could be used to allocate

[11] Full details of the methodology can be found in the Final Report, above fn.5.

[12] The 13 countries involved in the pilot study were Australia, Canada, Chile, Croatia, Egypt, Ethiopia, Greece, Indonesia, Malaysia, New Zealand, South Africa, the UK and Vietnam. See R. Highfield, C. Evans and M. Walpole, "The development and testing of a diagnostic tool for assessing VAT compliance costs: pilot study findings" (2019) 16(3) *eJournal of Tax Research* 620 for full details of the pilot study and the basis upon which the four factors were selected.

participating countries into groups of relative VAT compliance burden.[13] Importantly, the score allocated, and the consequent positioning of countries towards the low or high end of the scale, was not an absolute measurement but a relative one. Hence, any one country's position would depend not only on how that country was performing in absolute terms in the operation of its own VAT, but also on how everyone else was faring. The purpose of the exercise, in other words, was to allow countries to consider how they are performing relative to others.

A significant challenge posed by the exercise was the difficulty of devising generic questions as part of the diagnostic tool that have to be interpreted in the context of often vastly different tax regimes that may share a common name (VAT) but operate in very different ways. The design of the tool inevitably left open the possibility of misunderstandings, although every attempt was made—in the operationalisation of the tool, explained in the next section—to minimise any such scope for miscomprehension.

B. Administration of the survey

The jurisdictions targeted for engagement in the extended study were those member countries of the FTA that administer a VAT— some 47 countries as of August 2018.[14] These countries provide a broad level of global representation, covering all continents and reflecting a mix of advanced and developing economies.

Planning for the project commenced in July 2018 and the project was formally launched in August 2018 with surveys completed for all countries in early 2019. Each of the 27 compliance burden indicators required a single rating on the project's "Rating and Evaluation Form". There was provision for any qualifying or elaborating comments to be made by researchers if deemed necessary and helpful for research purposes. The relevant fiscal year for rating purposes was 2017 (financial year 2017–18 in the UK). While ratings for some of the indicators could be determined independently by country researchers using published materials, a number required data and insights that were held only by government agencies, in particular the tax administration body or ministry of finance (MOF), or representatives of business and the tax advisor accounting profession. Guidance was provided on suggested data sources where appropriate for the indicators.

To carry out the preliminary research required, staff of KPMG member firms in each country undertook a range of enquiries needed to complete the diagnostic tool's "Rating and Evaluation Form" in respect of the country's VAT system. In the relatively short time available, KPMG country-based staff were required to research relevant publicly-available materials and liaise, to the extent practicable, with relevant government authorities, academics and

[13] The process is explained in Highfield, Walpole and Evans, above fn.10 and Highfield, Evans and Walpole, above fn.12. The weightings were considered by a panel of experts from eight countries and a geometric mean of their views was adopted. As a result of this process, Factor B was identified as carrying the greatest weight, whilst Factor D carried least weight. As noted in Highfield, Evans and Walpole, above fn.12, 628, the relative weightings were Factor A: 1.282; Factor B: 1.334; Factor C: 1.256; and Factor D: 1.101.

[14] The 47 FTA jurisdictions included in the project were Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Israel, Italy, Japan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Peru, Poland, Portugal, PRC (China), Russian Federation, Singapore, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey and the UK. FTA jurisdictions excluded from participation in the survey were Hong Kong (SAR) and the US, neither of which impose a VAT, and Malaysia which repealed legislation for its VAT system in 2018 and reverted to the Sales Tax that existed up to 2015.

professional bodies for completion of the survey, the results of which were then collated, verified and analysed by the central project team. KPMG Global exercised an important co-ordination and control role in the whole process, which was critical to the 100 per cent response rate from the 47 countries and the high quality of those responses.

Each participating country's VAT system was then rated against the 27 indicators and ultimately assigned a final normalised weighted score. Each score was converted into a "compliance burden index" applying a 10-point scale, with an index rating of 1 reflecting the compliance burden of the (theoretically) most simple and least burdensome VAT system while a rating of 10 is indicative of the compliance burden of the (theoretically) most complex and burdensome VAT system.

III. Key findings

A. Overview

Table 1 provides a summary of the overall findings and the relative rankings of each of the 47 countries involved in the survey. It is clear that no countries scored a "1" (minimum possible compliance burden), but also that no countries were so poor in terms of the burden of their VAT compliance that they scored 8 or more.

Table 1: VAT compliance burden index for surveyed countries (47)

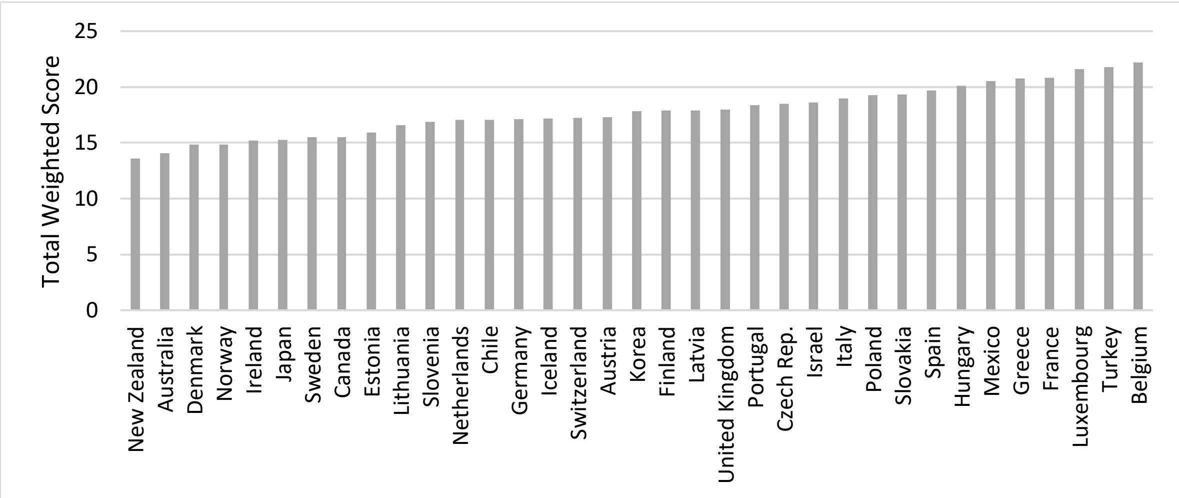
Compliance Burden Index	Countries
1	-
2	Singapore
3	Australia, Costa Rica, New Zealand, South Africa
4	Canada, Denmark, Estonia, Ireland, Japan, Lithuania, Norway, Russian Federation, Sweden
5	Austria, Chile, Czech Rep., Finland, Germany, Iceland, India, Indonesia, Israel, Korea, Latvia, Netherlands, Peru, Portugal, Peoples' Republic of China, Slovenia, Switzerland, UK
6	Argentina, Colombia, France, Greece, Hungary, Italy, Kenya, Mexico, Poland, Slovakia, Spain
7	Belgium, Brazil, Luxembourg, Turkey
8	-
9	-
10	-

Source: adapted from Table 5 of the Final Report, above fn. 5

Out of 47 countries, 14 had a compliance burden index score of 4 or less, including five where the index score was less than 4, while 15 countries were reported as having an index score of 6 or more, including four with an index score of 7. The UK was one of 18 countries in the middle of the range with a score of 5. No country recorded an index score above 7.

As noted above, the survey looked at compliance burdens in terms of four factors that were combined using a differential weighting based on findings in previous compliance cost studies of the relative impact of different factors on total compliance burdens. Those familiar with UK VAT law might be quite surprised at the findings: the UK has a close to the middle ranking out of 47 countries surveyed in total, as well as out of the 35 OECD countries and the 23 EU countries surveyed.[15] Figure 1 summarises the outcomes only for the (then) 35 OECD countries involved in the survey. It suggests UK businesses face higher compliance burdens than counterparts in many jurisdictions. Within OECD countries, the lowest compliance burdens were found in New Zealand and Australia while the highest were observed in Belgium and Turkey.

Figure 1: all compliance burden factors (35 OECD Member Countries)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

While this study focuses on the relative compliance position of the UK in terms of OECD members, the UK holds a similar position if considered in terms only of EU members included in the survey in respect of three of the four compliance burden factors reviewed. As a then member of the EU, the UK was required to ensure its VAT law conformed to the European Sixth Directive[16] and subsequent VAT Directive.[17] It might be expected that with a common structure and prescribed treatments of different types of supplies, EU nations would be a relatively cohesive cohort in respect of OECD and global rankings. Bending to political reality, however, the European Commission has allowed Member States remarkable facility to depart from the common system by way of derogation and the UK has fully embraced the opportunity to be different by adopting more generous concessions than those found in other EU systems, in a number of cases zero-rating supplies that are treated as reduced rated supplies in other EU jurisdictions. Prima facie, the use of zero-rating rather than reduced rate should not exacerbate the compliance burden in terms of classifying supplies in terms of qualifying or not qualifying for concessional treatment. However, as explained further below, the measurement system used

[15] At the time of the survey, the UK was included in the count of EU countries.

[16] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, as amended [1977] OJ L145/1.

[17] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L347/1.

in the study rated the UK VAT as more complex than that of many other EU countries in terms of cost of concession indicator.

The most significant deviation from the EU mean, however, is apparent in respect of the second factor, the number and frequency of administrative requirements, which suggests the difference is not so much in terms of the substantive VAT law but the specific procedural rules used in the UK.

In the following analysis, each of the four factors, together with the 27 indicators relating to those four factors, is considered in the light of their relevance to the UK VAT system.

B. Factor A: tax law complexity and burden resulting from core elements of VAT policy

Factor A is associated with the perceived degree of complexity and compliance burden resulting from core elements of the VAT policy framework. The set of core elements and associated indicators (six in total, as identified in Table 2) were selected on the basis of previous studies suggesting they have a direct impact on compliance costs.[18]

Table 2: compliance burden indicators for Factor A

FACTOR A: TAX LAW COMPLEXITY AND BURDEN RESULTING FROM CORE ELEMENTS OF VAT POLICY		
Compliance Burden Indicators	**Range**	**UK Score**
The VAT rate structure	1–4	3
The scale (that is, revenue impact) of reduced rates and exemptions	1–4	4
The use of cash records by specified small businesses to calculate the VAT liabilities	1–4	3
Use of rules for prescribed industries that simplify calculations of VAT liabilities	1–4	2
VAT registration requirements	1-–8	5
Optionality (that is, the availability of optional regimes to small businesses)	1–4	4
Total unweighted score range	6–28	21

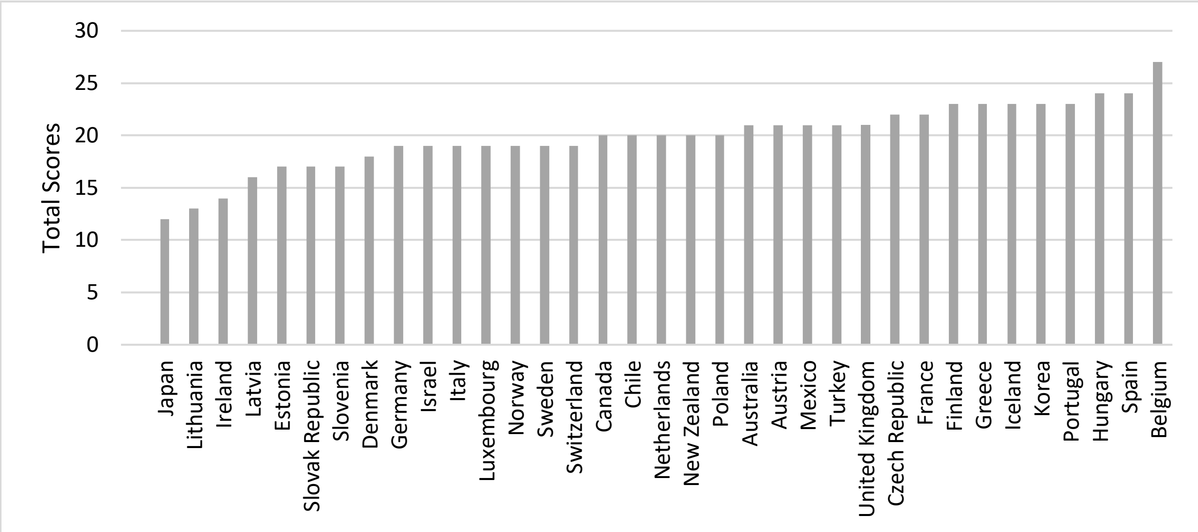
Source: authors’ own calculations based upon data compiled for the Final Report, above fn. 5

The outcomes for Factor A, illustrated in Figure 2 just for the 35 OECD countries, show the UK ranks relatively poorly compared to most of the other OECD members: equal 21st out

18 See for example, C. Sandford, “The administrative and compliance costs of taxation: lessons from the United Kingdom” (1985) 15(3) *Victoria University of Wellington Law Review* 199; C. Sandford, M. Godwin and P. Hardwick, *Administrative and compliance costs of taxation* (Bath: Fiscal Publications, 1989); S. Cnossen, “Administrative and compliance costs of the VAT: a review of the evidence” (1994) 63(12) *Tax Notes* 1609; and K. Bain, M. Walpole, A. Hansford and C. Evans, “The internal costs of VAT compliance: evidence from Australia and the United Kingdom and suggestions for mitigation” (2015) 13(1) *eJournal of Tax Research* 158.

of 35. The outcomes also suggest UK law is marginally more complex and burdensome than New Zealand law,[19] commonly held out as a model of simplicity.[20]

Figure 2: Factor A, tax law complexity and burden resulting from core elements of VAT policy (35 OECD Member Countries, six indicators)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

The rankings in terms of Factor A, VAT complexity and compliance burden resulting from core elements of VAT policy, illustrate the impact of some operational aspects of the diagnostic tool methodology. One operational aspect is the equal weighting of indicators in each factor. Six indicators were used to measure the first factor, tax law complexity. Each was given equal weighting but in any particular instance specific indicators may have a much greater or lesser impact than others on the compliance burden faced by a business. For example, as noted below, the UK received a high score for the impact of concessions (reduced rates, zero rate and exemptions), indicating greater complexity, and an even higher score again for the proportion of businesses registered, while receiving relatively lower scores for four other indicators. However, the impact of the concessions—often involving ambiguous borderlines giving rise to costly classification processes—that apply across the board to all registered enterprises apart from small businesses using a simplified calculation method are likely to affect far more businesses than, for example, the option to use annual accounting, which only applies to a portion of the total pool of registered businesses.

Another operational aspect that impacts on the relative ranking of surveyed countries is the different number of possible responses to queries about each indicator. For example, there are four response categories for most indicators used to measure tax law complexity and burden but eight response categories for the query regarding VAT registration requirement (see Table 2). In each case the range of possible responses was based on data gathered in the course of the pilot study. Where there was a significant difference between practice in countries as was the case, for example, with registration thresholds, and preliminary investigation suggested

[19] The UK's total score for all six indicators is only one point higher than New Zealand.
[20] US Government Accountability Office, *Value-added taxes: lessons learned from other countries on compliance risks, administrative costs, compliance burden and transition* (Washington, D.C., April 2008), 12, fn.12: "New Zealand's VAT – which has a broad base with few exceptions – is generally considered by VAT experts to have the simplest VAT design among OECD countries."

responses would place countries along the entire spectrum from highest to lowest, more choices were offered to respondents as necessary to avoid ranking significantly different jurisdictions in the same group. Addressing the "spread" problem, however, can lead to distortions as all the scores are totalled to find the relative position of a particular country in terms of a compliance burden factor. Thus, for example, the poorest score in the registration requirement question (8) can offset excellent scores for all other indicators or shift the position of a country relative to others.

Notwithstanding these methodological concerns, closer examination of each of the six indicators reveals a number of interesting points related to the design of the UK VAT relative to its European and broader counterparts.

Number of rates

The initial indicator considered for complexity in terms of core VAT design is the number of rates in the tax. Multiple rates give rise to an increased compliance burden by creating more borderlines. The UK has a somewhat different rate structure from those used elsewhere in Europe, providing two positive rates plus, unusually for Europe, also extending the zero rate, commonly reserved for exports, to some domestic supplies.[21] The complexity and the resulting compliance burden are evidenced by the volume of costly litigation, concerning the rates to be applied to particular types of supplies. The zero-rating of food has been the source of continual disputes considering such arcane issues as whether, for example, brownies, tea cakes, and snowballs should be characterised as zero-rated cakes or standard rated confectionery or chocolate-covered biscuits.[22] The problem appears to not be the concession per se (food is often subject to a lower rate elsewhere, leading to similar borderline problems), but rather the problematic definition in the UK of food qualifying for the concession. Moreover, the definitional problems in the law are exacerbated by the constant development of new and innovative products that do not fit neatly into the pre-existing categories designed in 1970s.[23]

In contrast, modern tax systems such as those of Japan, Canada, Australia and New Zealand have only one positive rate in addition to a zero rate. In terms of rate structure, the first of the six indicators considered for complexity, the UK, with two positive rates, is definitely more complex than countries such as New Zealand with one positive rate, though both are recorded as equally complex in respect of this indicator. It might be argued, however, that the partial application of the VAT to some types of supplies in New Zealand could be considered the equivalent to a reduced rate. This is the case, for example with supplies of long-term

[21] The VAT Directive, above fn.17, which governs the structure of VAT laws in the EU, provides for reduced rates or exempt (input taxed) treatment of concessionally taxed items. The UK was allowed to zero-rate many concessionally taxed supplies by way of derogations from the Directive. The derogations were originally sought by the UK to mitigate domestic political opposition to the adoption of the VAT by removing tax from goods that were untaxed under the predecessor Purchase Tax.

[22] See, for example *Pulsin' Ltd v HMRC* (*Pulsin'*) [2018] UKFTT 775 (TC) (sale of chocolate brownies); *Marks & Spencer plc v CC&E (No.5)* [2009] UKHL 8 (sale oftea cakes); *Lees of Scotland Ltd, Thomas Tunnock Ltd v HMRC* [2014] UKFTT 630 (TC) (sale of snowballs); *Swedish Snowball Production Ltd v CC&E* (MAN/86/0305) (sale of snowballs).

[23] In *Pulsin'*, above fn.22, [2018] UKFTT 775 (TC), the First-tier Tribunal noted that: "It is the Tribunal's view that the current state of the law on the taxation of food items is not fit for purpose and will necessarily present apparently anomalous results as tastes and attitudes to eating change. The Tribunal fundamentally disagrees with HMRC's guidance that the borderline between cake and confectionary presents few problems. The lines set and perceived by HMRC in the application of this out of date provision…drives anomalous outcomes."

residential accommodation in commercial dwellings, where the tax is imposed on only 60 per cent of the value supplied.

Percentage of the tax base lost to reduced rates and exemptions

The second indicator of tax policy contributions to the compliance burden looks at the extent of concessions in the VAT law, measuring these as a percentage of the tax base lost to reduced rates (including a zero rate) and exemptions. The larger the scope of goods and services subject to concessions, the more likely categorisation problems will arise.

Some concessions are almost universal. Almost all VAT systems under-tax some or all real property, treating particular supplies or all supplies of real property as exempt supplies. Almost all countries also characterise at least some financial supplies as exempt supplies, meaning they are concessionally taxed for final consumers and over-taxed for businesses and depositors. Found in all but a few VAT systems, the financial supplies concession should, in theory, have almost no impact on the relative ranking of jurisdictions in respect of this indicator. The magnitude of the impact will depend, however, on both the extent of the exempt treatment and on the relative size of the financial sector in the jurisdiction. The UK is particularly susceptible to complexity from the treatment of financial supplies as exempt supplies with the financial sector accounting for almost 7 per cent of the UK GDP, a larger proportion than that of 29 other OECD countries.[24]

The UK sits, with a number of EU Member States and some other countries, in the highest complexity group in terms of the reduced rates and exemptions indicator. In one sense, the result may underestimate the impact of concessions in the UK, however, as the survey lumped together all jurisdictions in which the revenue cost of tax expenditures exceeded 30 per cent of the estimated VAT base (that is, the base that would be subject to tax if not for concessions), leaving the UK, with a tax expenditure cost closer to 40 per cent of the potential base, with the same score as jurisdictions with almost 25 per cent smaller tax expenditure ratios.

Leaving aside the compression into one group of jurisdictions with a range of higher levels of concessions, the UK has a higher score (signifying a higher compliance burden) than some of its former fellow EU states and clearly above most countries outside the EU. The UK and all EU jurisdictions will share a degree of complexity attributable to compulsory concessions mandated by the EU VAT Directive. The Directive requires Member States to treat a number of specified supplies, including financial supplies, education and medical services, as exempt supplies.[25] But the UK fares poorly even within this group. To a limited extent this is attributable to its use of standard and reduced rates—Denmark, with a single positive rate, not surprisingly scores better than the UK, for example. The most significant cause of the UK's relatively poor ranking compared to its former fellow members within the EU camp, however, is the adoption of tax concessions not mandated by EU law, the most important of which is the zero-rating of most types of food, removing all tax from these supplies.

In another sense, this indicator, based on the percentage of the tax base lost to concessions, may exaggerate the tax burden in the UK relative to other countries. The same boundary

[24] C. Rhodes, "Financial Services: Contribution to the UK Economy" (31 July 2019) House of Commons Library, Briefing Paper No.6193.
[25] VAT Directive, above fn.17, Arts 131–137.

problems arise whether a concession takes the form of a lower rate, an exemption, or a zero-rate.[26] All three types of concession present taxpayers with the prospect of additional costs incurred to determine whether multi-element supplies should be characterised as mixed supplies (supplies that can be severed into different components for VAT purposes) or composite supplies (supplies comprising different elements but considered to be single supplies for VAT purposes).[27] They do not lead to similar revenue losses, however, with the cost of the UK's zero-rated concessions higher than that of the reduced rates or exemptions found in many other countries.

In addition to these costs, exemptions give rise to a further compliance burden in terms of calculating entitlement to input tax deductions when businesses, known as "partially exempt businesses" in the UK, make both exempt and taxable supplies. As deductions for input tax are only allowed where an input is used to make a taxable supply, these businesses must track the application of all inputs to apportion the use of inputs between taxable and exempt supplies. While the UK VAT law provides a standard method for apportionment, it allows, subject to the approval of HMRC, taxable persons to use a special method that achieves a fair and reasonable result.[28] This significantly increases compliance costs as businesses do multiple calculations to achieve the best result and the special methods devised by businesses are often challenged by HMRC, leading to expensive appeals.[29] The Office of Tax Simplification suggested that there is scope to simplify rules regarding the standard method.[30] However, there is no easy solution to the continuing disagreements between HMRC and taxpayers over the special methods proposed by the taxpayers unless the scope of exemptions could be narrowed.

Percentage of small businesses that use cash accounting[31]

The third indicator considered in the measurement of tax law complexity is the percentage of small businesses that use cash accounting with a lower percentage signifying a higher level of complexity. This builds on an assumption that cash accounting results in a lower compliance burden for small businesses. The UK was assigned a score higher than average, presumably because fewer small businesses considered in the survey use cash accounting. However, the relatively low take-up of the cash accounting option may be a poor proxy for greater complexity. It may, rather, reflect the relatively high registration threshold in the UK, which leaves the smallest businesses that might form the bulk of cash accounters outside the VAT

[26] See, for example, in respect of the zero-rating of food supplies: *Compass Contract Services UK Ltd v HMRC* [2006] EWCA Civ 730; [2006] STC 1999; [2006] BVC 569 (sale of cold prepared food from retail outlets on unrelated business premises); *Mucho Mas Ltd (t/a Chilango) v HMRC* [2016] UKFTT 302 (TC); [2016] TC 05071 (sale of take-away Mexican-style food and salads). Examples of characterisation problems resulting from exemption of education supplies include: *Hocking v HMRC* [2014] UKFTT 1034 (TC) (supply of pilates lessons); *Cheruvier (t/a Fleur Estelle Belly Dance School) v HMRC* [2014] UKFTT 7 (TC) (supply of belly dancing classes); and *Marcus Webb Golf Professional v HMRC* [2012] UKUT 378 (TCC); [2013] STC 574 (supply of golf lessons).
[27] See, for example, *British Airways plc v CC&E* [1990] STC 643 (CA) (meal on flight incidental to the air travel); *Sea Containers Services Ltd v CC&E* [2000] STC 82 (QB) (meal on train ride the primary element of the supply and distinguishable from travel component).
[28] Value Added Tax Regulations 1995 (SI 1995/2518) regs 101(2) and 102.
[29] See, for example *St Helen's School Northwood Ltd v HMRC* [2006] EWHC 3306 (Ch) (school applied for a partial exemption special method input tax calculation where sports complex rented to a subsidiary).
[30] Office of Tax Simplification, *Value Added Tax: Routes to Simplification* (2017).
[31] VAT taxpayers generally pay VAT (or claim input tax credits or refunds) when invoices are issued (or received). In many countries, small businesses have the option to use a cash accounting method, under which VAT is calculated on the basis of payments received or made.

system. Alternatively, it may reflect the possibility that the supposed simplification benefits from cash accounting are largely imagined by policy makers.

Small and medium enterprises, particularly those selling to final consumers, are most likely to sell on an immediate payment basis. The most important source of accrual transactions with deferred payments in many small businesses is purchases from larger businesses that invoice customers. In these cases, cash-basis accounting brings no deferral benefit in terms of obligation to remit VAT but does entail the cost of deferred entitlement to input tax credits.

It is also not clear if cash-basis accounting is less costly for taxpayers from a technical procedure perspective. Where an enterprise issues an invoice allowing for deferred payment, it must record the debt due at the time of sale and keep track of the debt regardless of whether consideration for a supply is recognised upfront or when the invoice is paid; in other words, the benefit of cash-basis taxation appears to come from the time value of money, not simpler or more complex accounting systems.[32]

Importantly, the focus on the compliance burden aspect of a cash-basis tax accounting regime may mask other consequences of the regime. Evidence has shown cash-basis options can be exploited by taxpayers using mis-matching schemes between related entities when a cash-basis vendor sells to an accrual-basis buyer and the buyer's entitlement to an input tax credit is not matched by an offsetting liability by the seller to remit output tax.[33] The arrangements could trigger a refund for the buyer, effectively interest-free finance until a project in train matures into the sale of taxable supplies. The problem has prompted the adoption of specific anti-avoidance rules in a number of jurisdictions that place constraints on access to cash-basis accounting, in the process adding a further layer of complexity to the law.

There may be a correlation between the robustness of anti-avoidance rules aimed at abuse of cash-basis accounting and the take-up rate of this option by small businesses. It seems, for example, that cash-basis accounting is used less in the UK than in New Zealand, which uses a specific anti-avoidance rule that is less strict than the specific anti-avoidance rule in the UK,[34] and the take-up is greater again in Australia, which has no specific anti-avoidance rule and instead relies on a vaguer general anti-avoidance rule[35] not targeted at this particular type of abuse.[36]

Rules for prescribed industries to simplify the calculation of VAT liability

The fourth indicator considered for Factor A is the percentage of VAT registrants using special schemes for prescribed industries that simplify calculations of VAT liabilities. The underlying assumption is that regimes designed to simplify calculations reduce the compliance burden.

[32] Empirical research supports the conclusion that the primary reason for using cash accounting is the financial benefit it offers and further that businesses recognise the increased complexity it entails; see R. Klahr, et al., *Behaviours and Experience in Relation to VAT Registration: Final Report* (HM Revenue and Customs Research Report No.446, 2017).

[33] See Y. Zu and R. Krever, "GST cash and accrual mismatches: avoiding the avoidance" (2017) 46(4) *Australian Tax Review* 271 .

[34] Goods and Services Tax Act 1985 (NZ) s.19D(1); Value Added Tax Regulations 1995 (SI 1995/2518) (UK) reg.58(2), amended by Value Added Tax (Amendment) (No. 3) Regulations 1997 (SI 1997/1614) (UK) reg.3.

[35] A New Tax System (Goods and Services Tax) Act 1999 (Cth) Div. 165 (AU).

[36] For a discussion on the anti-avoidance rules in the UK, New Zealand and Australia, see Zu and Krever, above fn. 33.

The UK obtained a score that is one level higher than the least complex score available for this indicator. Special regimes in the UK VAT include systems that are optional at the discretion of the VAT registrant, systems that are optional but available only on approval by HMRC, and a compulsory system.

One of the most common forms of simplification calculation rules is a rule prescribing presumptive input tax entitlements. The UK has two types of schemes for presumptive calculations of input tax credits. The first is an optional scheme that can only be used by enterprises that first obtain HMRC approval to use the scheme. The Flat Rate Scheme (FRS) is an example of such a scheme.

The FRS is an optional presumptive regime that allows eligible enterprises to opt for a pre-determined input tax entitlement rather than accurately measuring the input tax incurred on acquisitions used to make their supplies. The scheme is available to small businesses across all industries and sectors provided their turnover is below the eligibility threshold. The presumptive credit is calculated as a percentage of the value of sales and is set by regulation on the basis of estimates of the average input tax entitlement of businesses making particular types of supplies.[37]

Because they are based on assumptions of average entitlements, the presumptive allowable credits are almost certain not to equal exactly the entitlement of any particular business, with some businesses able to realise financial benefits from the presumptive credits while others would suffer financial detriment were they to use the presumptive credits. Small businesses therefore have an incentive to calculate their liabilities both under the ordinary VAT system and the FRS, a process that no doubt increases their compliance burden.[38] In 2017–18, about 60 per cent of all VAT registrants were eligible to join the FRS, but only 24 per cent of those who were eligible to join actually did so.[39]

The more types of supplies specified for presumptive input tax purposes, the more accurate the estimated tax may be. Canada's regime,[40] for example, divides all businesses into two categories. The UK regime has 55 different presumptive input tax categories. However, the greater breakdown also impacts on complexity of the regime and resultant compliance burden as taxable persons need to classify their supplies across far more borderlines. Also, the proliferation of categories is more likely to give rise to complications from mixed supplies that may fall in different input tax recovery bands.

With taxpayers required to break their businesses down to fit into 55 different presumptive categories, the FRS provides an excellent example of a regime that is intended to simplify but in practice generates considerable complexity. Unfortunately, a questionnaire that uses generic questions, a prerequisite for multiple jurisdiction surveys, cannot always capture specific operational considerations of this sort.

The second type of presumptive input tax credit scheme is a set of optional schemes, not dissimilar in operation from the FRS, that can be used by small businesses without first obtaining the approval of HMRC. The retail schemes are leading examples of the second type

[37] Value Added Tax Regulations 1995 (SI 1995/2518) reg.55K.
[38] KPMG, *Administrative Burdens – HMRC Measurement Project: Report by Tax Area Part 27: Value Added Tax* (March 2006).
[39] HMRC, *Value Added Tax (VAT) Annual Statistics 2017-2018* (2018), Tables 5a and 7.
[40] Known as the "Quick Method of Accounting for GST/HST".

of scheme.[41] These schemes provide simplified calculation methods that remove the need for retailers to separately calculate input tax credits from acquisitions and output tax on sales. Instead, the two processes are consolidated by substituting a presumed overall VAT liability based on sales of supplies at each VAT rate.

The most significant compulsory simplification regime in the UK VAT is the Tour Operators Margin Scheme (TOMS), which was obligatory under EU law.[42] Under the TOMS rules, travel agencies that purchase and resell travel entitlements calculate VAT liability on their margin, removing the need to register in multiple EU Member States to recover VAT while ensuring there is no further tax imposed on tax-inclusive acquisitions of services from the other jurisdictions. Once again, the accuracy of an assumption that use of a "simplified" regime is an appropriate indicator of a reduced compliance burden might be questioned. Special regimes for a particular prescribed industry assume businesses operate in strict silos, an assumption often out of step with modern commercial practice. Travel arrangements, for example, may be provided in the context of conference services, leading to complex questions as to whether the supply is a single supply of conference services or a severable mixed supply of conference and travel arrangements, with the latter component subject to the TOMS regime.[43]

A truly accurate assessment of the impact of presumptive regimes would require knowledge of the take up rates for the schemes. Information on take up rates varies depending on whether the schemes fall into the compulsory, optional with approval, or optional with no approval needed groups. While data on the uptake of schemes that are compulsory or that require HMRC agreement could potentially be provided by HMRC, the tax administration has no information on the number or character of taxpayers who use other schemes to calculate their VAT liability.

The variety of simplification schemes used in a single jurisdiction provides a useful illustration of the limitations of generic questionnaires to unravel the nuances of individual systems. For example, a question on the take-up of simplification schemes will not be able to capture the impact of compulsory schemes such as TOMS with a 100 per cent participation rate and optional schemes such as FRS with less than a quarter of eligible businesses participating. The scheme with a fraction of the participation rate may be much larger in absolute terms given the scale of its coverage—almost all small businesses.

Proportion of businesses that register for VAT purposes

The fifth indicator used to measure complexity from core policy features of the VAT is the proportion of businesses that register for VAT purposes. The UK was assigned a relatively high (more complex) score for this indicator, reflecting the fact that a high percentage of businesses in the country are registered VAT taxable persons. Ironically, the large proportion of businesses that are registered comes despite the fact that the UK has a very high registration threshold—

[41] Three VAT retail schemes are available. Retailers who are able to identify the VAT rate for each item at the time of sale can use a "Point of Sale Scheme". Other retailers can use what is known as the "Apportionment Scheme". Retailers who make only a small proportion of sales subject to one VAT rate and the majority subject to another can use a "Direct Calculation Scheme".
[42] VATA 1994, s. 53, implementing the VAT Directive, above fn. 17, Arts 306-310.
[43] See, for example, *Travel Incentives Meetings Exhibitions Ltd v HMRC* [2016] UKFTT 24 (TC).

higher than any of the other EU or OECD countries surveyed. The reason for the high participation figure is its remarkably high voluntary registration rate of about 45 per cent.[44]

The fact that many registrations are voluntary does not negate the value of this indicator as a proxy for measuring structural complexity in the VAT—whether they volunteer or are required to register, once in the system taxpayers must bear any compliance costs flowing from participation in the VAT regime. Voluntary registration, on its face, indicates that the enterprises believe ancillary benefits—entitlement to input tax credits by businesses making zero-rated supplies or the ability to sell to registered enterprises that only buy from other registered businesses, for example—outweigh the costs of compliance. In 2017–18, voluntary registrants claimed a total refund of £1,480 million from HMRC, rather than making net payments.[45] On the other hand, the high voluntary registration rate may simply reflect the fact that overall the additional costs of VAT compliance are unlikely to be significant for businesses that must record all sales and purchases in any case for income tax purposes, particularly in the digital era when record-keeping and calculations are largely automated.

Optionality

The final indicator in Factor A is the availability of optional regimes for small businesses. In some cases, options not only "simplify" compliance tasks but also reduce a business' VAT liability by substituting factors such as permitting tax deferral or providing presumed input tax entitlements more generous than those actually arising. The survey assumes the greater the number of options available, the greater the compliance burden, a consequence of a taxable person computing liability both with and without the optional treatment to determine which results in the lowest effective tax burden. The UK does poorly in this respect, with many choices available to small businesses. A number of these were described above in the context of (elective) presumptive input tax credit schemes. As explained above, some optional schemes require HMRC approval while enterprises can elect to use others without notifying HMRC. An important optional scheme outside the presumptive input tax credit group is the option to use, with HMRC approval, annual accounting periods.

C. Factor B: number and frequency of administrative requirements to comply

Factor B is associated with administrative obligations and events arising under the VAT law and the compliance burden these impose on business. Eleven indicators, as specified in Table 3, were used to measure the impact of this factor on compliance costs.

Table 3: compliance burden indicators for Factor B

FACTOR B: NUMBER AND FREQUENCY OF ADMINISTRATIVE REQUIREMENTS TO COMPLY		
Compliance Burden Indicators	**Range**	**UK Score**

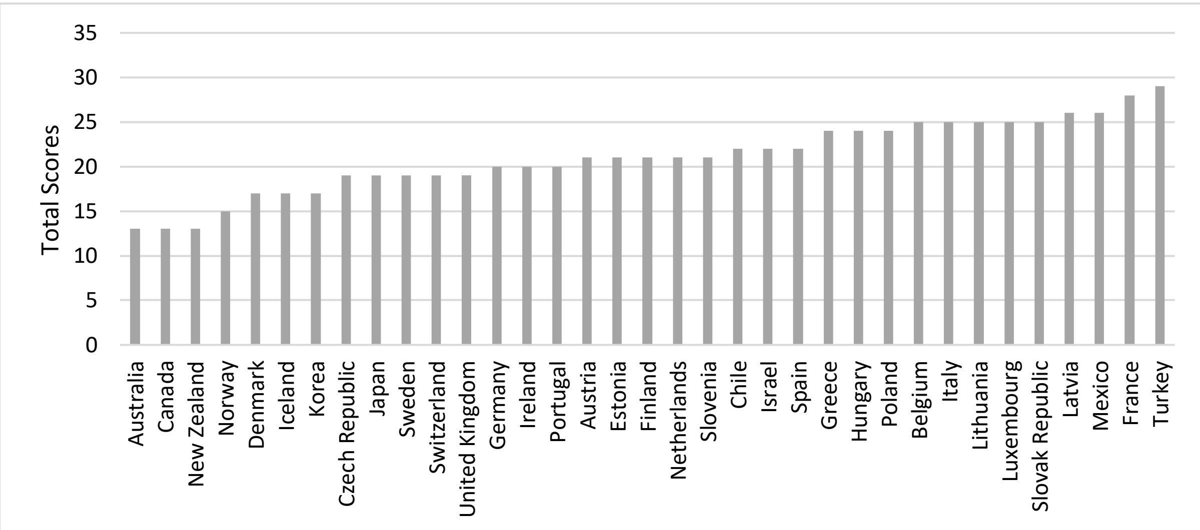
[44] Authors' calculation based on HMRC, *Value Added Tax (VAT) Annual Statistics 2017-2018*, above fn.40, Table 5a. The voluntary registration rate is the percentage of the total number of registrants that has registered voluntarily
[45] HMRC, *Value Added Tax (VAT) Annual Statistics 2017-2018*, above fn.40, Table 5b.

Electronic VAT registration	1–4	1
Staggered VAT payments for small businesses	1–3	1
Staggered return filing periods	1–3	1
Information requirements of typical VAT return form	1–4	1
Documentation requirements for exported goods and services	1–4	1
Other reporting requirements in addition to the VAT return	1–4	4
Use of electronic VAT invoices between businesses	1–4	1
Invoice reporting requirements to revenue body	1–3	1
Record retention periods	1–3	2
Number of VAT verification actions	1–-3	3
Level of disputed VAT assessments	1–3	3
Total unweighted score range	11–-38	19

Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

Figure 3 summarises Factor B outcomes for the 35 OECD countries.

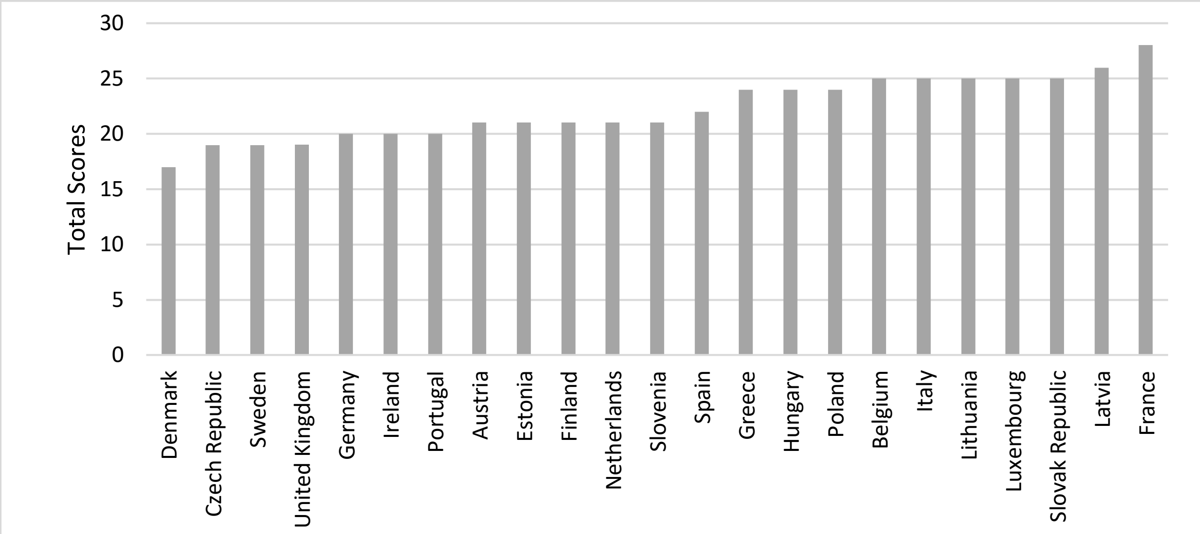
Figure 3: Factor B, number and frequency of administrative requirements to comply (35 OECD Member Countries, 11 indicators)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

The UK's placement in terms of Factor B (see Figure 3) is better than the middle point for all OECD countries surveyed. It is the only factor in which the UK's relative position changes notably (in this case positively) if its score is compared only to surveyed EU countries rather than the larger set of surveyed OECD countries (see Figure 4).

Figure 4: Factor B, number and frequency of administrative requirements to comply (selected EU countries and the UK, 11 Indicators)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

The outcome is a consequence of the fact that a number of non-EU OECD jurisdictions perform better than the UK in terms of this factor. The UK was given the lowest possible scores (signifying the lowest compliance burden) for complexity in seven of the 11 indicators for this complexity factor:

- the large number of businesses that make use of electronic registration (more than 50 per cent);
- the less frequent payment periods provided to small businesses;
- the less frequent filing requirements for small business;
- the small amount of information required on returns;
- the absence of any requirement for extra documentation for exports;
- the extensive use of electronic invoices between businesses; and
- the extremely limited requirement to furnish copies of invoices to HMRC.

The UK's ranking with the lowest compliance burden score in terms of tax return filing frequency does not mean the UK has achieved a superior performance in this area. More than 70 per cent of the countries surveyed were ranked similarly, an outcome that perhaps reflects the choice of the criterion used to determine the compliance burden in terms of filing, with the best possible score being given for quarterly or less frequent filing for small businesses. It is not uncommon for VAT systems generally to be based on quarterly filing for all but the largest businesses, which are subject to monthly filing, so quarterly filing does not reflect a concession for small businesses so much as the norm for businesses other than the very large.[46]

The UK has a middle ranking in terms of record retention periods and sits in the group of highest burden countries in terms of the number of taxable persons required to provide further information in the course of revenue audit activities, the number of disputed VAT assessments and reporting requirements in addition to the periodic VAT return. The UK score for the last

[46] In some cases, VAT systems permit taxable persons regularly entitled to VAT refunds to file more frequently and may require more frequent filing by taxable persons on an administrative watch list.

indicator matches that of most other EU jurisdictions and most likely reflects the fact that under European law, taxable businesses located in Member States must provide monthly statements of exempt intra-Community supplies of goods and services (subject to derogations permitting quarterly filling for supplies below a trigger threshold) to assist in the detection of intra-Community VAT fraud.[47] The fact that it is a European requirement applicable to all EU Member States means the lower score has no impact on the relative position of each country..

D. Factor C: revenue body capabilities in meeting taxpayers' service and compliance needs

Factor C is assigned eight indicators that provide an insight into how well each country's revenue body helps taxable persons comply with their obligations and thereby reduce their compliance burdens. The indicators (see Table 4) relate to the nature and quality of specific services of the revenue body (for example, the comprehensiveness of its website, the quality of its phone enquiry service, the ability to provide timely VAT refunds).

Table 4: compliance burden indicators for Factor C

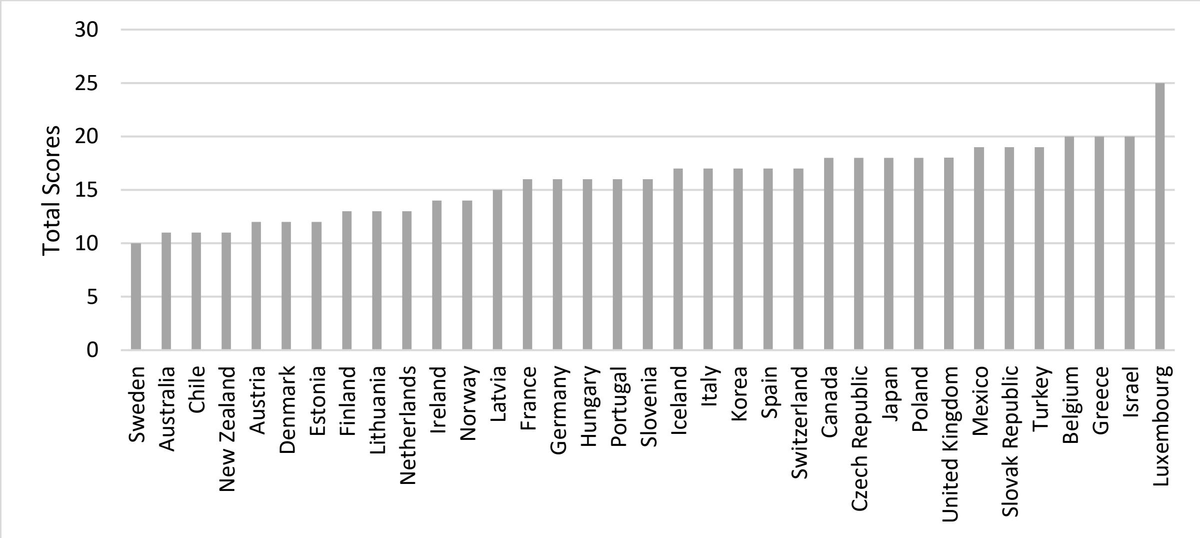
FACTOR C: REVENUE BODY CAPABILITIES IN MEETING TAXPAYERS' SERVICE AND COMPLIANCE NEEDS		
Compliance Burden Indicators	**Range**	**UK Score**
The revenue body's website	1–3	1
The revenue body's phone enquiry service	1–4	3
Support for newly registered businesses	1–4	4
The revenue body's online tax payment facilities	1–4	1
The revenue body's VAT online return filing service	1–4	1
Quality of the revenue body's online transaction services	1–4	2
The revenue body's refunding of excess VAT payments	1–4	3
The revenue body's private rulings service	1–3	3
Total unweighted score range	8–30	18

Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

Figure 5 summarises the outcomes for Factor C for the 35 OECD countries.

[47] Known as "recapitulative statements". Council Directive 2008/117/EC of 16 December 2008 amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions [2009] OJ L14/7 Art.1(3).

Figure 5: Factor C, revenue body capabilities in meeting taxpayers' service and compliance needs (35 OECD Member Countries, eight Indicators)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

The UK is ranked poorly in terms of revenue body capabilities in meeting taxpayers' service and compliance needs, with the ranking consistent across all surveyed jurisdictions, OECD members and EU Member States surveyed. While the UK had the lowest possible score, indicating the lowest compliance burden, for three of the eight indicators used to measure this factor, many countries obtained the lowest scores across more indicators. HMRC's website, along with their online payment and online return filing services, all received the best score possible. Three factors for which HMRC received a mid-point score, lowering their relative placement, were the time required to complete refunds, the quality of responses to telephone enquiries, and the time required for a private ruling. Their poorest ranking was in terms of support for newly registered businesses.

E. Factor D: monetary costs and benefits associated with the act of complying

Factor D is allocated two indicators that explore aspects of the monetary costs and benefits involved in complying with VAT laws, as shown in Table 5.

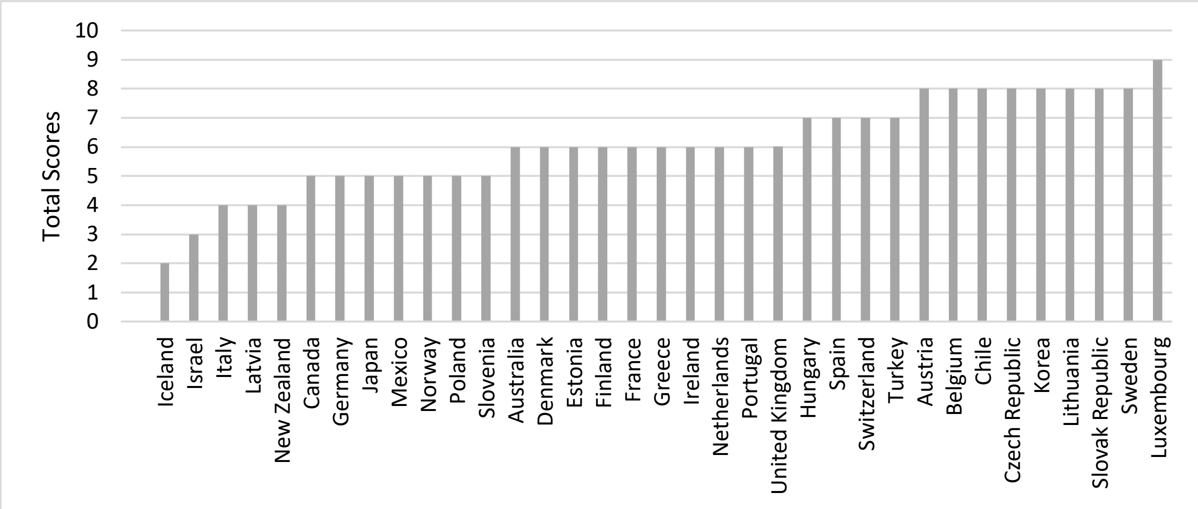
Table 5: compliance burden indicators for Factor D

FACTOR D: MONETARY COSTS OR BENEFITS ASSOCIATED WITH THE ACT OF COMPLYING		
Compliance Burden Indicators	**Range**	**UK Score**
The payment of interest on delayed refunds	1–4	1
Aggregate value of annual VAT refunds	1–5	5
Total unweighted score range	2–9	6

Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

Figure 6 summarises the outcomes for Factor D for the 35 OECD countries.

Figure 6: Factor D, weighted scores (35 OECD Member Countries, two indicators)



Source: authors' own calculations based upon data compiled for the Final Report, above fn. 5

The UK, along with nine other jurisdictions, sits mid-way along the compliance burden spectrum in terms of the fourth factor considered in the study: the monetary costs and benefits associated with the act of complying. The first of the two indicators used to measure monetary costs and benefits is the payment of interest on delayed refunds. The UK was found to have the lowest compliance burden score for this indicator, with interest, referred to as a "repayment supplement" in the UK, payable if HMRC take longer than 30 days to approve ("authorise") a repayment. The 30 day period commences the day HMRC receive a VAT return and ends the day the repayment is approved, not the day it is received. HMRC exclude from the time period days taken to check that a return is accurate and legitimate, and to correct any errors or omissions. Importantly, the repayment supplement is the higher of 5 per cent of the repayment or a minimum £50 payment. This could be much higher than the normal interest rate payment that would be paid on delayed refunds in other jurisdictions.

The second indicator used to measure the monetary costs and benefits factor is the aggregate value of annual VAT refunds, an indicator that reflects the churning feature of a VAT that imposes tax on supplies both to final consumers and registered businesses that can recover the tax by means of input tax deductions. The UK was given the highest compliance burden score for this indicator, meaning the value of VAT refunds annually is 40 per cent or more of annual gross VAT collections. VAT refunds arise where output tax exceeds input tax in a period. Generally, enterprises may be entitled to refunds in five different situations: when they acquire higher levels of stock in one period for sale in the next following ordinary business cycles; when they acquire capital assets that will be used in the business for many tax periods in the future; when they are in a loss position; when they make substantial zero-rated supplies that incur no output tax but give rise to an entitlement to refunds of input tax; and when they are entitled to input tax credits on acquisitions used to make out-of-scope supplies such as supplies by government-owned bodies and authorities.[48]

[48] VATA 1994 s.33 sets out details of public bodies that may claim input tax credits even though they make no business supplies.

The first three situations that might give rise to refunds arise in all economies and are probably close to neutral in their impact on ranking on this particular issue. The key difference between the UK VAT and that of other jurisdictions likely arises in respect of the fourth reason an enterprise might be entitled to a refund, significant zero-rated sales. The most significant group of supplies that give rise to excess VAT credits in most countries comprises zero-rated exports, the sole type of zero-rated supply in most VAT jurisdictions. This is not the cause of the UK's abysmal ranking in terms of the monetary costs and benefits factor. Exports are high in the UK—almost 30 per cent of GDP is attributable to exports[49]—but the importance of exports in the UK is still less than that in Italy,[50] which sits at the opposite end of the compliance burden scale in terms of the refunds indicator.

The crucial difference between the UK VAT and that of most other jurisdictions is the use of zero-rating to subsidise the acquisition of many types of supplies, most notably food. Elsewhere, and in the EU in particular, concessions take the form of reduced rates or exemptions. The latter can never generate refunds of excess VAT credits as businesses making exempt supplies are not entitled to credits for tax on inputs and the former can give rise to refunds only if the claimant has inputs that are taxed at higher rates than outputs and very small profit margins on sales.

Tax scholars have long criticised the breadth of the UK zero-rate concessions that achieve no discernible policy objective[51]: the deliberate subsidy for cake, but not biscuits, for example, is cited time and again as an example of poor policy-making.[52] But while the often bizarre distinctions and many borderlines to which they give rise undoubtedly lead to onerous compliance costs, it may not be accurate to view the process for distributing the subsidy, refunds of excess credits on zero-rated supplies, as an indicator of the burden of tax compliance. The level of refunds might more accurately be described as an indicator of the subsidy cost borne by suppliers. Rather than subsidise consumers directly, the Government pays the subsidy to suppliers in the hope that the subsidy will be passed on entirely to the consumers. It does so, however, only after the suppliers have paid the full tax-inclusive price for inputs, leaving suppliers out of pocket for the period between acquisition and refund.

IV. Challenges and policy implications for the UK

The placement of the UK in the overall ranking as a jurisdiction with a higher compliance burden than more than half the OECD nations may reflect in part the questions asked and differing interpretations of the questions by survey respondents. Among other things, the survey results show how generic questions necessary for a multi-jurisdiction survey covering 47 tax jurisdictions cannot always capture the specific nuances of sometimes significantly different regimes. They also reveal considerable confusion as to the most appropriate indicators of higher or lower compliance costs. The availability of elective presumptive input tax credit regimes, for example, is simultaneously considered a contributor to reduced compliance burdens in the input tax indicator (the "use of rules for prescribed industries that simplify

49 Office for Budget Responsibility, *Economic and Fiscal Outlook* (October 2018), Cm.9713).
50 World Integrated Trade Solution, *Italy Trade Statistics* (World Bank), available at: *https://wits.worldbank.org/CountryProfile/en/ITA* [Accessed 1 July 2020].
51 See, for example, I. Crawford, M. Keen and S. Smith, "Value added tax and excises" in Adam, et al. (eds) for the Institute for Fiscal Studies, *Dimensions of tax design*, above fn.1, 275; and E.H. Davis and J.A. Kay, "Extending the VAT base: problems and possibilities" (1985) 6(1) *Fiscal Studies* 1.
52 *United Biscuits (UK) Ltd v CC&E* [1991] LON/91/160. VAT Decision 6344.

calculations of VAT liabilities") and a contributor to higher compliance burdens in the optionality indicator. The former view reflects that of the policy makers who have adopted the system in the belief that it may reduce the compliance burden. The latter reflects the view of practitioners who are responsible for making the alternative calculations. The seemingly contradictory indicators are not evidence of poor survey design. Rather, these reveal the complexity involved in policy making regarding some features of VAT systems. Special regimes that were adopted as simplification schemes may increase the compliance burden in other ways. This requires policy makers to take an all-round view and carefully balance simplification benefits and the additional compliance burden that would arise when considering adoption or designing simplification schemes.

Despite the many acknowledged difficulties, it is probable that all misplaced, misstated or contradictory indicators similar to those that distort the actual position in the UK also impact on the absolute scores of other jurisdictions. Leaving aside the accuracy of the absolute or relative ranking of the UK, it is clear there is scope for reduction of the compliance burden borne by UK enterprises fulfilling their VAT obligations.

Features of both the legislation and the administrative rules and practice can give rise to compliance burden. While the UK tax administration generally scores well in the study, there is some room for improvement, particularly in respect of the performance of HMRC in dealing with newly registered enterprises. The most significant sources of compliance burden, however, are not in the administration of the law but rather in its design. Many features of the UK VAT, particularly the generous concessions that give rise to continual interpretation disputes, are based on derogations from the governing EU law granted to the UK so it could replicate conditions in the predecessor Purchase Tax, mitigating some of the opposition to adoption of the VAT.

Whatever their political merits four and a half decades ago, the multitude of concessions in the UK VAT system are particularly ill-suited for a society and economy fundamentally different in all respects from that in place almost half a century ago.[53] There is no doubt that removing concessions would significantly reduce the complexity of the VAT. There were, to be sure, both technical and political hurdles confronted by would-be reformers. The technical constraints came in the form of rules in the EU VAT Directive that mandate exemptions for a wide range of supplies. Political concerns explain the continuing use of zero-rate concessions, with rare attempts to remove the concessions invariably rebuffed.[54] It is, nevertheless, essential that means to overcome these constraints be found if there is to be a serious winding back of deadweight and counter-productive compliance burden. The UK's departure from the EU has removed the technical constraints; only the political hurdles remain.

The UK has a once in a generation opportunity to effect real change. A government that seized the opportunity to reform the VAT law to make meaningful reductions to the business compliance burden could provide lasting improvements to the internationally competitive position of UK businesses. The unknown element in the equation is the extent of those political hurdles. The importance of addressing the current causes of compliance costs becomes all the

[53] Office of Tax Simplification, above fn.30.

[54] A useful illustration of the difficulties may be found in the Conservative Government's 1993 attempt to impose VAT on domestic energy that had been subject to zero rate since the introduction of VAT in 1973. Following its defeat on the issue, the Government was only able to impose a reduced VAT rate of 8%, which was lowered to 5% by the Labour Government in 1997. For the history of reform of VAT on domestic energy, see A. Seely and R. Twigger, *VAT on fuel & power* (House of Commons Library Research Paper 97/87, 9 July 1997).

more pressing in the face of pending new costs UK businesses will face post-Brexit. The freedom created by Brexit in terms of VAT design should be exploited to achieve compliance cost reductions needed to offset new costs likely to arise in the post-Brexit era.