The Future of VAT in the UK

January 2023

Building a better working world

Future of VAT in the UK

Dear reader,

Thank you for joining EY on our journey to consider the future of VAT in the UK.

We are delighted to introduce this report, which summarises our findings and explores ‘what might be next’ for the VAT regime in the UK.

This report is the culmination of conversations with many businesses and clients, extensive research via completed questionnaires, meetings, and workshops. Each of the different methods of engagement have held one common thread: ideas being shared by people who are passionate about the VAT regime and want to see it more effectively meet the needs of all stakeholders and wider society to build a better future.

While this report is the culmination of our work since January 2021, it feels like it is just scratching the surface. We couldn’t possibly summarise all the information we have received, and the opinions contributed. However, if we distil all the contributions, we have heard two clear messages:

1. We are at a unique moment for the UK VAT system: with HMRCs aspiration to move towards real-time reporting and wider digitisation; the end of the Brexit transition period; the opportunity for indirect taxes to be used to drive sustainability and the economic challenges related to the COVID-19 pandemic. Therefore, now is the time for the Government to undertake a comprehensive review of the VAT system, to modernise it and ensure that it is aligned with its policy objectives.
2. To achieve the ambition of delivering real-time reporting by 2030, HMRC needs to share a sufficiently detailed and clear roadmap for implementation, which gives businesses enough time to invest in the necessary technology to achieve compliance.

EY also calls for further dialogue between the Government and businesses of all types and sizes along with their advisors, because the success of any review will be determined, in large part, by high levels of engagement from all stakeholders.

It is in the context of these overarching messages that we present this report to you. We have covered the following areas and we hope you find these both insightful and thought-provoking.

- VAT as a digital tax
- VAT as a lever for change, with a focus on sustainability
- The HMRC relationship with business
- The alignment of the UK VAT regime with other indirect tax regimes globally, in particular, EU VAT

Where we have included suggestions or recommendations, these should be read as examples of what should be considered under the comprehensive review of the tax.

As we finish, we thank everyone who has been involved with the Future of VAT in the UK campaign and look forward to continuing to working with you.

Yours,

Jamie Ratcliffe
EY UK&I Indirect Tax Leader

David Reaney
EY UK&I Indirect Tax Partner

Value Added Tax (VAT)

Value Added Tax (VAT) has been a staple of the UK economy since 1973, when the country joined the European Economic Community. It was designed to meet the societal needs of the time, and the tax has been tweaked in the decades since, but always within the framework of the EUs evolving VAT system.

The world has changed significantly in the last 50 years – whether through the explosion of computer technology, the relentless pace of cross-border business, the evolving geopolitical context, or the urgency of climate change.

Despite this, VAT has never had a thorough public review during this period.

It's a worthy ambition. VAT can be a powerful lever. It could be reimagined to drive the latest social policy, encourage new behaviours and support the UK in meeting a range of ambitious objectives – whether hitting carbon net-zero by 2050, boosting exports for "Global Britain", or levelling up across the UK.

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For example, the Government could change rates in seeking to drive sustainable practices. It could adopt variable rates that respond in an agile fashion to fluctuating energy prices, that might ease the impact of the cost-of-living crisis. It could change the rules with the intention of boosting exports of digital healthcare and education innovation.

With the UK having left the EU, the UK Government has a compelling opportunity: to look forward and consider an ambitious and strategic transformation of VAT, one that reflects how the tax can best serve the country today.

HMRC has already taken steps to move VAT forward – not least with the launch of Making Tax Digital and its stated aim to introduce real-time VAT reporting by 2030. However, scanning the global landscape for indirect tax reporting suggests that the UK remains some way off the pace set by other jurisdictions.

The purpose of the EY Future of VAT in the UK campaign is: to highlight the opportunities that could arise from developing a VAT system that's suitably adaptable, resilient, and responsive; and to work with HMRC and businesses to collaboratively explore ideas for how best to communicate its plans and get business on board.

EY has conducted deep dives into some key areas:

1. VAT as a digital tax
2. VAT as a lever for change
3. HMRCs changing relationship with business
4. The alignment of the UK VAT system with other indirect tax systems globally, in particular EU VAT
5. Potential opportunities for technical reform

This report explores the attitudes and expectations EY uncovered among clients and industry groups and this is supplemented with input from within EY.

One notable takeaway is that the prospect of making significant changes to the VAT regime wasn't necessarily a popular idea among VAT professionals. Yet change is inevitable. Our engagement with clients and industry peers reinforces the point that making that transformation proactively, and enjoying the many benefits of being proactive and in control, is better than simply reacting to fast-moving circumstances and hoping for the best.

Another clear theme is that VAT is not a simple matter. Legislators must strive to balance various aspects of the tax – as a mechanism to raise revenues, and as a tool to influence and achieve behavioural change, for example – while ensuring fairness for taxpayers.

Looking at HMRC, we recognise it faces plenty of its own challenges in terms of resource and internal transformation.

Yet the insight gleaned from our surveys, workshops and other engagement shows that the VAT conversation should be a priority, and that now is the time to have it. EYs hope is that this report will encourage the Government to actively engage with stakeholders on the vast potential of VAT transformation, so that all parties can shape the future of VAT in a way that's right for the country.

Section 1:

VAT as a digital tax

When HMRC introduced Making Tax Digital (MTD) for VAT in 2019, it marked a significant step in its ambition to create a tax system fit for the challenges of the 21st century.

Since 2019, more than 1.6 million businesses have started using MTD for VAT, submitting more than 11 million returns.

It seems, however, that the experience has not been universally positive and this is a point acknowledged by HMRC in its evaluation of the introduction of MTD for VAT. In our February 2022 survey, one third of respondents were dissatisfied with the implementation of MTD for VAT.

The reasons cited included a lack of detailed guidance from HMRC, and the implementation costs. One survey respondent wrote: "HMRC appears unaware of the commercial consequences / impact of such a digital roll-out to businesses and the extra costs involved." There was also some frustration with the various delays and soft-landing periods – although valued by some, others considered that these undermined the roll-out.

There was a strong sense from our surveys and conversations that MTD hasn't been transformative enough in the period since 2019. As one survey respondent wrote: "MTD feels like a halfway house between increased digitisation and full-on real-time reporting. As a result, MTD required updates to processes which will likely become redundant in a few years when a more comprehensive real-time reporting solution is implemented."

David Reaney, who leads the EY Future of VAT in the UK campaign, elaborates on this point.

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HMRC introduced MTD but the perception of many businesses I speak to is that, at crucial points along the way, for various reasons, it watered down the requirements. So, one view is that a taxpayer can make a handful of minor tweaks to their old practices and comply with the basic requirements. In practice, some people feel that is far from making tax digital.

It's worth noting that MTD is merely the first phase of HMRCs digital transformation, which aims for real-time reporting for VAT by 2030. But there's clearly still a long way to go before UK taxpayers are providing the same level of transactional data as some other jurisdictions.

"There are a number of countries across the world which are much more advanced on this," says Vikki Parr, a Director in the EY UK Indirect Tax practice. "We're out of sync with the EU, and even more so with other countries, for example Brazil. While 2030 feels quite a long way away, the general view from advisors and businesses is that there's still a lot of work for HMRC to do just to bring us in line with these states [EU and Brazil]."

If there's a long way to go before UK businesses catch up on real-time reporting, there's already confusion around when and how they are expected to make the transition. Many assume the UKs system will mirror those seen overseas, but different countries are already implementing real-time reporting in contrasting ways: in some, businesses simply provide VAT information in real-time; in others, the VAT itself is sent to Government bank accounts automatically at point of sale.

VAT of course, is only one tax and HMRC has commenced Making Tax Digital for income tax and corporation tax. The move to real-time reporting for VAT by 2030 will take place in the context of the digital transformation of a range of taxes.

When businesses were asked for their current understanding of how HMRC would achieve its vision for real-time reporting for VAT by 2030, responses included "very little", "no real current understanding", and "none – 2030 doesn't seem feasible, despite the fact it is eight years away."

It seems businesses have been left guessing what the future will look like – which only reinforces the opinion expressed by some business leaders that critical information and guidance from HMRC could be more forthcoming.

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HMRCs digital ambition is to be applauded. Feedback throughout the Future of VAT campaign supports substantial change in digitisation. To achieve this HMRC will need to invest further in both technology and expertise. In this process it will be crucial to better support and understand taxpayers, and key to this will be more consultation with businesses to gain a better understanding of the commercial impact of the proposed changes.

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The digital transformation of VAT is a great idea, but this isn't just a matter of writing legislation and then implementing and investigating it," says Ben Woodfield, EY UK&I Indirect Tax Partner. "It involves the digital transformation of HMRC itself, including leveraging technology and utilising new skills. So, it's a new and complex challenge for them too.

The good news is that UK businesses do want HMRC to be ambitious with its real-time reporting plans. But what they need is a clear and fixed roadmap for the journey to real-time reporting, with enough time to prepare a business case to secure the funding needed to transform and then to deliver that change.

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"There's an expectation that HMRC has to move on the digital agenda," says Parr. "The ask from business is for clarity, and certainty in what is required and when. That way, taxpayers will have a fighting chance of being compliant with whatever HMRC decides. Unless there's a clear statement of the roadmap along with confidence this will be delivered, tax teams may struggle to get the early internal investment they need."

Section 2:

VAT as a lever for change – sustainability

In the face of an increasingly urgent climate crisis, the world is starting to act collectively to change behaviours. The 26th UN Climate Change Conference of the Parties (COP26) delivered a strong statement of the global intent to end international support for fossil fuels, and to redirect funds to cleaner energy.

COP27 has since taken place and further reinforced and advanced agreement from COP26. COP remains an important level playing field, moderating complex issues, providing a climate change 'North Star' around which business and policy makers convene.

The UK has set its own target: to reach carbon net-zero by 2050. The onus is now on the Government and the private sector to initiate change, so a positive shift can be encouraged in behaviours, and work together towards this goal.

VAT can be a powerful tool that could be leveraged to help facilitate sustainable practices: it could be lowered to encourage desirable behaviours and raised to deter practices and products harmful for the environment.

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This position was reflected in our client research. In our deep-dive discussions, several clients supported the principle of extending the reduced rate of VAT to promote energy-saving choices, and the blocking of input VAT recovery for non-sustainable products and services. There was also support for the use of financial incentives to make sustainability a more cost-effective approach for less established businesses.

This would aid cash flow in the long-term and help make sustainability a more viable choice.

VAT has already been used in this way for social policies. Since Brexit, for example, tampons now have a zero rate of VAT in the UK.

Other countries have also adopted this approach. For example, until recently, Norway had a zero rate of VAT on all electric vehicles (EVs). This VAT reduction, combined with other related financial incentives for EVs (e.g., reduced road tolls, use of bus lanes, free parking), and the higher running costs for diesel cars, has contributed to a significant shift to EVs. Statistics from the Norwegian Road Traffic Information Council shows that, in 2021 just under two thirds of all new car registrations in Norway were EVs. Steps have been taken to remove the VAT rate incentive for the most expensive EVs which demonstrates both the success of the measure and also the complex context in which VAT rates are used to incentivise behaviour.

Using VAT in a considered way alongside other taxes and financial incentives can be an effective lever for behavioural change.

Sustainability is, however, a multifaceted issue, and VAT changes must be considered against broader social and political concerns. For example, the UK Government may be unlikely to apply a VAT increase to pollutive energy sources, given the potential impact on already rising household energy bills. With VAT fundamentally being a revenue-generating tool for the Government, measures proposing removing VAT on certain sustainable products and services to support influencing behaviour, would need to ensure objectives are met and sufficient revenue is still generated.

Yet global warming won't stop for such considerations. Significant systemic change is inevitable. Businesses have been challenged in preparing for the recently introduced new plastic packaging tax (PPT), as well as future Extended Producer Responsibility regulations, and the EUs Carbon Border Adjustment Mechanism. There is a risk that the Government underplays the value of using the existing VAT regime to deliver its objectives.

"Feedback suggests that, the tax cost of PPT alone will not alter behaviours, due in part to the range of other factors in play, including access to recycled plastic and regulatory requirements, but its implementation has been a significant administrative burden for businesses. To meet this burden, businesses have had to invest to remain compliant with PPT and other green taxes. VAT is an alternative lever that could be used, and businesses already have the compliance teams, systems and processes in place" says Danny Vu, Tax Director in Indirect Tax, EY UK.

If the Government chooses to use VAT more as a sustainability lever, it would need careful application. Our conversations with stakeholders showed that, for any policy changes to be accessible and incentivising, VAT should only encourage or deter the specific behaviour, with clear, definable boundaries and limited disruption to other aspects of society.

Any measures aimed at penalising the consumer would need to be supported with other Government interventions and viable alternatives. For example, if fossil fuels were penalised with high VAT rates, an easily accessible, green alternative should be available as well.

Sustainability is a pressing issue that will help to define the coming decades. The UK now has a compelling opportunity to use VAT as a lever to drive positive change.

HMRC guidance on the application and implementation of such policies would need to be clear and consistent. Any policies would need to focus on long-term environmental benefits, while ensuring they weren't impractical for taxpayers.

Sustainability has rightly been the focus of this consideration of VAT as a lever for change, but it is just one example of how VAT could be used to promote change. It is an accessible example of the change that VAT could promote through the comprehensive review of the tax we are calling for, but the review should consider how VAT could be used far beyond sustainability.

EY believes it's time for the Government to decide how it will enhance its use of this lever.

Section 3:

HMRCs relationship with business

The ties between HMRC and business have evolved dramatically over the past few decades. HMRCs service was once shaped by the personal touch of local advisors; now it is a centralised, largely standardised provision that businesses often access via helplines.

Communication with HMRC was cited in the Future of VAT survey in April 2021 as one of the three most challenging facets of VAT. With the number of employees dramatically reduced, and delivery models changed accordingly, the quality of communication by HMRC has been affected. Many businesses reported an unhelpful, frustrating, and costly experience, and difficulty developing relationships with individuals within HMRC. Phone helplines and webchat were ranked the lowest-rated form of HMRC communication in terms of usefulness.

"The impression of business is that HMRC often develops its thinking on a change in isolation," says Reaney. "Their experience is that HMRC could have more direct day-to-day contact with businesses at a policy level, and policy changes may well be of a higher quality as a result. The changes it makes could be enhanced if HMRC engaged more with businesses and advisors."

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One respondent to February 2022's Future of VAT survey revealed the lack of understanding of the business as a cause of dissatisfaction, when they wrote: "We are a specialist firm, and HMRC has less knowledge and experience in our sector and this is reflected in their guidance on the topic. Their guidance is also not updated in a consistent way, leading to confusion and doubt on their actual policy."

It is important to note that the feedback wasn't all negative. Workshop participants said that the detail and quality of HMRCs older published guidance compares favourably with other jurisdictions. But there was some criticism that guidance isn't updated consistently and that changes to policy are often communicated at short notice.

It is understandable, then, that business may be left wondering where it stands on VAT policies. Participants in the workshop felt HMRC had no clear direction in terms of the future of VAT, and that if it did, it had not shared it.

One facet of VAT that drew a positive response was the Customer Compliance Manager (CCM) model in Large Business. Our workshop revealed that clients who have access to a dedicated CCM value the direct relationship they have. Nearly two-thirds (62.5%) of our survey respondents said the most valuable aspect of the CCM model was having a named tax specialist contact.

As the future of VAT will no doubt involve a move towards greater automation, perhaps with virtual assistants answering the bulk of taxpayer queries, it is worth considering the potential value in reigniting the lost sense of personalisation – perhaps by extending the CCM model or some key aspects of it to medium-sized businesses.

"Expanding the CCM model would raise questions around resource, and potentially risk diluting the service received by those businesses that already have a CCM," says Reaney. "But it may be worth investigating whether some elements of the service could be delivered more widely."

There are potential quick wins here too. The suggestion cited as most important by respondents to EYs Future of VAT survey in February 2022 was a self-service online VAT portal, which would offer the intuitive ease of a banking app, to give taxpayers access to copies of registration certificates, tax returns, key correspondence and VAT notifications, e.g., options to tax.

This would align with HMRCs aim of creating a digital tax administration and the central repository of documentation would make communication with HMRC easier to manage. HMRC could then divert resource from customer response into forging deeper relationships.

Fears over the future are easy to understand. 60% of respondents when asked about the time it would take to prepare for real-time reporting stated they expect it to take at least two years to prepare their business for real-time VAT reporting, with 22% indicating that it may take more than four. As such, businesses are particularly concerned about the lack of communication received from HMRC regarding the 2030 real-time reporting ambition.

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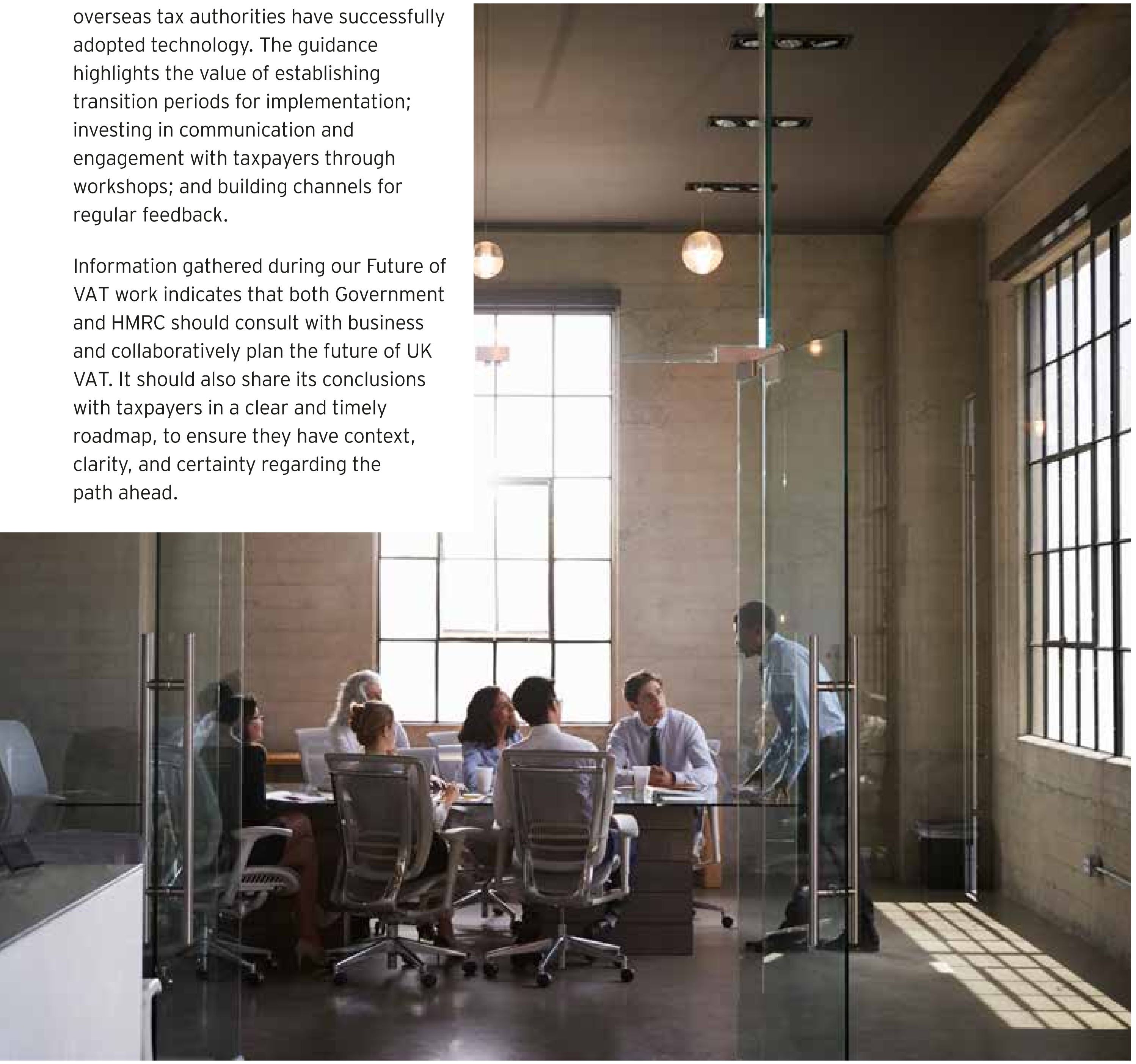
Over the next decade, from a VAT perspective we would love to see this saved resource reallocated, redirected and reinvested into VAT services, especially direct customer relationships," says Reaney.

For suggestions on how to effectively communicate its plans for real-time reporting, HMRC could reflect upon recent Organisation for Economic Co-operation and Development (OECD) guidance around online cash registers, which examines how overseas tax authorities have successfully adopted technology. The guidance highlights the value of establishing transition periods for implementation; investing in communication and engagement with taxpayers through workshops; and building channels for regular feedback.

Information gathered during our Future of VAT work indicates that both Government and HMRC should consult with business and collaboratively plan the future of UK VAT. It should also share its conclusions with taxpayers in a clear and timely roadmap, to ensure they have context, clarity, and certainty regarding the path ahead.

That would be a significant step – re-establishing relationships with businesses and showing commitment to building a VAT regime that works for them, the economy, and the country as a whole.



Section 4:

The alignment of the UK VAT system with the EUs VAT system

As membership of the EU brings all member states under a common VAT system, the UK was always very limited in its ability to chart its own course with VAT.

But that has now changed. Since leaving the EU, even with the complex position for goods in Northern Ireland, the UK can potentially make more of its own decisions – whether that involves reducing the standard rate of VAT below 15%, changing the scope of different reliefs, or altering fundamental principles that underwrite the entire system.

Seventy-five per cent of respondents to EYs initial Future of VAT survey in April 2021 said they saw Brexit as an opportunity to reform the UK VAT system.

"Previously, a wide-ranging and innovative discussion around what we actually wanted to achieve from VAT could have been largely futile because we might not have been able to implement the ideas," says Reaney. "Now, there are fewer limitations on what the country could do if it really wanted to." This scope for change should encourage a global perspective, both in idea generation and alignment.

Yet survey participants also expressed reluctance to decouple from EU VAT, largely fearing instability and the potential compliance burden and costs of changing such a complex tax.

Brexit: the UK could change the scope of different reliefs or alter fundamental principles that underwrite the entire system.

Most would only welcome divergence if it reduced costs or increased opportunities – whether through reduced VAT rates, increased reliefs, or new business opportunities. Even then, 20% of respondents to the February 2022 Future of VAT survey said they wouldn't support temporary zero rates, even if it did result in a cost-saving or revenue boost. This response suggests that the administrative and systems implications of a change could result in a negative response from those required to implement it, and that this could undermine the potential benefits. As a result, the Future of VAT should not only be an operational issue but become an issue for the C-suite, viewing VAT through the lens of business opportunity rather than simply compliance.

Indeed, there are plenty of potential benefits of targeted changes to VAT, which could outstrip the inherent compliance costs arising from change.

As part of our deep-dive discussions with stakeholders, we examined the opportunity to modernise the way UK VAT treats healthcare and education — two innovative sectors that, in mixing private and public providers, are now unrecognisable from the simple state-run provisions of the early VAT days.

The UK has a stated desire to be a world leader in these fast-moving fields. Yet some providers risk incurring increased export costs, as they could be restricted in the recovery of input tax and could face double taxation if VAT rules remain the same. By moving away from the EU model and offering these providers input tax recovery, for the 'export' of these services, the UK would be delivering similar benefits to those already offered to providers of specified supplies in financial services and enhance the ability of UK business to compete globally.

"If the UKs desire to be a global leader in financial services warrants special provision," says Reaney, "it's worth asking whether the desire to be a global leader in digital health and education demands the same."

The thought of overhauling the entire UK VAT system is daunting. As such, it may make sense to target specific areas, for example, the scope of VAT exemptions where restrictions disincentivise innovation. One example is the definition of "transfer of money". Generally, the EU approach draws a distinction between transfers made by bank card and those made by mobile apps — two acts that are, to the customer, essentially the same thing. This position has historically been criticised in the UK. Other contested areas include VAT on energy-saving materials and vouchers where the UK was previously restricted by the EU in terms of the rules it could implement.

"In principle, the UK Government now has much more capacity to adjust definitions and categorisations within the VAT system with a view to boosting the UKs competitiveness. The challenge now is to translate that capacity into practical measures than can support ambitions such as firmly establishing the UK as a hub for financial services and an accommodating attractive location for fintech start-ups" says Steven Effingham, Director, Tax Policy at EY.

Feedback from stakeholders suggests that the immediate challenge is achieving the right alignment with the EU VAT system while ensuring changes are targeted and well thought through. The opportunity to align with other global indirect tax regimes seems like a far-off opportunity for most stakeholders at present.

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Section 5:

Opportunities for technical reform

As discussed above, the UK now has scope to move its VAT system in a direction that could benefit taxpayers, the Exchequer, and the economy as a whole. Having explored a range of ideas for potential VAT reform, this section sketches out three more innovative approaches. These are not proposals but rather examples which we hope will stimulate thought, discussion, and an expanded sense of what is possible for the UK VAT system.

Using technology to become more agile

Rather than having largely fixed VAT rates, which tend to change slowly (linked to the annual Budget and/or Spring Statement), machine learning technology could be harnessed to drive a more flexible system. For example, the Government could introduce an agile rate of VAT to counter market fluctuations for certain goods. Wholesale price changes could trigger a real-time automatic adjustment to the VAT rate for that supply. However, controls would be required to ensure the benefit of the change is passed to consumers and challenges, including in relation to certainty, would need to be considered.

The Government could also introduce progressive, agile tax rates based on consumer income or other consumer factors rather than the nature of the supply. For example, many zero rates of VAT (e.g., on food) are to avoid increasing the costs for those who can least afford it. Purchases of supplies that would otherwise be standard-rated by those who qualify could be complemented with a credit equivalent to the VAT amount directly into the bank account used for the purchase. This would need to be weighed against potential costs and risks such as the potential for fraud.

Opportunity: machine learning technology could be harnessed to drive a more flexible system.

The approach suggested could potentially be applied to any pressing social or policy issue and it is this flexibility in approach that makes it truly agile. Of course, there are several other considerations, including the practical application of any changes, certainty, and compliance. However, the opportunity is clear.

Boosting Britain's business appeal

The Government has a stated policy goal of maintaining the UKs position as a financial hub and fostering its reputation as an attractive location for innovative companies in fields such as fintech.

Rethinking the input VAT deduction for holding companies and costs related to M&A transactions may help make the UK a more attractive place to do business. This would also help keep VAT appropriate to its true purpose of taxing consumption. As the UK becomes a more attractive business destination, it would have its own knock-on effects, including an uptick in tax collected from transactional activity drawn here.

Tackling VAT fraud

Due to the way tax is paid and recovered in the VAT process, the system is currently subject to fraud. When suppliers act on behalf of HMRC to collect and pay tax, there's always the risk of fraudulent activity. To reduce this risk, HMRC could consider extending the reverse charge mechanism, already in place for certain limited supplies, and applying it to a broader range of domestic transactions in order to remove cash from the process.

One aspect of HMRCs future ambition, which has been made public, is the possibility of using split payments for VAT, whereby the net value is remitted to the supplier and the VAT to HMRC. This digital transformation if delivered, should also help tackle VAT fraud, such as missing trader fraud.

A more radical solution to the fraud problem could lie in blockchain. As HMRC aspires to reach a form of real-time reporting by 2030, it makes sense to adopt other leading-edge technologies in the collection of VAT. Blockchain is designed to give visibility and authenticity to historical transactions. Used across a chain of supplies, it could be incredibly effective in combating VAT fraud, however, a number of other factors, including energy use, would need to be explored if this is to be considered as a solution.

Against the backdrop of rapidly evolving technology and wider challenges such as the COVID-19 pandemic and Brexit, alongside the example set by indirect tax authorities in other jurisdictions, the UK VAT system will require a comprehensive overhaul in the future if it is to remain fit for purpose. These ideas represent just three types of change the UK could consider now that it has the freedom to dictate the shape of its own VAT system. While we are not proposing these specific suggestions, we believe this is a window of opportunity to entertain all possible solutions, and to create dialogue between HMRC and business.

Conclusion

HMRCs ambitions for Making Tax Digital and the introduction of real-time reporting by 2030 are clearly to be commended. But our surveys and discussions with clients, peers and internal experts suggest the VAT revolution could and should go much further.

The Government has the opportunity to align VAT with its broader ambitions – to achieve net-zero emissions by 2050, boost exports and level up the UK, while keeping pace with the indirect tax technology employed by other states.

The Future of VAT report has been compiled and published with the aim of raising questions, making new suggestions, priming VAT as a subject for further discussion between Government and business, and exploring what shape that future may take.

Having conducted surveys, workshops and discussions with clients and peers on a wide range of VAT-related issues, as well as seeking insight from EY indirect tax thought leaders, our key takeaways are as follows:

1. The Government should undertake a comprehensive review of the VAT system, based on the full range of policy objectives, to modernise the regime and align it with Government policy.
2. To achieve the ambition of delivering real-time reporting by 2030, HMRC needs to share a clear, detailed, and certain roadmap, with appropriate stakeholder consultations in its development, so that business can invest with confidence and in sufficient time to make the transformation a success.

Our stakeholder insight has revealed a range of potential 'quick win' changes that HMRC could introduce in the near-term. These include creating an online portal for business to access HMRC communications; expanding the CCM model and its benefits to medium-sized organisations; and consulting on extending VAT exemption to certain healthcare and education supplies to boost service exports.

Yet as VAT touches millions of daily transactions across the country, it makes sense to take a holistic look at the role, purpose, and execution of the tax, and to attempt comprehensive and strategic change, rather than adopting a piecemeal approach.

HMRC also needs full Government support to create the VAT system that's right for the country. This should be a Government priority and there is reason to focus on this to close the VAT gap and utilise VAT as a lever for social change and improvement.

As for EY, we see this report as the culmination of the first stage in our own process of exploring the future of VAT. In each of these areas – digital, sustainability, relations with HMRC, and wider Government – we will now engage further with HMRC to share our findings and conclusions in greater detail, and to seek its opinion on next steps. We hope to facilitate conversations and formal workshops between HMRC and businesses, so HMRC can directly hear and respond to their feedback.

The aim: to bridge the gap between businesses, consumers, and policy makers; to contribute to the design of a leading-edge VAT system; and to ensure a smooth implementation and uptake of new initiatives in the future.

Methodology

Future of VAT in the UK survey

The Future of VAT in the UK survey, which was live between April and May 2021, was a wide-ranging exploratory research campaign to identify the areas most in need of reform. We received 346 responses from a diverse group of respondents; these came from small not-for-profit organisations through to large multinational businesses across sectors, ranging from financial services to agri-food to consumer products.

Some of the questions and topics explored included:

- Whether the UK VAT system was fit for purpose
- Brexit as an opportunity to reform the UK VAT system
- The biggest VAT challenges that businesses are facing
- How the UK VAT system compares to other jurisdictions
- Making Tax Digital and real-time reporting
- HMRC relationships and more

While we had positive engagement from a range of business sizes and sectors, we recognise that this sample is unlikely to be fully representative of the UK business landscape. The results will have been skewed towards those who are willing to respond to an EY survey – typically larger businesses, with VAT specialists. Yet the findings should be considered as part of a wider conversation, rather than quantitative research.

The feedback has given us a rich picture of the challenges and opportunities in the VAT regime. It also shaped our next steps in the Future of VAT in the UK campaign: to publish an interim findings report, leading to areas of deep-dive focus.

Future of VAT in the UK interim findings report

Released in the late summer of 2021, the Future of VAT in the UK interim findings report provided an update on what we heard through our Future of VAT in the UK survey, conversations with clients, discussions with sector groups, and at an EY Leaders in Indirect Tax event involving 35 of our largest clients, with HMRC in attendance.

The breadth of engagement we received underlines the importance of VAT for business and reflects the interest in VAT when the UK stands at a crossroads: COVID-19 has brought unprecedented challenges to the economy; the end of the Brexit transition period brings new opportunities to change the regime; and HMRCs aspiration to move towards real-time reporting by 2030 provides a possible vision for the future of the tax.

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

1. The UK as a digital tax administration
2. VAT as a driver of change
3. UK VAT in the international context
4. The need for clarity, consistency and certainty

Click here if you'd like to read the Future of VAT in the UK interim findings report.

EY deep dives – leaders' events, client workshops and conversations

As clearer themes emerged, EY identified key specialists who could lead workshops, conversations, and idea-gathering in a variety of areas:

1. The future of UK VAT as a digital tax
EY sought insight from several businesses through its Future of VAT surveys, including asking for their experiences of Making Tax Digital for VAT, as well as what changes they hoped to see in the future. Their responses also formed a view of how HMRC may choose to approach digital initiatives, including real-time reporting.

2. How UK VAT can be used to promote sustainability
Following the initial Future of VAT discussions and surveys, EY held discussions with a range of clients, from not-for-profit organisations to large multinational businesses. These conversations further explored the topic of how VAT could be used to promote the sustainability agenda, and spelled out the concerns, opportunities, challenges, and barriers the participants saw.

3. The alignment of the UK VAT system with the EUs VAT regime
Here, EY sought to understand stakeholders' perspectives on the potential to diverge from the EUs VAT system, and to source suggestions for how to do so without negative impact. This involved a combination of surveys, a review of the available literature, and deep-dive discussions with clients and internal client handlers. As part of this deep dive, we explored a specific VAT change that could be made with the cross-border supply of exempt services, focusing specifically on healthcare and education.

4. HMRC relationships, communication, and collaborative policy development
EY sought to gain an understanding of businesses' experiences of interacting with HMRC, as a precursor to considering ways of improving this relationship. This involved two surveys, in April 2021 and February 2022, and a follow-up workshop with a range of companies in March 2022. This work sought to understand participants' current challenges in communicating with HMRC, and to source suggestions on how the relationship could be improved, including their take on the CCM model and on improving online access.

5. Other areas of technical reform
EY ran an internal initiative asking for innovative ideas about VAT changes. It asked: if you could make any change to the tax system, what would it be? Around 200 indirect tax professionals responded. The team worked to explore the ideas generated.

Throughout 2021 and 2022, EY hosted client workshops and conversations to facilitate specific interest that arose from industry regarding the deep dive topics.

EY Leaders in Indirect Tax

During the Future of VAT campaign, we held two workshop sessions with a group of senior indirect tax specialists who represent some of the largest businesses operating in the UK. In the first session we were joined by HMRC who provided a perspective on the current state of the VAT regime and some future plans.

This forum provided an opportunity for open discussion about current experience and aspirations for the future.

LinkedIn updates

Throughout the campaign, we've also shared and contributed to several articles, updates and creative content to keep those following the Future of VAT in the UK campaign updated.

Some of these updates can be seen here:

- Future of VAT in the UK video
- Future of VAT: reflections on the first year
- VAT in times of crisis: written by Steven Effingham and Joseph Eloi for the deep dive topic: **The alignment of the UK VAT system with other global indirect tax systems**
- The case for shaping VAT policy to reflect sustainability targets and changing buyer behaviour: written by Andy Bradford for the deep dive topic: **How UK VAT can be used to promote sustainability**

Future of VAT team

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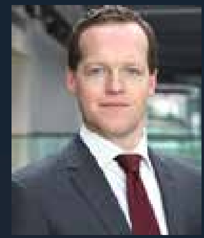

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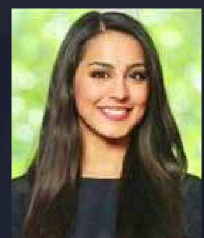

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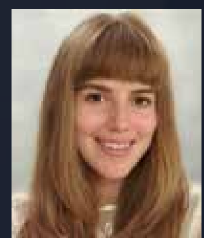

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EY | Building a better working world

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Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

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ED None

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