Response from ICAS to the HMRC consultation ‘VAT: Prompt payment discounts’

9 September 2014
About ICAS

The Institute of Chartered Accountants of Scotland (‘ICAS’) is the oldest professional body of accountants. We represent around 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

General comments on the consultation

The general principles of the proposed changes are from the Finance Act 2014 enactment and ICAS welcomes the opportunity to comment on the detailed implementation proposals. However, we have concerns about the implications of these changes on accounting systems and the administrative burden on the taxpayer of making sure that they account for correct amount of VAT. The changes will require taxpayers to review each transaction when payment is made to determine if the VAT originally posted to the VAT account should be adjusted and this is a significant issue for both parties to the transaction. The changes will also require the supplier to issue paperwork to reflect the adjustments to the VAT imposing additional burdens on taxpayers to ensure that they comply with the updated rules. These changes will affect the certainty of the VAT accounting for transactions by including an additional step in the VAT accounting processes and this has resource implications for businesses.

The changes will also help tackle situations where businesses have used the rules on prompt payment discounts to reduce the amount of VAT chargeable on transactions with other businesses who cannot fully recover their input VAT. This is not mentioned in the aims of the consultation but we are aware that this has been an issue in practice. The impact in this area does not have appear to have been reflected in the Tax Impact Assessment figures.

ICAS members have concerns about the crossover between these new rules – which require the adjustment of an invoice where a discount has been taken up by the purchaser - with the credit note concession under the VAT Guide Notice 700 paragraph 18.2.1/18.2.2 requiring the agreement of both parties. This concession eliminates the obligation to formally adjust the VAT charged as a result of a credit or contingent discount on a transaction where the purchaser is able to recover all the VAT on purchases. Although there is a requirement to adjust the box 6 and 7 totals on the VAT return in respect of the sales/purchases the concession allows the original amount of VAT to be used by both sides along with no requirement to adjust invoices already issued. This treatment is in marked contrast to the approach outlined for prompt payment discounts which will require revised paperwork to be issued in all cases. It would be helpful if HMRC could clarify how these differing rules will interact so that businesses have certainty of the impact on their processes.

The new regime for prompt payment discounts is intended to commence on 1 April 2015 and we would question whether there will be adequate time for software systems changes to be made by software suppliers and then implemented by businesses. We would also recommend that there is a “soft-landing” period for penalties in connection with the new rules to reflect the significant impact of these changes on accounting systems and processes.

Specific questions raised by the consultation

Question 1: Are there particular issues or difficulties in raising and issuing credit notes or revised invoices where a PPD is taken up after an invoice is issued? If so what are they?

The main issue with the requirement to issue credit notes or revised invoices where a PPD is taken up is the administrative burden on both the supplier and purchaser. This will significantly increase the accounting burden as the VAT has to be accounted for in full when the invoice is initially issued. When the payment is made the supplier will then have to track this back to the initial supply and invoice to ascertain whether any adjustment is required to the VAT amount originally shown on the invoice. At that point it will become apparent whether the supplier has to issue a credit note/revised invoice with the associated adjustments for the purchaser.
It may be possible to automate this process, but this will require changes to accounting software and systems to include the additional step in the process and involve additional costs for companies. It is understood that for some businesses, for example utility companies who offer prompt payment discounts to their customers, there are a large volume of transactions and for these types of businesses the cost of compliance with these new rules will be significant.

The tax impact assessment for the cost of compliance with this measure is £8 million of one off costs with £3.5 million average annual costs. These figures are surprisingly low given the number of businesses affected and we question whether these calculations fully reflect all the costs businesses and software suppliers will incur in changing accounting systems and processes to comply with this change. Businesses collect very significant amounts of tax on behalf of HMRC – through the PAYE, NIC and VAT system – and HMRC should be mindful of the costs it imposes on business to act as a tax collector. Sample testing with some major and smaller businesses as well as key software houses should be used to check that these are reasonable.

**Question 2:** If you have answered yes to question 1 have you identified any solutions which still ensure that output tax is declared by the supplier on the consideration received and that the customers can only claim the corresponding input tax?

It should be possible to find a systems-based solution to the issue so that the processes are automated but as noted above any solution will impose additional costs on business.

**Question 3:** Are there any particular challenges involved in processing payments and adjusting VAT when discounts are taken up? If so what are they? How might they be overcome?

The proposed rules require the payments to be matched to the invoice originally issued by the supplier. There may be issues for businesses who have a very significant number of smaller regular transactions in achieving this requirement and they may be required to devote significant resources to ensuring that they can comply with the revised rules. This issue is likely to be dealt with through computerised accounting systems that have been configured to deal with the previous rules and there are likely to be costs associated with the changes as well as the need for software providers to update their packages to reflect these changes.

**Question 4:** Are there any particular types of supply or arrangements, eg self-billing, which may result in other implementation issues? If so what are they? How might they be overcome?

There should not be additional issues for self-billing arrangements as the purchaser who issues self-billing invoices to cover transactions will have control over the payment arrangements. This type of arrangement will be more straightforward to deal with under the new arrangements than a more traditional supplier and customer invoicing trail.

**Question 5:** Are there any other implementation issues that might cause businesses difficulties? If so what are they? How might they be overcome?

The interaction of the proposed rules with the credit note concession noted above should be considered. There may be circumstances where it is not clear whether the transaction can be treated under this concession with no formal paperwork involved or whether revised invoices / credit notes are appropriate. For transactions where both parties are fully taxable and have no restrictions in recovering input tax there is no actual loss to the exchequer if the original invoice is allowed to stand and there may be some merit in considering whether the concessionary treatment might be extended to cover prompt payment discount between fully taxable registered persons.