

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2020

2020 No. 1384

1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 The Agricultural Flat Rate Scheme (AFRS) is an alternative to Value Added Tax (VAT) registration for farmers and other people involved in designated activities. It is designed as an alternative for small farming businesses to the administrative burden of VAT. This instrument amends the eligibility criteria of the AFRS. It introduces an entry threshold so that businesses can join the AFRS when their annual turnover for farming related activities is below £150,000 and an exit threshold so that HMRC may cancel the certification of a business under the scheme if their annual turnover for farming related activities exceeds £230,000 (or if their turnover for a single month for farming related activities exceeds £230,000). Businesses will be required to notify HMRC if any of these new exit criteria are met. These businesses will be removed from the scheme and must register for VAT instead.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation no statement is required.

6. Legislative Context

- 6.1 The scheme an alternative to VAT registration for farmers. Section 54 of the Value Added Tax Act 1994 introduced the scheme and allows for the introduction of regulations to govern this. In the Value Added Tax Regulations 1995, regulations 202

to 211 provide for admission to the scheme, certification and cancellation of certificates, and the requirement to keep and produce records.

- 6.2 Regulation 204 details the requirements for entry to the scheme. This instrument will amend regulation 204 to now include an entry threshold so that businesses can only join the scheme when their annual turnover for farming related activities is below £150,000.
- 6.3 Regulation 206 will be amended to provide HMRC the power to cancel the certificate entitling businesses to use the scheme once their annual turnover for farming related activities exceeds £230,000 (or if their turnover for a single month for farming related activities exceeds £230,000). The certificate can also be cancelled where the business becomes eligible to be registered as a part of a VAT group. New regulation 206A provides that businesses must notify HMRC if they meet any of these new exit criteria.

7. Policy background

What is being done and why?

- 7.1 The AFRS is an alternative to VAT registration for farmers and other people involved in designated activities. It is designed as an alternative for small farming businesses to the administrative burden of VAT. This is a separate scheme to the VAT Flat Rate Scheme which still requires businesses to register for VAT and submit returns.
- 7.2 From 2011 to 2014, HMRC became aware of larger agricultural businesses deriving substantial cash benefits from using the scheme, with some benefitting by more than £1m a year. As a result, HMRC removed 32 businesses from the scheme.
- 7.3 In 2017, the Upper Tribunal in *Shields and Sons Partnership v The Commissioners for HM Revenue and Customs* [2017] UKUT 504 ruled that HMRC had incorrectly applied 'Protection of the Revenue' powers to remove a business. The Upper Tribunal found that HMRC could only exclude certain categories of agricultural business, which must be defined on the basis of an objective, clear and precise criterion in United Kingdom legislation, as well as for those whom the application of the normal VAT arrangements is not likely to give rise to administrative difficulty.
- 7.4 This measure will provide small farming businesses with clarity around the scheme, ensure the scheme is operated fairly and that HMRC can effectively administer the scheme.
- 7.5 The statutory instrument will introduce eligibility rules for entry and exit from the scheme and these will be related to turnover. This will also provide consistency with other simplification schemes.
- 7.6 The eligibility rules mean that businesses can join the AFRS when their annual turnover for farming activity is below £150,000 and remain on the scheme until their annual turnover for farming activity exceeds £230,000. These thresholds will allow businesses using the scheme to grow in size.
- 7.7 Any qualifying businesses whose turnover from designated farming activities exceeds the clearly defined exit threshold will be ineligible to operate the scheme and will have to register for VAT. In line with existing rules, any business whose turnover from non-designated activities exceeds the VAT threshold will also have to exit the scheme and register for VAT.

7.8 The thresholds will provide clear and precise eligibility rules that businesses can be certain of.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 There are no plans to consolidate the legislation.

10. Consultation outcome

10.1 HMRC undertook targeted stakeholder engagement with representative bodies and other government departments in the spring and summer of 2019 to gather views on the issues and potential changes.

10.2 Participants at two meetings organised by the Department for Environment, Food and Rural Affairs had no immediate objections to a threshold test being used for the AFRS. It was confirmed at the meetings that some small and medium businesses already use turnover as a basis for union membership payments. Participants believe that HMRC could create distortion in the market if the introduction of a threshold goes ahead and is too high which could cause businesses to limit sales to stay under the threshold. Therefore, it was suggested that HMRC should stick to a threshold of £85,000 for AFRS as this would be the same as the VAT registration threshold. Participants also commented on the rigidity of a threshold, they believe flexibility over the period which turnover is measured is important because agriculture financial performance can vary greatly.

10.3 Participants at the Ulster Farming Union (UFU) meeting believed that using a threshold for the AFRS would disadvantage a lot of users of the scheme and it was suggested that margins may be more reflective of agricultural businesses.

10.4 Engagement with Northern Ireland trade bodies highlighted a divergence between the AFRS and the Republic of Ireland equivalent which is more generous in certain aspects.

10.5 The government has considered the views expressed by stakeholders and the findings of the Upper Tribunal. It is important that the rules for the AFRS are clear and precise, and that the AFRS remains a simplified alternative to VAT registration for small farming businesses. These thresholds provide businesses with clarity around their obligations when using the scheme.

11. Guidance

11.1 Initial guidance detailing the eligibility criteria of the Agricultural Flat Rate Scheme can be found at <https://www.gov.uk/guidance/agricultural-flat-rate-scheme-notice-70046>. This guidance will be updated to reflect the amendments by 1 January 2021.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A Tax Information and Impact Note covering this instrument will be published on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

13.3 The basis for the final decision on what action to take to assist small businesses is as follows. As the AFRS is a scheme that aims to relieve small businesses of the administrative burdens of standard VAT obligations, the introduction of the thresholds will not negatively impact small businesses.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is to engage with the stakeholders over the next two years and evaluate the impact of the entry and exit requirements.

14.2 The instrument does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 because the power by which this instrument is made is being exercised so as to make or amend provisions imposing, abolishing, or varying any tax, duty, levy, or other charge or provisions in connection with such provisions.

15. Contact

15.1 Alice Jollans at VAT Infrastructure and SDIL, Customer Strategy and Tax Design (HMRC) email: alice.jollans@hmrc.gov.uk can be contacted with any queries regarding the instrument.

15.2 Alongir Ali, Deputy Director for VAT Infrastructure and SDIL, Customer Strategy and Tax Design (HMRC) can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.