

# AVOIDING THE CLIFF EDGE:

## CONSIDERING POSSIBLE OPTIONS FOR A VAT THRESHOLD SMOOTHING MECHANISM



**KEY FINDINGS FROM THIS INDEPENDENT REPORT BY PRAGMATIX ADVISORY LTD:**

**CLIFF EDGE:** The UK has one of the highest thresholds in Europe. The current VAT threshold at £85,000 at 20% has a cliff edge effect which stifles growth, encourages non-reporting and reduces tax revenues to HM Treasury.

**LOWER VAT CASE STUDIES:** Case studies in Finland and Netherlands show the positive impact of lower VAT rates e.g. the Netherlands lowered VAT to 6% in the 2000s for labour-intensive services, which led to the creation of 4000 sector jobs.

**HAIR AND BEAUTY SECTOR:** 93% of sector businesses are below the VAT threshold.

### SMOOTHING MECHANISM

**OPTIONS STARTING AT THE CURRENT THRESHOLD:** the report models two options where graduated VAT could start at £85,000 (meaning reduced VAT revenue for the Government). With a moderately graduated option, HMT would see a loss of **£2.5 billion** in VAT revenue, counteracted by an additional **£2 billion** in increased compliance.

**OPTIONS STARTING BELOW THE CURRENT THRESHOLD:** five options from 'least graduated' to 'most graduated' where VAT, starting from a lower rate would increase in steps towards the current standard rate of 20% (the government would see no loss in VAT revenue).

- **BOOSTED REVENUES:** The report estimates that an additional £25.2 billion in turnover would be declared returning an additional **£2.2 billion** in VAT revenue to HM Treasury with at least **£33m** of this coming from the hair and beauty sector.
- **ADMIN BURDEN A SMALL SHARE OF LABOUR COSTS:** the report estimates an admin cost for businesses (£1000 per business per year in time and software costs), however this would be a small share (2.5%) of average sector labour costs.

### WHAT DO SECTOR BUSINESSES THINK? VIEWS ARE MIXED.



**86%** of hair and beauty businesses supported a graduated approach.

**50%** say that a reduction in VAT would be most beneficial for their business.

**25%** say that raising the VAT registration threshold would help their business.

**7%** felt that lowering the threshold would help their business.

