

That's of interest (VAT)

Indirect Tax



18 November 2024

On 1 January 2023, HMRC introduced new penalty and interest rules that changed the way VAT registered persons were penalised if they made late submissions of VAT returns and made late payments of VAT. Whilst the new system was welcomed for its less punitive approach for late payment penalties than the former default penalty system, not everything improved for late payment interest.

Late payment interest is charged on underpaid taxes in order to represent 'commercial restitution'; that is to compensate the Exchequer for the loss of the use of monies during the period the tax had been unpaid. However, for transactions subject to VAT supplied to 'fully taxable' VAT registered persons, that is those who are able to recover all VAT on their costs (subject to the usual rules), the VAT declared by the supplier is normally able to be promptly recovered by the customer. If the supplier charges the VAT late, the customer can only recover it at the later time so there is still no overall loss of use of the monies.

Example

If the supplier does not charge the right amount of VAT at the right time, say where a supply of construction services was treated as zero-rated initially but subsequently found to be standard rated, the supplier must raise a VAT invoice to correct the tax. The customer is only able to recover the VAT at the time they received the corrected invoice. However, for the supplier, the corrected VAT would still be due from the original date of the supply (ignoring transactions below the voluntary disclosure thresholds).

Under the old default interest system, the late payment interest due on a VAT error in an earlier period where that same VAT was fully recoverable by the customer could be inhibited by HMRC under their discretionary powers. This was on the basis that if it had been charged at the right time, the customer would have recovered it at the right time too. Under the new system, HMRC no longer have discretionary powers to inhibit the interest, so the supplier in this example would have to pay interest on the error from the date of the original supply to the date that the error was resolved.

Autumn Budget 2024

Prior to the Autumn Budget, the CIOT submitted a Budget representation (see www.tax.org.uk/ref1361) on repayment interest and commercial restitution. The submission discussed the wider issue of the impact of HMRC charging a higher interest rate for late payments made by taxpayers as opposed to cases where they repay taxpayers late themselves, and also called for the re-introduction of HMRC discretionary powers to inhibit late payment interest for VAT.

Unfortunately, the Budget did not re-introduce discretionary powers and the position will be worsened by the introduction of a 1.5% increase to the interest rate on unpaid tax from April 2025. We voiced our concerns in our post-Budget press release (see tinyurl.com/3m38wtkz). We will continue to raise our view with the government that the re-introduction of discretionary powers for HMRC to inhibit interest in cases where no commercial restitution applies is long overdue.

Jayne Simpson jsimpson@ciot.org.uk