



Faculty of Taxation

TAXREP 18/03

VAT: INPUT TAX DEDUCTION WITHOUT A VALID INVOICE

Memorandum submitted in June 2003 by The Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation paper issued in April 2003 by Customs

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VAT: INPUT TAX DEDUCTION WITHOUT A VALID VAT INVOICE

GENERAL COMMENTS

1. We welcome the opportunity to comment on the draft Statement of Practice described in the Consultation paper issued in April 2003.
2. We consider that the checks suggested by the consultation paper would be unreasonably burdensome, and affect significantly more taxpayers than suggested by the consultation paper. We do not accept Customs' argument that these changes will reduce missing trader intra-community ("MTIC") fraud, but view the provision as an attempt to penalise compliant traders by denying them the right to recover VAT paid to other businesses in the supply chain.
3. Businesses require certainty in order to be able to plan properly. The statement of practice does not provide sufficient certainty to enable them to plan with confidence. In particular, the word "satisfactorily" in the flowchart in Appendix 1 does not guarantee that input tax will be deductible even where the trader has, to the best of his ability, carried out the checks in Appendix 2.
4. A system should not be introduced that will do little to reduce the opportunities for dishonest people to cheat the system but instead will penalise the innocent. Rather, the system should be changed to make it difficult, if not impossible to circumvent.
5. We therefore recommend that the gold scheme, whereby for transactions between registered traders the VAT element of the price is paid direct to Customs by the buyer, be extended to cover the goods affected by this measure. If the answer is that this cannot be done, then we would welcome cogent reasons as to why.

DETAILED COMMENTS

Background

6. We recognise that MTIC fraud poses an increasing threat to VAT receipts in the European Union and that tax authorities in other Member States have legislated to prevent such evasion. At the time that the Single Market legislation was introduced in January 1993 we expressed concern that the "transitional system" would enable frauds of this type to happen. We are unconvinced, however, that the measures proposed will have an appreciable impact on the fraudsters.
7. It appears to us that the major effect of the revised policy will be to shift the burden of tax losses away from the exchequer and place it on businesses that may not be aware that their supplier or another supplier in the supply chain may be committing a VAT fraud. It looks as if Customs are seeking to mitigate exchequer losses by imposing additional tax and administrative costs on the wider business community. Given the difficulties that Customs, with all the resources of a Government Department, appear to face in combating these frauds, how can businesses be expected to identify them?

Application of the measure

8. The consultation paper suggests that only businesses dealing in computers and related goods, telephones and related goods, alcohol, and oils held out for sale as road fuel will be affected by this measure. In practice, however, nearly all businesses use and regularly purchase some or all of these items in connection with their business activities. We believe that nearly all businesses could be affected by this measure. This means that the compliance cost for business as a whole will be much higher than is suggested in the consultation paper.
9. If the measure is implemented as seems to be contemplated by the consultation paper, nearly all businesses face the prospect of having to carry out checks on many of their suppliers. We presume that a “one-off” check will not be sufficient to satisfy Customs of the continuing bona fides of a supplier so it seems probable that a programme of regular supplier verification exercises may be needed to confirm the continuing status of suppliers. Even with such continuing checks, there would be no certainty since any default by the supplier would inevitably happen after the check was carried out. We question whether in this case the costs for business are proportionate to the risk.
10. We are also concerned as to how a business is to identify any invalid VAT invoice. Many of the more sophisticated “missing trader” frauds use what appear to be valid VAT invoices, which contain all of the information required by the VAT regulations and a valid VAT registration number. However, where the VAT charged is not brought to account because the supplier “goes missing”, the consultation paper seems to contemplate the denial of input VAT recovery to the buyer of the goods.
11. Short of checking with Customs before any supply of affected goods takes place (and probably not even then), it is hard to see how a business can protect itself against a supplier “going missing” and not accounting for the VAT. It appears to us that neither business nor Customs would wish to institute such a resource intensive process. The difficulty that Customs have encountered in its efforts to counter this type of VAT evasion illustrates how difficult it can be to identify the fraudsters. What is difficult for Customs, with all the resources available to it as a revenue department will be nearly impossible for an ordinary businessman.
12. We would welcome confirmation that Customs will offer the facility for traders to seek confirmation that a VAT number on an invoice is valid and corresponds to the other information, for example business name, address and telephone number. The timescale for Customs’ response will need to be short, and we would be grateful for confirmation that such information will be available by telephone or by email.

Appeals

13. The draft statement of practice sets out how Customs intend to operate the legislation. What safeguards do traders have to ensure that individual Customs officers take a reasonable approach when dealing with cases in practice, for example, in interpreting “satisfactorily” where the decision flowchart in Appendix 1 says: “can you satisfactorily answer most of the questions in Appendix 2?” and “can you satisfactorily answer all or nearly all of the questions listed at Appendix 2?”? We do not consider judicial review a realistic remedy for the average trader in these circumstances.

Reasonable Steps

14. Whilst accepting that situations such as those outlined in paragraphs 16 and 17 of the consultation paper can (and probably do) occur, we do not believe that they are symptomatic of the “organised” frauds that seem to be the major concern here. It appears to us that if a fraudulent supplier is able to persuade a business to part with, say, £50,000 for goods before they are delivered, we doubt that there will be any documentation surrounding the transaction. It seems far more likely that the fraudster will disappear with the money and never be heard of again.
15. Similarly, the fuel tanker turning up on a forecourt with fuel for sale for cash or alcoholic drinks being sold from the back of a van are hardly symptomatic of organised missing trader fraud of the sort that these measures would catch. Whilst such frauds do undoubtedly go on, in many cases paperwork is likely to be largely, if not completely, lacking.
16. Where, as is normal, payment follows delivery of the goods being paid for, the key commercial protection afforded to a purchaser is that payment is not made until satisfactory delivery has been effected. Some, but by no means all, businesses carry out some checks on suppliers. In the context of mobile phones, it has become more common for businesses to seek confirmation that their suppliers have a VAT registration. Some businesses have obtained copies of supplier’s VAT registration certificates to evidence this.
17. Where, as is often the case, the goods that are the subject of the supplies on which the supplier does not account for VAT do exist and are supplied to the buyer, who then sells them on and accounts for VAT, all of the requirements for the buyer to deduct VAT in the purchase will normally be present. There will have been a genuine supply by an ostensibly-VAT registered supplier who will usually issue a document carrying most or all of the features required of a VAT invoice. If it is the intention to seek to deny input VAT recovery in such situations, where the supplier fails to account for the output VAT, we have strong reservations about whether there is vires for this as a matter of EU law and over the equity of the process. It appears to us that this would be nothing more than an attempt to make the customer meet the cost of Customs’ inability to collect the output tax from the supplier.

Recommended solution

18. Rather than seeking to penalise the buyer of the goods in this way, a better solution is to reduce the scope for the supplier to collect VAT on sales and to then fail to account for it. Although it would involve additional administrative costs for businesses, we believe that a more effective and equitable solution would be to adopt an approach similar to the special VAT accounting scheme used in relation to gold.
19. Under such a scheme, the buyer of specified goods would account for the output tax on the supply to Customs direct, rather than handing it over to the supplier. At the same time, input tax recovery would be available.

20. This has the double advantage of not imposing an additional VAT burden on buyers of the goods and, at the same time, removing the tax that the fraudsters might otherwise collect from buyers and not account for correctly. It would have the further key advantage of giving businesses certainty that input tax will not be disallowed. Although traders would have to alter their purchases payment procedures for the supplies affected, a mechanism of this kind is likely to be both more acceptable to the wider business community and more effective in countering the frauds than simply preventing others in the chain from reclaiming input tax.

Cost/benefit analysis

21. The Regulatory Impact Assessment contains details of the estimated cost to industry to implement the new checks regarding the legitimacy of suppliers and customers. If the measure is implemented as described, we feel that the time businesses will spend in verifying the legitimacy of suppliers is substantially more than Customs predict. The task will be particularly onerous for larger businesses that may have hundreds or even thousands of suppliers. Not only do we believe these measures are unnecessarily burdensome and highly discriminatory against legitimate taxpayers in the industries affected, but we foresee that these measures will shift the burden for unpaid VAT to compliant traders.
22. In *Protecting Indirect Tax Revenues*, Customs affirm that they will endeavour to “make it simpler and less costly for [businesses] to comply with the requirements of the VAT system, and crack down hard on those who continue to abuse the system through fraud, abusive avoidance schemes and persistent non-compliance.”. In our opinion, this attack on the ability of businesses to recover VAT on their purchases is completely inconsistent with this statement in that the proposals appear designed to punish the innocent rather than the guilty.

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