TAXREP 30/02

VAT: DELAYED ACCOUNTING FOR VAT AT IMPORT SCHEME (DAVIS)

Memorandum submitted in October 2002 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document issued in July 2002 by Customs

CONTENTS

EASING THE IMPACT OF VAT ON BUSINESS: DELAYED ACCOUNTING FOR VAT AT IMPORT SCHEME (DAVIS)

INTRODUCTION

1. We welcome the opportunity to comment on the proposals in the consultation paper issued in July 2002. Since that date we have participated in two general meetings to discuss the proposals further, and our comments in this response also reflect these discussions.

2. We endorse fully the points made in the representations already submitted to Customs by our representative on Customs joint working group and member of our VAT Sub-committee, John Arnold. Our memorandum includes the points and questions raised in his paper, in particular those on security, compulsory electronic filing, discrimination against non-UK established businesses, state aid and rights of appeal.

WHO WE ARE

3. The Tax Faculty is the focus within the Institute of Chartered Accountants in England and Wales for those Chartered Accountants working in the area of tax. It is a centre of excellence and the authoritative voice for the 123,000 members of the Institute on taxation matters. The Tax Faculty makes representations to Government and other authorities and public pronouncements on major tax issues. Chartered Accountants are in tax practices and in businesses ranging from the largest to the smallest concerns.

EXECUTIVE SUMMARY

4. We welcome the initiative of the proposals, and the effort to reduce the cost of VAT accounting for importers, particularly SMEs. Whilst we appreciate that Customs need to protect the exchequer against fraud, we remain concerned that the new system as proposed is so circumscribed with conditions and restrictions that it may deter many businesses, particularly SMEs, from taking it up.

5. There appears to be a general assumption in the paper that many businesses will be fraudulent, hence the perceived need for comprehensive controls, approvals and discretionary powers. We would prefer a system that assumed that the vast majority of businesses are honest, with more emphasis on credibility controls which would not inconvenience businesses to the same degree. All imports are already subject to controls for customs duty and VAT, and these will remain.

6. Other issues of concern include the following:
   - clarification is needed on certain aspects of the security to be provided, including the extent if any to which Customs will be able to change their requirements once agreement has been given;
   - the rules, procedures and payment of customs duties will remain unchanged. UK businesses using the new system will have to account for VAT and customs duty on import in two separate ways, which will inevitably reduce the attraction.
   - there should be an absolute right of appeal to the VAT and Duties Tribunal against a refusal or a subsequent change of the conditions by Customs;

- form C79 should not be withdrawn;
- non-UK established businesses need to be treated equally and on a non-discriminatory basis. If this is not done, the proposals will be open to legal challenge; and
- the proposed regime should not be confined to those filing electronically.

DETAILED COMMENTS

Paragraph 2.7

The two options

7. Paragraph 2.7 of the consultative document introduces the proposed two options. Option 1 offers a reduced or zero level of security/bank guarantee for those who wish to continue to use the current deferment system. We are concerned that under this option, security will still be required for customs duties which will make this option less attractive. We appreciate that the security requirements for customs duties are governed by the (European) Customs Code (in particular Article 225), and therefore cannot be changed unilaterally by the UK.

8. We welcome Customs' suggestion that they could approach the European Commission with a view to including customs duties in the reduced level of security required, but this would only go part way to resolving the problem, as dual accounting will still be required.

9. We note that the general rules, procedures and payment of customs duties will remain unchanged. As with the requirement to provide security, we appreciate that these are governed by the (European) Customs Code (in particular Article 227), and therefore cannot be changed unilaterally by the UK. However, the effect is that UK businesses using the new system will have to account for VAT and customs duty on import in two separate ways, which will inevitably reduce the attraction of the new VAT system.

10. The main cost for businesses is usually incurred in setting up the DAN and obtaining security in the first place. There is not likely to be much saving attached to a reduction in the level of security.

11. We would welcome clarification of the following:

    (a) In what circumstances will zero security be required, and in what circumstances a reduced level?

    (b) Will Customs be able to change the requirements after agreement has been given, and if so, how and on what grounds?

    (c) What right of appeal will there be to the VAT and Duties Tribunal against any refusal or subsequent change of mind by Customs (see below)?

12. We would also welcome clarification of how the zero security deferment scheme will operate in cases where the UK is used as an import location for supplies to European

Union countries. Would it be possible to have an express clearance declaration in respect of goods which are immediately shipped outside the UK, where no VAT is due?

13. The consultation document indicates that even if businesses adopt Option 2, Customs will still require businesses to use the current deferment system for any customs duties, etc payable. We would welcome clarification of the following:

    (a) Any business moving on to Option 2 will have to use two systems, one for VAT and one for customs duties, which will be confusing for small businesses. Have Customs ascertained the extent to which this might be a problem, ie what proportion of goods imported bear customs duties?

    (b) What right of appeal will there be to the VAT and Duties Tribunal against any refusal or subsequent change by Customs (see below)?

14. We consider that C79s should not be withdrawn for those businesses adopting Option 2 as this would cause considerable problems for internal accounting procedures. We understand that these may now be retained.

Right of appeal

15. Paragraph 2.9 states that decisions of Customs would be 'subject to the normal appeal procedures available to businesses'. We have expressed our view in the past that as a general rule there must be an absolute right of appeal on all matters within Customs' discretion. Applying this principle to DAVIS means that the business must be able to appeal against any refusal, or change to the conditions, and the VAT and Duties Tribunal must be able to substitute its own judgement if it disagrees. Anything other than an absolute right of appeal would be contrary to Judgments of the European Court of Justice, for example in the case of *Garage Molenheide* (joined cases C-286/94, C-340/95, C-401/95 and C-47/96, 1997 ECR I-7281). The issue is being further considered by the ECJ in the pending *Schneider* case (C-380/01), and there is also the case law of the ECHR.

16. If Customs decide to limit the right of appeal, that of itself could be subject to legal or infringement proceedings.

Approval standards

17. We consider that some of the conditions in paragraph 2.9 are very subjective, so the points above about an unfettered right of appeal are very important. We would welcome clarification of the following:

    (a) Why does the consultative document state that Customs will 'normally', as opposed to always, contact the business concerned prior to taking action where they decide to change or revoke the approval?

    (b) In what circumstances would they not contact the business?

(c) If the business appeals to the VAT and Duties Tribunal, what would be the position in the interim?

(d) Where Customs have recourse to outside agencies in connection with ascertaining a business' financial standing/credit rating, what rights will the business have to have access to and to challenge the accuracy of any information, whether under the Data Protection Act or otherwise?

18. We suggest that other approval criteria that Customs might consider include whether the business has a deferment account, or whether it is a payment on account trader. Customs might also employ other general business methodologies for credit risk assessment.

19. The treatment of businesses that are recently established needs consideration as they will have no compliance track record to act as an indicator of whether they meet the approval standards proposed in paragraph 2.9. We understand that Customs are considering what should be the approval criteria and what, if any, additional tests should be introduced. We are concerned that new businesses should not be put at a disadvantage to established businesses.

20. One possible solution would be to cap the level of imports on which a new business could delay the accounting for VAT under Option 2 to a level commensurate with prospective turnover. There would then need to be a system under which a business could apply for a higher level at a later stage. Whilst this would not of itself prevent fraud, it could well reduce the scale.

Non-UK established businesses

21. The treatment of businesses established in other EC Member States (but with no establishment in the UK) could form a major legal obstacle to some of the control aspects of the proposals, since it would leave the UK open to direct legal action by the business concerned, or to infringement action by the European Commission.

22. Whilst we accept that the number of such businesses importing goods into the UK from third countries is likely to be small (if only for logistic reasons), it is not possible to state that no 'foreign' business will do so: some may well import into the UK, for example for processing by a third party before onward shipment to the 'home' Member State.

23. The question therefore arises as to how the 'potential approval standards' in para 2.9 of the consultation document can be met by a business established in another EC Member State which is neither established in the UK nor has a history of making supplies here. In our view, the proposed tests on the submission of VAT returns and payment of the VAT due, as well as VAT compliance more generally, cannot be confined to the UK without contravening the EC Treaty. If the tests were confined to the UK, they could be seen as:

(a) contrary to the provisions in Art 43 EC Treaty on freedom of establishment and the case law of the European Court of Justice, for example *Halliburton Services BV v Staatssecretaris van Financien*, (Case C-1/93, ECR [1994] I-

1137) and *Metallgesellschaft/Hoechst* (Joined Cases C-397/98 and C-410/98), and *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v Commissioners of Inland Revenue and HM Attorney General* (Joined cases C-397/98 and C-410/98, ECR [2001] I-1727), and/or

(b) a state aid under Article 87 EC Treaty: see *Lunn Poly* (1999 STC 350) or the pending ECJ case of *Gil Insurance and others v Customs & Excise* (Case 308/01), and/or

(c) discrimination under Article 90 EC Treaty.

24. The only way that we can see of avoiding this obstacle is for the final provisions to treat businesses established in other Member States but not in the UK on the same footing as UK-established businesses. This means that under the final provisions Customs must be prepared to obtain the information necessary to satisfy the 'potential approval standards' from the tax administration in businesses' 'home' Member State.

25. If this is not done, the UK provisions will be at risk from infringement action by the European Commission or direct legal action by a business affected. Such a business could also make a formal Complaint to the European Commission.

Paragraph 2.10

Electronic filing

26. We share the concern expressed by others about the proposal in paragraph 2.10 that all businesses that adopt the deferred accounting system will be required to file electronically. We welcome Customs' subsequent decision to review this further.

27. Electronic filing would cause problems for a number of businesses. Large businesses may find electronic filing difficult because of firewall security systems. Many small businesses may not have the capability to submit electronically, or even access to a computer or the internet, and to obtain this would involve additional cost. There is also the question and cost of the electronic signature required. It is also unclear how easy it would be for non-established businesses to file electronically. These factors are likely to prevent many businesses from taking up DAVIS if electronic filing were made a condition.

Further consultation

28. We would be happy to be involved in any further consultations, or to provide practical information if this would be useful.

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