

## **TAXREP 19/03**

### **VAT: JOINT AND SEVERAL LIABILITY: REASONABLE CHECKS**

*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*

## **CONTENTS**

	<b>Paragraph</b>
<b>GENERAL COMMENTS</b>	<b>1-7</b>
<b>DETAILED COMMENTS</b>	<b>8-31</b>
	<b>Annex</b>
<b>FURTHER EVIDENCE SUBMITTED IN MAY 2003 TO THE HOUSE OF LORDS SELECT COMMITTEE ON ECONOMIC AFFAIRS SUB-COMMITTEE ON THE FINANCE BILL</b>	<b>A</b>
<b>EXTRACT FROM QUESTIONS SUBMITTED ON 3 JUNE 2003 TO CUSTOMS</b>	<b>B</b>
<b>ADDITIONAL DETAILED QUESTIONS ON THE JOINT AND SEVERAL DRAFT S/P</b>	<b>C</b>

## VAT: JOINT AND SEVERAL LIABILITY: REASONABLE CHECKS

### GENERAL COMMENTS

1. We welcome the opportunity to comment on the “reasonable checks” described in Customs’ consultation paper issued in April 2003.
2. The checks contained in the consultation paper will be unreasonably burdensome, and we think that they will affect significantly more taxpayers than is suggested by the consultation paper. We believe that new section 77A to the Value Added Tax Act 1994 contravenes the principles of the EC Sixth Council Directive and is anti-competitive. We are cautious about Customs’ argument that these changes will reduce missing trader intra-community (“MTIC”) fraud in the medium to long term. The immediate effect seems to have been to produce near paralysis in the marketplace and we consider that such interference with legitimate business transactions cannot be in the interests of the economy. We view the provision as an attempt to penalise compliant traders by reallocating the burden of proof and making them responsible for VAT due from other businesses in the supply chain.
3. Businesses need certainty in order to be able to plan properly. The law in Clause 18 of the Finance Bill is oppressive. Although we have had a very constructive meeting with Customs who have provided assurances that the Department does not want to catch the innocent, the draft statement of practice does not provide certainty.
4. We reproduce in *Annex A* evidence submitted in May 2003 to the House of Lords Select Committee on Economic Affairs Sub-committee on the Finance Bill (whose Report was published on 17 June 2003 - see <http://www.publications.parliament.uk/pa/ld/ldeconaf.htm>) which includes reasons why we consider that administrative safeguards are insufficient. As recommended by the House of Lords Sub-committee, we are of the particular view that Customs should have to obtain approval from a VAT and Duties Tribunal Chairman before issuing a Notification Letter, and that the application should be approved by the Commissioners of Customs and Excise without power of delegation.
5. We set out in *Annexes B* and *C* a selection of detailed questions on the draft statement of practice on which we would welcome clarification, many of which together with others we have already put to the Department.
6. We would also welcome confirmation that the liability allocated to a trader will be proportionate to his involvement in the chain of supply, that is to say, his liability will not be more than the VAT that he has accounted for on the transactions that have passed through his hands. As the law stands, an innocent VAT-registered trader who makes a single purchase as part of the chain may have a potentially unlimited liability for the VAT that has gone missing elsewhere in the chain.
7. Rather than introduce law and procedures that will do little to reduce the opportunities for dishonest people to cheat the system but instead will penalise the innocent, the system itself needs to be changed to make it impossible to circumvent it. We therefore recommend that the gold scheme, under which for transactions between registered traders the VAT element of the price is accounted for 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**

8. 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 kind to happen.
9. We have some concerns, however, that by shifting the burden of tax losses away from the exchequer and placing it on businesses that may not be aware that at some point in a supply chain a VAT fraud may have occurred, Customs are seeking to mitigate revenue 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 face in combating these frauds, we question how businesses can be expected to identify them.

### **Scope of the joint and several liability measures**

10. We recognise that MTIC fraud is particularly prevalent in the supply of two categories of goods, namely computers and computer equipment and telephones and telephonic equipment.
11. This is a market that can be categorised largely by a small number of high volume manufacturers and distributors, with numerous smaller distributors. Such businesses have a number of concerns about Customs’ proposals.
12. The consultation paper appears to be founded on the assumption that businesses regularly carry out specific checks to ascertain the integrity of a potential supplier. We believe that this is incorrect. The market for these goods is highly price sensitive. Many businesses operating in it will enter into transactions on the basis of the price and the availability of the goods. Wholesalers and trade distributors tend to purchase high volumes of goods and trade with a large number of different suppliers, as demand for these goods rises and falls, largely dependent on price.

### **Application to other businesses**

13. Customs’ intention to apply the joint and several liability provision in respect of telecommunications and computer equipment is likely to affect all businesses. It is extremely rare for businesses not to use computers and fixed line and mobile telephones and almost all businesses purchase such equipment as a matter of routine, and many will, within three or four years, sell it on. We think it likely that Customs’ assessment of the number of traders that will need to carry out the proposed checks and will be affected by these measures is considerably less than in reality.

14. In our opinion, it is unreasonable to assume that businesses invest time in verifying the legitimacy of a supplier from a VAT compliance perspective. We feel it is administratively burdensome and costly for businesses to perform the checks proposed by Customs, whilst the ability of potential fraudsters to hide behind a legitimate corporate veil means that the checks, if carried out, would not eradicate the problem of MTIC fraud. The difficulties encountered by Customs in attempting to counter these frauds illustrate how intractable the problem is. We find it difficult to believe that businesses will have any more success than Customs, with immeasurably greater resources, have had. It seems probable that the principal effect of the change will be to transfer the cost burden of the frauds from the exchequer to innocent businesses in the wider business community.

### **Valuation of goods**

15. The draft Statement of Practice indicates that Customs will consider that a business has made a gain or have received a benefit arising from a supplier's failure to pay VAT where the specified goods were purchased for less than the lowest open market value of the goods or the price payable for the goods by any previous supplier.
16. It is not clear to us how these measures would be arrived at in practice. How is the "lowest open market value" to be determined, and by whom? Are businesses to face the burden of conducting wide scale tests of market pricing each time they enter into a transaction? Will businesses have to show that they have not bought at the lowest available price? As has been mentioned already, the market for these goods is extremely price sensitive and businesses are constantly seeking to buy at the lowest price available. What is the difference between a well-negotiated price for a buyer and one that produces a "gain" or "benefit" for that business?
17. Given the state of the marketplace, it is virtually inconceivable that a business could find out whether the price it is paying is less than that paid by its supplier. Such information is likely to be regarded as commercially sensitive by any supplier and few, if any, businesses are likely to be prepared to disclose it. It would take the resources of a body like Customs and Excise, with access to the records of all the businesses involved in a transaction chain, to establish whether or not this is the case. We consider it to be manifestly unfair and unreasonable to apply a test that cannot be satisfied in practice by those who are supposed to apply it.
18. Quite apart from the difficulties over the application of these tests, the assumptions that underpin them seem to be unrealistic. By their very nature, telecommunications and computer equipment may be subject to price fluctuations in the supply chain as a result of technological advancements and changes in supply and demand. It would be far from unheard of for the price of these goods to fall as they progress through the supply chain to the final consumer as particular models are substituted by goods which are technically more sophisticated. However, the goods remain merchantable, as they are useable and not completely obsolete, albeit at a lower price than more up-to-date replacements.
19. It is our view that the assumption that goods sold at lower than "market value" (however that may be determined) may be indicative of VAT evasion is tenuous. A supplier may legitimately offer goods to a customer at a price below the current

market value in order to encourage further business and stimulate loyalty. This is a feature that is seen every day in a wide range of businesses that routinely offer “loss leaders” in the expectation that margins on other sales will make up for any losses on promotions. Similarly, a supplier may justifiably wish to reduce the stock he holds on site or raise cash. In view of the above, we do not believe that the inference that the supply of specified goods at a price less than “market value”, or less than the price payable by any previous supplier, is necessarily evidence of MTIC fraud.

### **“Reasonable grounds to suspect”**

20. The consultation paper provides no clear definition of this phrase. It appears that any taxpayer who is unable to verify the legitimacy of the entire supply chain in which he participates (in other words, almost anyone) may be held to have had reasonable grounds to suspect that VAT evasion *may* transpire elsewhere in the supply chain.
21. We consider it essential that Customs state clearly what constitutes “reasonable grounds to suspect”. Moreover, that test must take account of what a taxpayer can do to identify this. Most businesses are not, and cannot be expected to be, investigation experts. As matters stand, we would expect that taxpayers held to be jointly and severally liable for unpaid VAT as a result of this measure would inevitably appeal to the VAT and Duties Tribunal.

### **Effects on the supply chain**

22. Many businesses are deeply concerned about the proposal to extend the joint and several liability measures to every business in the supply chain where Customs suspect that fraudulent activities may have occurred. It would be logistically impossible for manufacturers of telecommunications and computer equipment to verify the lawfulness of every customer further down the supply chain from a VAT perspective. Similarly, it would be impossible for any buyer to establish that all those involved in the supply chain had complied fully with their VAT obligations. Such businesses would be unable to definitively rule out the possibility that VAT fraud may occur elsewhere in the supply chain, as they have no ability to ascertain whether the goods have been bought or sold by fraudulent traders at some point.
23. Since the draft statement of practice does not relieve such businesses from the joint and several liability provision, it is feasible that compliant businesses would be unjustly liable for VAT fraud that occurs elsewhere in the supply chain.

### **Cost/benefit analysis**

24. We feel that the time that will be spent by businesses in verifying the legitimacy of suppliers and customers is substantially more than Customs predict, and that the processes will be particularly difficult to implement in conglomerates that may have many thousands of suppliers and customers. Not only do we believe these measures are unnecessarily burdensome and highly discriminatory against legitimate taxpayers in the industries affected, but foresee that these measures will shift the burden for unpaid VAT to compliant traders.

25. 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, the joint and several liability provision is completely inconsistent with this assertion.

### **Anti-competitiveness and legislative analysis**

26. We are concerned that the joint and several liability provision is anti-competitive. UK businesses may prefer in future to source goods from non-UK (possibly non-EU) suppliers to avoid the risk of incurring joint and several liability for any fraud which may have previously occurred in relation to the goods concerned.
27. We also have concerns about the EU law basis for the new provision. Article 21 (3) of the EC Sixth Council Directive, states: “*Member States may provide that someone other than the person liable for the payment of the tax shall be held jointly and severally liable for payment of the tax.*”
28. It is our opinion that this does not give Member States the right to attribute liability for the payment of tax to any other person, but only to a person appointed as a VAT representative or agent of the taxpayer. Therefore, we feel that Customs’ application of this derogation may be ultra vires EC law.
29. It is evident that these measures are punitive. Following the case of *Han & Yau* (CA, 2001), the Courts have stated that taxpayers cannot be jointly and severally liable for punitive penalties. Therefore, we foresee that any attempt to apportion liability under the joint and several liability provision would be subject to a challenge under the European Convention on Human Rights.

### **An alternative approach**

30. One of the defects with the current proposal to make buyers jointly and severally responsible for VAT on supplies to them is that they face a doubling of the VAT burden. In addition to paying VAT on the supplies to the supplier, the proposal means that, in addition, they may be held liable to pay it again to Customs if someone in the supply chain does not account for it correctly. Although it would involve additional administrative costs for businesses, we believe that a more equitable solution may be to adopt an approach similar to the special accounting scheme used in relation to gold.
31. Under such a scheme, the buyer of specified goods would account for the output tax on the supply directly to Customs, rather than handing it over to the supplier. At the same time, input tax recovery would be available. 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 they will not become liable for someone else’s VAT. 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 collecting the unpaid VAT from another trader.

20.6.03  
PCB  
14-69-69

## **FURTHER EVIDENCE SUBMITTED IN MAY 2003 TO THE HOUSE OF LORDS SELECT COMMITTEE ON ECONOMIC AFFAIRS SUB-COMMITTEE ON THE FINANCE BILL**

### **Clauses 17 & 18 to the Finance Bill 2003**

#### **Requirement to Provide Security/Joint & Several Liability**

In our paper to the Committee dated 28 April 2003, we set out our concerns that Clauses 17 & 18 were not acceptable as they are too wide-ranging, contain insufficient safeguards, and are therefore generally open to challenge in law. We provided more detail in our formal representations to the Chancellor of the Exchequer on the Finance Bill (TAXREP 14/03), also sent to the Committee.

We gave oral evidence to the Committee on Wednesday 14 May 2003. This paper is in response to the request by the Chairman of the Committee (Lord Peston) to provide the Committee with more precise suggestions as to how carousel fraud could be countered. We accept that there is no simple solution to counter such fraud. However, we believe that there are steps that can be taken to counter such fraud which do not penalise the innocent and which do not impose unreasonable burdens on businesses or on Customs and Excise. We have set our suggestions in Section A.

In Section B we set out our further views on the protection of legitimate businesses from the effects of these clauses (Questions 10 and 11 of the Committee's *Questions for Accountants and Legal Witnesses*.)

In respect of the burdens placed on legitimate businesses, Clauses 17 & 18 place such heavy and wide-ranging burdens on legitimate businesses that we consider that all of our suggested approaches merit detailed consideration. All of the approaches will impose some additional administration burdens on businesses, and some impose additional administration burdens on Customs.

### **A. ANTI-FRAUD MEASURES**

#### **1. Removing the VAT charge**

The 'VAT-free' cross-border supply of goods arises from the refusal of Member States to agree to alternative methods of charging VAT proposed by the European Commission. The opportunity for carousel fraud stems mainly from such VAT-free supplies as the fraudster then sells (ostensibly) plus VAT but does not then pay the VAT over to Customs and Excise. One approach to reduce this fraud is to remove the VAT charges in the supply chain until such time as it reaches a non-VAT registered consumer. Two ways of achieving this result are as follows.

##### *1.1 Reverse charge along the supply chain*



To impose a ‘reverse charge’ procedure along the supply chain between VAT registered businesses (ie until the supply to the final consumer). This would mean that a business would not charge VAT to another VAT-registered business. The customer business would instead charge itself VAT, which it could deduct in the same VAT Return period. The system is already used for certain services received from abroad and, as we have stated above, for intra-EC supplies of goods. It is also used, on security grounds, for domestic supplies by non-resident businesses to resident businesses in Austria, the Netherlands, Spain and Sweden. A further advantage of this proposal is that the supplier could be required to quote the VAT registration number of the customer, thus providing a more secure audit trail.

Whilst this proposal would reduce the scope for charging VAT along the supply chain, it would not stop the fraudster selling the goods to private individuals/non VAT-registered businesses in the domestic market and pocketing any VAT. However, selling into the domestic market is unlikely to be viable given that these carousels trade in transactions where the underlying subject matter consists of many individual items bundled up into one transaction.

## 1.2 *‘Black box’ or terminal market*

The existing VAT rules allow in certain circumstances for no VAT to be charged on transactions between members of certain defined terminal markets. A terminal market arrangement could be established for those dealing in the particular goods subject to carousel trading. The members of this terminal market would all require to be approved in advance by Customs & Excise. We accept that, unlike existing terminal markets, the number of businesses involved may make this difficult to operate. In addition, because fraudsters are unlikely to be approved, they would still be free to charge VAT on their supplies and then disappear. However, a major advantage of a terminal market arrangement is that it enables bona fide businesses to be identified. This will then allow Customs to target their resources on those committing the fraud.

## 2. **Earlier identification of fraud**

### 2.1 *Monthly or shorter VAT Return periods*

Businesses in risk sectors could be required to file VAT Returns and payments monthly or even shorter periods. For example, Russia had a 10-day VAT Return and payment period in the early 1990s to protect the state from high inflation.

### 2.2 *Copies of purchase and sales invoices*

Businesses in risk sectors would be required to provide Customs with copies of their purchase and sales invoices when they submit VAT Returns. (If electronic invoicing were compulsory, daily electronic reporting of transactions could be required, providing Customs with up to date intelligence.). Customs already require this as a control measure with the first VAT Return from non-UK businesses, and it has also been used more extensively in the Netherlands.

### 2.3 *Reporting of unusually large transactions*

Requirement for traders in risk sectors to report unusually large transactions (as, for example, under the Money Laundering rules).

### 2.4 *Approved turnover and/or input tax recovery limits*

Customs to set approved turnover and/or input tax recovery limits for each business in the risk sectors. Thus, for example, a business with a normal annual turnover of £500,000 could be given a limit of £800,000. Business would have to apply in advance for permission to exceed the limit. Customs would need to respond quickly so as not to hamper legitimate business activity.

## 3. **Protection of Payment**

### 3.1 *Direct payment*

Purchasers to pay the VAT charged on an invoice directly to C&E, as currently required by the 'gold scheme'.

### 3.2 *Secure payment by special bank accounts*

A variation of 3.1 above, used for construction industry PAYE/NIC in the Netherlands, requires the purchaser to pay the VAT on an invoice into a specially-denominated bank account held in the name of the supplier, but under the joint control of the supplier and the tax administration. The money in that account can only be used to pay tax, unless the tax administration authorise the bank to release all (or usually part) of it back to the supplier.

## B. **ADEQUACY OF ADMINISTRATIVE SAFEGUARDS**

### **General Comments**

1.1 We consider that administrative safeguards are always insufficient. They are not legally binding, can be changed with no further parliamentary scrutiny, and do not need to be followed in particular cases if Customs decide otherwise. Whilst Customs could then perhaps be challenged by judicial review, the cost would deter all but the largest businesses.

1.2 It is clear that Customs intend to use these new powers widely. In an article in *The Tax Journal* of 28 April 2003, the Head of Fiscal Fraud Policy at Customs & Excise estimated that some 2,000 businesses would be affected by the guarantee/security provisions, and 20,000 businesses would need to introduce or strengthen their checking systems for the joint and several liability requirements. As Customs state on page 12 of their *VAT Strategy: Joint & several liability, Consultation on reasonable checks*, published in April 2003:

**“How will Customs apply the measure?”**

Customs will send you a Notification Letter:

- if you have bought and/or sold the specified goods; and
- Customs believe that the transactions carried out through a particular supplier were traded within a supply chain where VAT would go unpaid.

The purpose of this Notification Letter is to inform you that Customs consider you may be jointly and severally liable for the unpaid net tax. It will give you the opportunity to demonstrate that you have a legitimate reason for the low purchase price of the goods, or if there are other factors which you feel Customs should consider.

A Notification Letter will be sent to each known trader in the chain of supply. If after a period of 21 days a legitimate reason has not been demonstrated, a Demand Notice will be issued for the unpaid net tax.”

All businesses in the supply chain can therefore expect to receive the Notification.

1.3 Customs’ Consultation paper lists possible reasonable checks which a business could carry out on its immediate supplier and customer, but is silent on what checks could be carried out further up and down the supply chain. This is perhaps not surprising, as it is difficult to see what checks could in fact be done, even though clause 18 holds taxpayers equally at risk from these remoter businesses.

1.4 Customs’ history in introducing and applying such provisions does not provide reassurance. We referred when giving evidence to the early years of the civil penalty legislation (1985-1990) where there were many instances of judicial criticism before the law was changed and the penalties reduced. The method of introducing and applying the three-year cap in 1997 has similarly been criticised by the judiciary, with the European Court of Justice deciding in 2002 that the UK law was ‘incompatible with the principles of effectiveness and the protection of legitimate expectations’. (*Marks & Spencer*, Case C-62/00, ECR 2002, I-06325)

1.5 More recently, the Finance & Tax Tribunals in decisions reported in 2003 have found against Customs in a significant number of post-*Hoverspeed* decisions. The *Hoverspeed* cases concerned cross-channel shopping for tobacco and alcohol. In July 2002 the High Court ([2002] 4 All ER 912) decided that the procedures adopted by Customs in checking and detaining passengers arriving in Dover, and seizing goods and vehicles were unlawful. The UK law was subsequently changed. Customs appealed on some minor aspects, and were partly successful in a judgment of the Court of Appeal on 10 December 2002. What is significant here is not that Customs did not succeed – a tax administration will inevitably both win and lose cases – but the comments of the various Chairmen on Customs’ actions. We give four examples below. The full texts of these Decisions and other cases are available from the Tribunal and selected cases are on the Court Service web site ([www.courtservice.gov.uk](http://www.courtservice.gov.uk)). The amendments in square brackets are ours, inserted for clarification.

- It is a fact that most [Customs’] reviews coming before the Tribunal are defective in law.

(E00372, *Creamer*, para 9)

- It was [the Customs officer's] function to consider all the circumstances and to come to her own decision on the facts which were in the possession of the Commissioners. The review letter shews that she did not do that. What she did was .... to apply the Commissioners' policy....

(E00374, *Hacon*, para 18)

- I considered imposing a penalty [on Customs] for non-compliance with the original direction and would have done so if there had been no costs to award. This is not an isolated case, being one of eighteen similar cases listed before me on 12 and 13 February for non-compliance. It seems clear that the number of officers employed by the Commissioners to carry out reviews .... is wholly inadequate. In a number of other cases I have imposed penalties on the Commissioners, however I do not do so in this case. It will be another matter if the Commissioners do not comply with the new deadline.

(E00386, *Kett*, para 27)

- We see the sense and justice in declaring [Custom's] decision to be unreasonable and, as just stated, we do so. However we see little point in giving directions to the Commissioners for the future except to say that they should observe the law properly (and, we might add, instruct its officials to cease behaving in a bullying and intimidatory way).

E00387, *Dickinson*, para 34

These were excise appeals where there were some, but not full, judicial safeguards, and we could cite many other examples. We are therefore concerned that internal safeguards will prove insufficient.

### **Further Protection for the taxpayer**

We consider that the following further legal safeguards should be introduced as a minimum.

2.1 No taxpayer should be required to provide security for the actions of a third party unless collusion in fraudulent activity can be shown.

2.2 No taxpayer should be held jointly and severally liable for the VAT debts of a third party unless collusion in fraudulent activity can be shown.

2.3 On appeal to the Tribunals, a taxpayer should be able to put forward an unrestricted 'reasonable excuse' defence.

2.4 The financial and operational consequences to a business of both clause are severe and could force it to cease trading. In addition, where (under clause 17) security for a third party is required, any business continuing to trade is liable to a criminal penalty of £5,000 for each supply (sale) that it makes whilst no guarantee is in place. Since time will be of the essence, and Customs will already have all the necessary information, we suggest that any appeal should be heard by the Tribunals within 14 days of the date on which it was made unless the taxpayer requests

otherwise. The normal waiting period is several months, but delays of that length will render many appeals otiose as the business will have had to cease trading.

2.5 Consideration could also be given to requiring Customs to obtain the consent of a Tribunal Chairman before they could require a business to provide security for a third party or hold them liable under the joint and several liability provisions. Customs could make the applications on an *ex parte* basis, and would need to demonstrate that the business involved was involved or complicit in the fraud.

## EXTRACT FROM QUESTIONS SUBMITTED ON 3 JUNE 2003 BY THE TAX FACULTY TO CUSTOMS

### General comments

#### *Adequacy of administrative safeguards*

2. We have publicly stated our grave concerns with these clauses in our Finance Bill submissions and elsewhere, and this was mirrored in the Standing Committee Debates. We also consider that the clauses are open to legal challenge. We do not repeat these here, although they remain our view. The purpose of this paper is instead to seek clarification of how Customs intend to operate the provisions in practice.
  
3. It is clear that Customs intend to use these new powers widely. In an article in *The Tax Journal* of 28 April 2003, the Head of Fiscal Fraud Policy at Customs estimated that some 2,000 businesses would be affected by the guarantee/security provisions, and 20,000 businesses would need to introduce or strengthen their checking systems for the joint and several liability requirements. For example, on the basis of Customs' statement on page 12 of *VAT Strategy: Joint & several liability, Consultation on reasonable checks*, published on 10 April 2003 under *How will Customs apply the measure*, all businesses in the supply chain can expect to receive the Notification Letter.
  - What is Customs' estimate of the number of businesses that will receive such a letter in the first year and the expected value of VAT that will be collected that would have been evaded ?
  - When do Customs estimate they will issue their first ... Demand Notices under cl ...18 ?

#### *Interaction with recent case law*

4. We would welcome clarification of the interaction.
  - How will the recent cases of *Bond House (18100)* and the joined cases of *Fulcrum and Optigen (18113)* be applied in relation to businesses who prima facie come within clause ... 18 ?
  - Will Customs confirm that no businesses will be penalised twice, once under the provisions of clause 18 and secondly through the disallowance of input tax ?

## **Detailed comments**

### ***General***

19. Customs' draft Statement of Practice on security provides for a warning to be sent to businesses, and also a safe harbour so that provided a business has ascertained the bona fides of his immediate suppliers and customers, Customs will not issue a Notice of Requirement of security to the business in respect of others in the supply chain. We consider that Customs should operate similar safeguards for businesses before they are asked to compensate the Exchequer for VAT evaded by others in the supply chain under the joint and several provisions of Clause 18.

### ***Effect of provision***

20. New section 77A makes no distinction between missing businesses, contrived insolvencies and honest failed businesses. As drafted this clause can apply not only to fraud but to normal insolvencies or bad debts.
- Do Customs intend to apply the provision to
    - (a) normal insolvencies, or
    - (b) bad debts ?

### ***Notification Letters and Demand Notices***

21. The draft Statement of Practice in the consultation document issued on 10 April provides that Customs will send a Notification Letter to a business, who then has 21 days to convince Customs that he has not paid less than the lowest open market price of the goods or the price payable by any previous supplier in the chain, or where he has, has a legitimate reason for having done so, failing which Customs will issue him with a Demand Notice.
22. We would welcome responses to the same questions, *mutatis mutandis*, as those listed under Security. [See Annex C]
23. In addition:
- How will the business know that he has paid less than the price payable by any previous supplier in the chain ?

- Even if the business does know that he is purchasing at below a price paid previously in the chain or the lowest open market value, he may be unable to refuse to purchase the goods owing to having entered into a binding long term contract: in such circumstances, will Customs refrain from issuing a Demand Notice ?
- Will Customs grant extensions to the 21 day time limit if asked ?

### ***Allocation of debt to specific businesses issued with Demand Notices***

24. Where Customs have identified 'a supplier in a high risk supply chain where VAT would be unpaid' and establish the debt
- How will Customs allocate the debt to businesses in cases where Demand Notices are issued to more than one business in the chain ?
  - Will the entire debt be allocated to each business in the chain ?

### ***Appeals***

25. Section 83 VAT Act is amended by the addition of sub-clause (ra) to enable a business to lodge an appeal in respect of 'any liability arising by virtue of [new] section 77A'. So far as the business is concerned, time will be of the essence. The normal waiting period for an appeal to be heard is several months.
- Would Customs be prepared to agree a procedure with the VAT and Duties Tribunals so that when a business appeals, the appeal is heard within 14 days of the date it was lodged unless the business requests a longer period ?
  - What information will Customs provide for a Tribunal hearing on the detail and reasoning for the security requirement, and how can this be verified independently by the appellant business ?
26. It will be sensible for businesses to document how they have checked the bona fides of their suppliers and customers.
- Will Customs accept that keeping a proper system of documentation which demonstrates that direct suppliers and customers have been adequately vetted constitutes a reasonable excuse so that the Notice will be withdrawn ?



- Will the Notice of VAT payable referred to new section 77A be treated as an assessment to tax hence allowing an appellant to plead hardship before the VAT and Duties Tribunal ?

27. The Statement of Practice sets out how Customs intend to operate the new legislation.

- At what stage does the right of appeal apply, ie only once a Demand Notice has been issued or on receipt by the business of a Notification Letter ?
- What safeguards are there to ensure that individual Customs officers do not exceed the self-imposed restraints (we do not consider judicial review a practical remedy) ?

### ***Training etc***

- Will all action on cl ... 18 need to be approved by Head Office staff or will Local VAT Office staff be involved ?
- If the latter, what training will Customs be providing to staff in local offices ?

## **ADDITIONAL DETAILED QUESTIONS ON THE JOINT AND SEVERAL DRAFT S/P**

**(Similar to those already put to Customs on Requirement for Security Notice 700/52)**

### ***Notification Letter***

1. The draft S/P states that a business will not be issued with a Demand Notice to pay the net tax unpaid without first sending the trader a written Notification Letter.
  - What form will the letter take?
  - Will it provide sufficient information to enable the business to know exactly what is of concern to Customs, eg which of the business' suppliers/customers he should not do business with and why?
  - Will the business be able to divulge this information to the supplier/customer? What other steps can the business take to verify the position ?
  - What reasons should a business give to its supplier/customer to explain why it is ceasing to do business with them ?
2. Once a Notification Letter has been sent to a business:
  - Will Customs advise the business of exactly what steps it has to take to ensure that it does not receive a Demand Notice ? We acknowledge that Customs provides generalised guidance in the S/P but some businesses may need more specific help.
  - Will Customs give the business written clearance once it has taken appropriate steps ?
  - If not, how will the business know that it is in the clear ?
3. If the Warning Letter does provide the business with information sufficient to remedy the perceived ill, Customs will probably need to divulge confidential taxpayer information.
  - How do Customs propose to reconcile disclosing confidential taxpayer information with the need to provide the business with sufficient detail to prevent the issue of a Demand Notice ?

- Can Customs confirm that if the business provides information to Customs about suppliers/customers, for example to satisfy them that he has taken appropriate action and remedied the situation, or indeed simply because it is a matter that he thinks they should look into (for example if he has been offered good at below market price), that they will not reveal the source of the information ?

### ***Demand Notice***

4. The draft S/P states that a Demand Notice will be issued to each person in the supply chain where Customs are satisfied that, on the balance of probabilities, the person had knowledge that the VAT on that supply would go unpaid.
  - What criteria will be used here to establish “knowledge” ?
  - How the VAT unpaid be calculated and apportioned between businesses in the chain ?
  - Will affected businesses be informed about the apportionment ?