



Response from ICAS
Penalty for participating in VAT fraud

11 November 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

1. ICAS welcomes the opportunity to contribute to the consultation 'Penalty for Participating in VAT Fraud' issued by HMRC on 28 September 2016.
2. Missing Trader Intra-Community (MTIC) fraud presents significant challenges and despite some HMRC successes in tackling it in recent years it continues to cost the exchequer between £0.5 billion and £1 billion per year. We therefore welcome attempts to reduce MTIC fraud further.
3. Whilst we support attempts to tackle MTIC fraud we are nonetheless concerned that further new penalties are being proposed whilst HMRC has not concluded its work developing its approach to all penalty regimes, following on from the 2015 discussion document, on which ICAS contributed its views. It would be preferable to incorporate all proposed new penalties (apart from the time-sensitive one linked to the Requirement to Correct) into the wider penalties review, to ensure consistency of approach and to avoid the need for future changes once the overall review concludes.
4. It would be useful to have clarification from HMRC on its view of the interaction between this proposed penalty and the new corporate offence of failure to prevent the criminal facilitation of tax evasion. This would potentially be relevant in cases where a company which might be subject to the civil penalty proposed in this consultation knew (rather than should have known) that a transaction was part of a VAT fraud.
5. It appears that the proposed new penalty is primarily aimed at VAT MTIC fraud. However, the consultation document refers to HMRC's use of the 'knowledge principle' to a lesser extent in tackling other VAT frauds. If the intention is to use the new penalty for other VAT frauds this should be explicitly stated and details of the circumstances in which it might be used should be set out and subject to consultation.

Specific questions

Q1: Do you consider that there is a good case for introducing a new penalty for participating in VAT fraud and if so, do you agree that the new penalty is aligned with the 'knowledge principle' and does not distinguish between whether a business or individual knew OR should have known of the connection with VAT fraud?

6. As set out in our general comments we support attempts to reduce VAT MTIC fraud further. If the intention is to use the new penalty more widely we would need additional details to enable us to comment.

Q2: Please outline your thoughts about the case for Option A? What do you see as the strengths and weaknesses of this option?

7. The main advantages of this approach are set out in paragraphs 3.6 to 3.8 of the consultation document. It is also a simpler approach than Option B.
8. The weakness of Option A is that it does not fit well with some of the penalty principles set out in paragraph 2.3 of the consultation. The second penalty principle states that "penalties should be proportionate to the offence and may take into account past behaviour". Principle 5 also notes that variations may be necessary to "take into account customer behaviours". A flat rate penalty takes no account of customer behaviour and may be disproportionate (given that the business will already have been punished by being unable to reclaim input VAT). In line with the penalty principles, an inexperienced trader (with no previous history of poor compliance) who does not carry out proper due

diligence and hence gets involved in MTIC inadvertently should not be subject to the same penalty as a persistent offender who knowingly takes part in a fraudulent series of transactions.

9. A flat rate penalty with no possibility of reductions for disclosure also offers no incentive for the individual trader or business to cooperate with HMRC. Paragraph 5.7 of the consultation document notes that in HMRC's experience "businesses which facilitate VAT fraud rarely make meaningful disclosures". However, this takes no account of those businesses which do get involved in MTIC fraud inadvertently (albeit carelessly). Even if these make up the minority of cases it makes sense and is more proportionate (in line with Principle 2) to offer an incentive to cooperation.

Q3: Is a 30% penalty an appropriate percentage to charge for this type of non-compliance?

10. The rationale for the 30% rate is that 'it is within the overlap of ranges of the current Schedule 24 penalty for both careless and deliberate inaccuracies'. The weakness of this approach is that under Schedule 24 the penalty could be 100% (subject to potential reductions for disclosure), where the behaviour falls into the deliberate and concealed category, or 70% for deliberate behaviour. We understand that HMRC consider that the majority of traders involved in MTIC cases fall into the category of 'knew' rather than 'should have known' ie their behaviour is deliberate; a 30% penalty therefore looks as though it could be too low in many cases.
11. Conversely, as set out in paragraph 8 above, a 30% flat rate penalty might be disproportionately high for a business which falls into the 'should have known' category and has become involved in MTIC fraud inadvertently.
12. Whilst criminal prosecution may be impractical in many cases, both Options A and B envisage acceptance of a lower penalty, in cases of deliberate behaviour, than is available under Schedule 24. HMRC should be seeking higher penalties for deliberate involvement in transactions involving fraud, even if criminal prosecution is not feasible.

Q4: Please outline your thoughts about the case for Option B? What do you see as the strengths and weaknesses of this option?

13. Option B is better aligned with the five penalty principles than Option A. Where there is an appeal against the knowledge decision it allows for a distinction between businesses which knew the transactions were connected with VAT fraud and those which should have known. It would also deter frivolous appeals.
14. However, as noted in paragraphs 10 and 12 above it means that those behaving deliberately will be subject to a lower penalty than that currently available under Schedule 24. In the case of Option B, where a business does not appeal the knowledge decision, the maximum penalty of 25% is well below that for deliberate behaviour under Schedule 24.

Q5: Do you think that having a higher penalty rate in cases where a tribunal finds actual knowledge would discourage legitimate appeals?

15. It is possible that legitimate appeals will be discouraged under Option B. A small business which has already had its input tax restricted might be deterred from appealing due to the fear of doubling the penalty – even where it considered that it had a good case for arguing that it had been careless (for example, due to inexperience and lack of understanding of due diligence procedures).

Q6: Do you think the proposed penalty percentages – of 25%, rising to 50% where a court finds actual knowledge of the fraud – are appropriate?

16. See our comments in paragraphs 10 to 15 above.

Q7: Do you think the new penalty (under either Options A or B) should apply to company officers that should have known of the connection with VAT fraud?

17. We consider that the new penalty should only apply to company officers where they knew of the connection with VAT fraud. Applying this approach where company officers should have known is likely to be disproportionate in some cases.

18. In general, we would not expect that a charity would be in a position where the new penalty would be relevant. However, if a charity was unwittingly drawn into transactions connected to VAT fraud it is unlikely to be appropriate for volunteer trustees to be liable to the penalty (or to naming and shaming).

Q8: Are there any other design options that we should consider for a new penalty for participating in VAT fraud?

19. See our comments above.

Q9: Do you prefer Option A or Option B or another design option?

20. Both options would need adjustments to address the points raised above.

Q10: Should the new penalty feature reductions for disclosure and cooperation with HMRC?

21. Yes. See our comments in paragraph 9 above.

Q11: If so, what should the reductions be for and what level of reduction should be allowed?

22. It would make sense to align these, as far as possible, with the regimes for other penalties.

Q12: Should those that participate in VAT fraud be named and shamed?

23. Only in cases where they knew that the transactions were connected to VAT fraud.

Q13: In your view, is naming and shaming appropriate when a customer only should have known of a connection with VAT fraud?

24. No; naming and shaming should be restricted to cases of deliberate behaviour, so to cases where the business or trader knew that the transactions were connected to VAT fraud. The existing naming and shaming provisions only apply to 'deliberate' behaviour; we cannot see any reason for altering that approach for this penalty.

25. See our comments in paragraph 18 above relating to volunteer charity trustees.

Q14: Do you have any further comments to make about the new penalty or this consultation exercise?

26. Businesses, particularly small ones, find it hard to keep themselves up to date with tax changes in general – and understanding changes to penalties will certainly not be their top priority when they are concentrating on running their businesses. For any new penalty to act as an effective deterrent HMRC will need to ensure it is properly publicised, particularly to businesses operating in sectors where MTIC fraud is known to be a problem.