HMRC consultation: Penalty for participating in VAT fraud

Indirect Tax

01 January 2017

The CIOT and ATT have each responded to HMRC's recent consultation 'Penalty for participating in VAT fraud', which proposes changes to the manner in which penalties will be imposed on both persons who actually engage in VAT fraud, and those who are caught up in a fraudulent chain of transactions where they knew or ought to have known that fraud was involved.

Background

HMRC published a consultation document putting forward proposals for a new penalty regime for VAT fraud. Although the proposals appear to have as their main aim MTIC (missing trader inter community) fraud, there is nothing to suggest that the proposals could not also apply to other frauds. Indeed, HMRC point out:'Organised VAT fraud presents a significant risk to the public revenue. It commonly involves supply chains which seek to distance those behind the fraudulent evasion of VAT from the parties and supplies in the chain.'

The consultation sets out two options for the new penalty. Option A (a fixed rate system) and Option B (an 'early payment' system), although HMRC go on to say that they are not restricted to those options and invite other suggestions.

CIOT response

We welcome initiatives aimed at reducing the incidence of tax fraud, where such measures are proportionate to the risk to revenue, contain safeguards for those potentially affected and are necessary to achieve their aim. We also recognise the difficulties faced by HMRC which arise under the current penalty regime. However,

the consultation was undertaken over a very short period (6.5 weeks), and we cautioned against rushing to implement the proposals without proper consultation.

We point out that applying the ‘knowledge principle’ (known or ought to have known) to the penalty regime, as opposed to using the existing behavioural approach, which has important differences between deliberate (fraudulent) behaviour, and careless (unwitting) behaviour, is a significant step away from HMRC’s five penalty principles. In brief, these principles are that penalties should:

1. Be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance rather than raise revenue.
2. Be proportionate to the offence but may take into account past behaviour.
3. Be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant.
4. Provide a credible threat, and that HMRC should be able to raise it accurately, and collect it cost-efficiently.
5. Have a consistent and standardised approach that is transparent to those affected.

We expressed surprise at the need for the proposals, given that the Exchequer impact set out in the consultation document is very modest.

In regard to the proposal to introduce a fixed penalty, we commented that we are strongly of the view that it should be mitigatable to take account of matters such as disclosure / co-operation etc, the level of culpability (eg ‘should have known’, rather than ‘known’), and the level of due diligence a taxpayer might reasonably have been expected to undertake having regard to their particular circumstances, eg the size of the business, the size of the transaction in relation to the business and whether the transaction was within the business’ normal area of operations.

We agreed with the concept that penalties should be able to be applied to company officers, but only in cases where they been found by the tribunals/courts to have actual knowledge of the VAT fraud; not simply that they ‘should have known’.

The CIOT has previously commented on the concept of naming and shaming. In principle, our view is that HMRC should approach naming and shaming with caution in view of its reputational impact. We reiterated our suggestion that HMRC commissions research to determine its impact. As with the extension of penalties to officers, we urged HMRC to limit naming and shaming to situations where the person

has been found by the tribunals / courts to have had actual knowledge.

We noted that a new corporate criminal offence of failure to prevent the criminal facilitation of tax evasion is being introduced in the Criminal Finances Bill. The legislation will impose a positive obligation on companies to consider the risks that they, their employees, agents or contractors might incur by facilitating tax evasion. We suggested that it would be appropriate to consider the extent to which that legislation might interact with these proposals.

We have offered to meet with HMRC to discuss our comments and the proposals.

ATT response

ATT's response makes many of the points referred to above. The ATT emphasised that the consultation itself does not make a convincing case for a new penalty and questioned the notion that the difficulties faced by HMRC in relation to VAT fraud justify a departure from the principle that the level of penalties must reflect the causal behaviour.

In relation to the proposed one size fits all fixed 30% penalty, ATT observes that (depending on the circumstances) the concept involves either extending an undeserved benefit of the doubt to taxpayers whose conduct was deliberate, by applying a rate of penalty that would otherwise only be available if they had made an unprompted disclosure, or applying the full standard penalty for careless behaviour without any recognition at all of any disclosure that might have been provided.

On the alternative 'early payment system' proposal which envisages an initial penalty of 25% which could be doubled to 50% following a tribunal finding of actual knowledge, ATT notes that the higher penalty is not really charged because of the underlying inaccuracy but because the taxpayer chose to subject an HMRC decision to scrutiny by the judiciary. It concludes that this 'appears to raise significant questions of constitutional and human rights law which are outside of our areas of competence'.

Referring to the proposed absence of any reduction for disclosure on the grounds that HMRC's 'experience in these cases is that businesses which facilitate VAT fraud rarely make meaningful disclosures', the ATT response describes the exclusion of a

disclosure provision as a self-fulfilling prophecy. It notes that if such provision was included but generated no meaningful disclosures, HMRC would not be disadvantaged as no reduction in penalty would arise.

Submissions

CIOT's full submission can be found on the CIOT website.

ATT's full submission (which includes a link to the HMRC consultation document) can be found on the ATT website.

Conclusions

There is no doubt that fraud and evasion presents a significant risk to the tax system. Most members strongly support efforts to tackle the problem but sometimes express concern about where the balance lies between what can be expected from business and what HMRC would like. As with all our submissions, we welcome comments and suggestions from members, particularly because if legislation is introduced there is likely to be further consultation on the detail