VAT trick

Indirect Tax



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Adrian Houstoun considers the mysterious case of overseas businesses using the online marketplace to sell goods in the UK

Key Points

What is the issue?

Rapid growth and development facilitated by new technology provides great benefit to many, however, it often also gives the unscrupulous opportunities to exploit it and avoid tax, especially as the tax collecting authorities inevitably lag behind in

detecting the tax losses and the subsequent introduction of prevention measures.

What does it mean to me?

In HMRC's Fulfilment House Due Diligence Scheme Publication, the cost of the e-commerce VAT gap by non-EU sellers is estimated to be £1.5 billion. The fact that the last two Spring Budgets have both involved measures to try and reduce the VAT gap in e-commerce is indicative of the size of the problem

What can I take away?

Previously HMRC might have focused its efforts at the UK borders, but with online sales of goods they will be increasing their focus on the actual online customer facing marketing sites. It will also introduce changes to collection methods such as a split payment system which is also, among others, being looked at by the OECD as many other countries are focused on driving down VAT fraud.

You should be careful what you wish for! Back in 1980 Sir Tim Berners Lee described the concept of 'hypertext' that would allow people, wherever they were based, to share information. Just nine years later he published a paper called 'Information Management: A proposal' in which he married hypertext with the internet, to create a system for sharing and distributing information not just internally but globally. As we all now know, he christened it the World Wide Web. Now, less than 30 years later ecommerce via the World Wide Web is the fastest growing retail market in Europe, with the UK leading the way and Germany close behind. It will be a surprise if this growth in e-commerce retail supplies does not continue to increase for the foreseeable future, and at a faster rate than conventional sales, such as in-store retail sales. Such rapid growth and development facilitated by new technology provides great benefit to many; however, it often also gives the unscrupulous opportunities to exploit it and avoid tax, especially as the tax collecting authorities inevitably lag behind in detecting the tax losses and the subsequent introduction of prevention measures.

The fact that the last two Spring Budgets have both involved measures to try and reduce the VAT gap in e-commerce is indicative of the size of the problem. HMRC regularly estimates a figure for the VAT gap. Last year David Gauke MP, Chief Secretary to the Treasury, stated in HMRC's Fulfilment House Due Diligence Scheme

Publication, in respect of the cost of the e-commerce VAT gap by non-EU sellers, ‘This abuse has grown significantly and now accounts for £1-1.5 billion of the total VAT gap. These overseas traders are unfairly undercutting all businesses trading in the UK, abusing the trust of UK consumers’. If the estimate of £1.5 billion lost VAT is accurate, it implies that there is £9 billion of lost sales revenue. That figure of VAT represents a pretty substantial amount of stock that would occupy a large amount of space in warehouses in the UK.

On 19 April the National Audit Office published the findings from its investigation into the concerns that numerous online sellers based outside the EU, selling goods situated in the UK, are not charging VAT on their sales to UK customers. The National Audit Office states that ‘online sales accounted for 14.5% of all UK retail sales in 2016, just over half of these were non-store sales, mainly through online marketplaces, where buyers and sellers can meet and transact’. This estimate represents approximately 10% of the total UK VAT tax gap of £12.2 billion in 2015/16. It is likely that the failure to account for VAT on e-commerce is fairly widespread, although not all of the loss is down to deliberate behaviour, some traders merely make mistakes and some no doubt, are not fully aware of the applicable VAT laws.

To date, there have been no prosecutions for online VAT fraud, but HMRC has carried out many civil operations against suspected evaders. These civil operations include approaching three hundred investigations of businesses, and approaching four hundred compliance interventions in 2016/17. There are sound reasons why HMRC has not carried out a prosecution, one of which is, as stated above, if a trader has merely made a mistake it would be difficult to prove intent. For example, I came across a case where a UK-resident consumer wished to buy an article of clothing and used the website of a US-based company to order it. The system of the USA clothing retailer automatically detected that the order was from the UK and arranged for the item to be despatched from its nearest outlet to the destination of the customer, which was in Birmingham. The transaction was recorded as a sale in the books of the US company. Having been recorded as a US sale, no UK VAT was accounted for. As it happened the article was not the best fit and the consumer took it back to the nearest store, and only then was it discovered that it had been ordered from and despatched by the USA with no UK VAT having been accounted for.

Seemingly, the accounts department was not previously aware that their merchandising system facilitated sales that were made and booked from the USA, to

be delivered and supplied from the UK. This was merely a mistake, as UK VAT should have been charged, with no deliberate attempt to avoid a VAT charge, but nevertheless gave rise to a potential VAT loss, and is one of the reasons why there have not been any prosecutions in this area. This case also shows that this is an area of VAT law where there is a great deal of lack of awareness of the rules, regulations and legislation. This is even more of an issue when you consider that the USA, like many, does not have a VAT system, but the accounting and tax teams would need to have a reasonable knowledge of VAT in a country where they supply goods, that are situated in that other country.

Unlike UK-based businesses who only have to register for VAT when their supplies of taxable goods and services breaches the VAT threshold – currently £85,000 – there is no VAT registration threshold for sellers based outside the UK. If such businesses sell goods which are located in the UK, for example in a fulfilment house, they must register for VAT in the UK, and charge VAT to their UK customers. When the goods were originally imported for storage at the fulfilment house, the appropriate amount of import VAT would also have had to be accounted for, as well as duty. The business must account to HMRC for the VAT charged to customers, less any import VAT through its periodic VAT return. The system is designed to align the VAT status of imports from outside the EU with that of EU producers so that they can each trade on equal terms. Therefore, any business overseas selling goods located in the UK should be registered for VAT. It may be confusing to the man on the proverbial Clapham Omnibus but, essentially, there are two main principles that such a business should consider but they act in opposite directions. The first is the commercial one which suggests holding stock in the UK so that a delivery can be made very promptly; this ensures reliability, as well as maintaining the corporate brand and reputation. However, the price to pay for prompt delivery by having a stock of goods in the UK is the requirement to charge UK VAT. The other model is the tax driven one in which goods are supplied from overseas to reduce the VAT compliance of the supplier of the goods, but where delivery times could be an issue, as well as being administratively less attractive to the buyer.

There are many VAT compliant traders making sales of goods sited in the UK. Amazon is one of the leading online marketplaces and has been for many years. To sell goods on Amazon the seller needs to provide them with its VAT number. The Amazon website states: ‘In accordance with the laws governing members of the EU, Amazon is obliged to charge VAT on all orders delivered to destinations in member

countries of the EU. VAT is charged in accordance with the local legislation in each member state'.

In the 2016 Budget, the Chancellor announced that he would make online marketplaces jointly and severally liable for VAT losses. These provisions, which came into force in September 2016, consist of three key provisions. The first makes the online marketplace liable for the VAT loss if HMRC has previously informed them of an issue with the seller; the second gives HMRC the power to require that companies from outside the EU that engage in online sales in the UK appoint a UK-based VAT representative; and the third imposes new regulations on fulfilment houses, with effect from April 2018. Under these rules, due in 2018, it is likely that any fulfilment houses, which receive a delivery of goods into the UK and then make an onward delivery on behalf of the supplier, will have an obligation to register and maintain accurate records. They will also have to provide evidence of the due diligence they have undertaken to ensure overseas customers are following VAT rules. This point about due diligence is interesting as, in other areas of potential VAT loss, HMRC is increasingly looking at the quality of a trader's due diligence in assessing their liability, culpability or right to a refund of VAT.

In the Budget statement of 8 March 2017, the Chancellor said that the government would look at alternative methods of collecting VAT in respect of overseas businesses selling goods to UK consumers via online marketplaces without paying VAT. It subsequently published a call for evidence on the case for an alternative collection method. Evidence was required by 30 June 2017, but the calling of the General Election may have impacted upon that.

The fulfilment of these provisions in the Finance Bill had, like many others, to be dropped in order that key provisions could be enacted before Parliament was dissolved.

It is likely that they will be resurrected by the new government. One of the methods being considered is known as the 'Split Payment model'. This would involve the use of technology that extracts VAT from payments made by customers and deposits it directly with the tax authority in real time. Other countries, such as Argentina and the Dominican Republic, have split payment systems to try and prevent VAT or tax fraud. Once a new system is introduced it will be imperative to take advice and ensure that you are compliant and not overpaying taxes.

In the meantime, businesses that incur VAT on import should ensure that, where possible, the VAT is recovered – again, you may need to seek assistance from your professional adviser on this point.

VAT rules require that all traders based outside the EU selling goods online to customers in the UK should, if their goods are already in the UK, charge VAT at the point of sale. These businesses and their professional advisers should ensure that the laws are fully understood and that compliance is a very high priority. The World Wide Web and other technological developments have opened up fantastic opportunities to carry on business in markets that were not previously within range. VAT collection methods have not significantly changed since VAT was introduced in the UK in 1973, but it is now clear that HMRC has to, and will change with the times in its attempts to cut down the VAT gap. Previously HMRC might have focussed its efforts at the UK borders, but with online sales of goods they will be increasing their focus on the actual online customer facing marketing sites.

It will also introduce changes to collection methods such as a split payment system which is also, amongst others, being looked at by the OECD as many other countries are focussed on driving down VAT fraud. HMRC says that it has had success with early cases in removing non-compliant traders from online market places, and rightly so. The cost of the non compliant, whether deliberate or just careless, is a cost to all taxpayers.