

Association of Accounting Technicians response to the HMRC consultation document “Penalty for participating in VAT fraud”

Association of Accounting Technicians response to the HMRC consultation document “Penalty for participating in VAT fraud”

1. Introduction

- 1.1 The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the HMRC consultation document “Penalty for participating in VAT fraud” published on 28 September 2016.
- 1.1. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.
- 1.2. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.3. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.

2. Executive summary

- 2.1 **AAT questions the timing of this review because there is an existing review of the default surcharge system and the penalty system generally (3.11).** A new penalty for participating in VAT fraud also seems unnecessary because the existing system whereby deliberate errors are penalised with higher rates of penalty than for careless errors, coupled with the powers to collect these penalties from company officers, would seem to give a significant deterrent already.
- 2.2 **AAT supports all efforts made by HMRC to reduce VAT fraud.** AAT supports the principle that honest businesses that pay taxes in a timely and accurate fashion should not be at a commercial disadvantage compared to those entities that deliberately seek to evade tax by unscrupulous means.
- 2.3 **AAT is, however, concerned that the proposals do not differentiate between the penalties raised against a business that ‘knew’ it was participating in VAT fraud, compared to a business owner who ‘should have known’. AAT is concerned that the naming and shaming of business owners who ‘should have known’ an arrangement was fraudulent will disproportionately penalise those who genuinely did not have any deliberate intent to evade VAT.** Such disproportionate actions could have severe repercussions on their business and, in extreme cases, lead to its closure. Establishing a distinction between “deliberate” or “careless” actions may be administratively inconvenient for HMRC but nevertheless the principle remains sound.
- 2.4 **Over the past seven years many ‘deliberate error’ penalties have subsequently been downgraded to ‘careless errors’ on appeal.** This has either been through an internal review or at a First-tier Tribunal hearing. The onus of proof has been on HMRC to show that a person has been guilty of being dishonest rather than careless. HMRC must give adequate consideration to the fact that some business owners are less educated and some will be more easily led than others. As a result the decision that an owner ‘should have known’ he was participating in VAT fraud can vary according to the skills, experience and background of the owner in question.

3. AAT Response to the questions in the HMRC consultation document “Penalty for participating in VAT fraud”

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?

- 3.1 The catch all phrase ‘should have known’ could mean that those who either make a genuine mistake or had no realistic way of knowing a VAT fraud was being committed will be treated in the same manner as those who have deliberately set out to defraud the taxpayer. In some circumstances this could lead to a substantial penalty which would be enforceable against their personal assets rather than their trading companies. The business owner might then face bankruptcy without having had any intention of defrauding or underpaying tax. Clearly this is wrong and is something that HMRC must carefully consider when seeking to change the penalty regime for administrative ease.
- 3.2 The existing regulations where errors are penalised if they are ‘deliberate not concealed’ and ‘deliberate and concealed’ are adequate to penalise offenders. Sch 24, FA2007 gives HMRC the power to issue penalties against company officers, where a company with very few assets can avoid paying any penalty that might be due. AAT supports the principle that individual directors or shareholders should be personally accountable for their actions in terms of a financial penalty if they ‘knew’ they were participating in VAT fraud and AAT’s interpretation of Sch 24 gives this outcome.
- 3.3 So, instead of either option A or B it would be preferable to continue with the existing system whereby deliberate errors are penalised with higher rates of penalty than careless errors, coupled with the powers to collect these penalties from company officers.

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

- 3.4 Instead of either option A or B it would be preferable to continue with the existing system whereby deliberate errors are penalised with higher rates of penalty than careless errors, coupled with the powers to collect these penalties from company officers.
- 3.5 That said, Option A offers the benefit of being easy to calculate as the same penalty would be applied whether a business ‘knew’ or ‘should have known’ that it was participating in VAT fraud. It also has the benefit of being administratively convenient for HMRC.
- 3.6 However, the simplicity of Option A raises concerns that as the same penalty is being applied where someone ‘knew’ they were participating in VAT fraud as well as when someone ‘should have known’, it is disproportionate.
- 3.7 The case where someone should have known is a lesser offence, as explained in the previous paragraph (3.1, above) and a lower penalty should apply in such cases.

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

- 3.8 As explained in the previous paragraph, AAT believes that the offence ‘should have known’ is a lesser offence than ‘knew’ and that the penalty percentage should reflect this situation.

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

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

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

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?

3.9 Again, as stated throughout this consultation document, instead of either option A or B it would be preferable to continue with the existing system whereby deliberate errors are penalised with higher rates of penalty than careless errors, coupled with the powers to collect these penalties from company officers.

3.10 AAT's main concern with Option B is that the 25% penalty rate for early settlement could deter honest taxpayers from making an appeal to the tribunal, especially as the end result of their appeal could be a 50% penalty if the judge decides they 'knew' about the fraud in question rather than 'should have known'.

3.11 Again, AAT is also concerned that the same penalty rate of 25% will apply to the principles of 'knew' and 'should have known' and considers that the latter outcome should attract a lower penalty as it should be considered a lesser offence.

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

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

3.12 Again, as stated in response to previous questions, instead of either option A or B it would be preferable to continue with the existing system whereby deliberate errors are penalised with higher rates of penalty than careless errors, coupled with the powers to collect these penalties from company officers.

3.13 The point made above notwithstanding, in terms of considering the two options against each other, Option B - an 'early payment' system with a 25% rate but with an increase to a 50% penalty when the case is appealed and the outcome is a finding of actual knowledge by the courts would appear to be preferable to Option A. This would better address the issue of non-compliance, serves as a useful deterrent and is more proportionate because it is higher only where actual knowledge has been proven.

3.14 That said, HMRC must be mindful of the risks that those who have made a genuine mistake may opt to make early settlement and admit wrongdoing simply to avoid the prospect of a much larger fine further down the line.

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

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

3.15 If a business has been deliberately participating in VAT fraud, then the owners are unlikely to co-operate with HMRC in the same way as an honest taxpayer who has been careless in his behaviour. The principle of an 'unprompted disclosure' is unlikely to be relevant to those who participate in VAT fraud and would only make the penalty process and administration more complicated if this was a possible outcome within the legislation.

3.16 A more challenging question is whether a reduction in a penalty would be appropriate for those whose actions have been detected by HMRC and the owners wish to give full co-operation i.e. a prompted disclosure situation. The argument in favour of this reduction is that it might make the enquiry quicker to conclude, and therefore the administration process is simpler, if the taxpayer has an incentive to co-operate with HMRC. However, the reality is that criminals involved with such activities are unlikely to co-operate with HMRC.

- 3.17 A penalty discount could be given to those who 'should have known' they were participating in VAT fraud rather than those who 'knew' about their actions. This would recognise there is a clear distinction between the two and that penalties remain proportionate.

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

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

- 3.18 It would be inappropriate to name and shame someone who 'should have known' of a connection to VAT fraud. In many business activities, professional credibility and integrity are crucial to the successful trading of the business. HMRC should recognise that the naming and shaming process in such cases could lead to the cessation of a business, loss of jobs etc. However, the process of naming and shaming someone who knew he was participating in VAT fraud would give a public list of people who have been found guilty of such actions, and this list might prove an important record for innocent customers who might otherwise inadvertently get involved with that person in a future business deal i.e. so they could then be avoided and an alternative supplier or customer could be found.

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

- 3.19 AAT questions the timing of this review because there is an existing review of the default surcharge system and the penalty system generally. A new penalty for participating in VAT fraud seems unnecessary because the existing system whereby deliberate errors are penalised with higher rates of penalty than for careless errors, coupled with the powers to collect these penalties from company officers, would seem to give a significant deterrent already.
- 3.20 As a separate concern, over the past seven years many 'deliberate error' penalties have been raised, which have subsequently been downgraded to 'careless errors' on appeal. This has happened either through an internal review or at a First-tier Tribunal hearing. The onus of proof has been on HMRC to show that a person has been guilty of being dishonest rather than careless. It is important with the proposed system of knowledge behaviour, that HMRC takes into account the fact that some business owners are less educated and some will be more easily led than others. As a result the decision that an owner 'should have known' he was participating in VAT fraud can vary according to the skills, experience and background of the owner in question.
- 3.21 If a new penalty regime is introduced, it should only be used in extreme cases where large amounts of tax are involved. To extend on the example in para 3.20 (above), if a window cleaner was found to have deliberately suppressed output tax on cash payments, then a penalty against the customer who paid him in cash would be both illogical and unfair.

4. About AAT

- 4.1 AAT is a professional accountancy body with approximately 50,000 full and fellow members and 80,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 4.2 AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail, please contact Aleem Islan, AAT Technical Consultation Manager, at:

E-mail: consultation@aat.org.uk Telephone: 020 7397 3088

Association of Accounting Technicians
140 Aldersgate Street
London EC1A 4HY