



HM Revenue  
& Customs

# Penalty for participating in VAT fraud

## **Consultation document**

Publication date: 28 September 2016

Closing date for comments: 11 November  
2016

<b>Subject of this consultation:</b>	Whether to introduce a new penalty for participating in VAT fraud.
<b>Scope of this consultation:</b>	<p>To consider a range of options for a new penalty for those that knew or should have known their transactions were connected with fraud. The consultation explores the case for a new penalty, including the following questions:</p> <ul style="list-style-type: none"> <li>• How should the penalty be structured? We have suggested two options: Option A (a fixed rate system) or Option B (an “early payment” system)? However we’re <u>not</u> restricted to these options.</li> <li>• Should the new penalty apply to company officers?</li> <li>• Should the new penalty feature reductions in the level of the penalty for co-operating with HMRC?</li> <li>• Should those that participate in VAT fraud be named and shamed?</li> </ul>
<b>Who should read this:</b>	We would like to hear from businesses, individuals, legal firms, accountants, and other interested parties.
<b>Duration:</b>	6.5 weeks, starting on 28 September and closing on 11 November 2016.
<b>Lead official:</b>	Kristian Jarvis: HMRC, VAT Serious Non-Compliance and Fraud Team
<b>How to respond or enquire about this consultation:</b>	<p>Please send responses to: <a href="mailto:indirecttax.vatsncfteam@hmrc.gsi.gov.uk">indirecttax.vatsncfteam@hmrc.gsi.gov.uk</a></p> <p>Alternatively you can write to:  Kristian Jarvis, VAT Serious Non-Compliance and Fraud Team,  Indirect Tax Directorate  HM Revenue &amp; Customs  Room 3/36  100 Parliament Street  SW1A 2BQ  03000 585747</p> <p>Please send enquiries about the content or scope of the consultation, or requests for a hard copy, to the above address.</p>
<b>Additional ways to be involved:</b>	<p>This is a technical issue with specialist interests and will largely be a written exercise. However, in order to engage directly with interested parties HMRC is happy to meet and discuss the proposed changes.</p> <p>If you would like to arrange a meeting please email: <a href="mailto:kristian.jarvis1@hmrc.gsi.gov.uk">kristian.jarvis1@hmrc.gsi.gov.uk</a></p>
<b>After the consultation:</b>	Responses to the consultation will be summarised and published. The results of the consultation will be considered and if the government decides to introduce a new penalty, we will publish draft legislation as part of the Finance Bill 2017 process.
<b>Getting to this stage:</b>	The background to the proposed changes is HMRC’s extensive experience of tackling VAT fraud cases using the knowledge principle.
<b>Previous engagement:</b>	This consultation begins our engagement with external stakeholders.

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# 1. Executive Summary

1.1. This consultation, announced at Budget 2016, seeks your views on the introduction of a new penalty for businesses that participate in VAT fraud.

1.2. The vast majority of customers meet their obligations in full and on time. Penalties are only applied to a small minority of taxpayers. However we need to penalise those that seek to cheat the system to protect honest taxpayers.

1.3. 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 proceeds of the fraud are typically realised through a VAT repayment further along the chain.

1.4. This new penalty is designed to penalise those that participate in VAT fraud and increase the downsides from engaging in this type of activity. Those affected are businesses and company officers that know or should know that their transactions are connected with a fraudulent default along the transaction chain.

1.5. If the government proceeds, HMRC will be able to levy the new penalty at the same time as they take action to address the primary fraud issue.

1.6. This will improve the effectiveness of HMRC's response to VAT fraud cases ensuring that those that facilitate fraud are penalised in a timely and efficient manner.

1.7. The following chapters explain the need for change and discuss how a new penalty might operate. Through this consultation we welcome your views on all aspects of the proposed new penalty.

## 2. Introduction

2.1. Before considering why this penalty is needed and any design features, it might be helpful to provide some context. HMRC is undertaking a broader penalties review and changes to other penalties are also being considered. This includes a penalty for those failing to correct past offshore non-compliance and late filing/payment penalties as part of 'Making Tax Digital'. Any changes will need to accord with this wider work.

### HMRC penalty principles

2.2. We apply penalties to encourage taxpayers to comply with their obligations, to act as a sanction for those who don't and to reassure the compliant majority that they will not be disadvantaged by rule breakers. We don't use penalties as a way of raising revenue, or to offset our running costs. In essence, we want compliance, not penalties. These high level principles were considered in an earlier consultation, 'HMRC penalties: a discussion document': <https://www.gov.uk/government/consultations/hmrc-penalties-a-discussion-document>

2.3. HMRC has five penalty principles, which are outlined below:

- 1) The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues
- 2) Penalties should be proportionate to the offence and may take into account past behaviour
- 3) Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant
- 4) Penalties must provide a credible threat. If there is a penalty, we must have the operational capability and capacity to raise it accurately, and if we raise it, we must be able to collect it in a cost-efficient manner
- 5) Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes.

2.4. With these principles in mind, we will now explain why we are consulting on a new penalty for participating in VAT fraud.

### The knowledge principle and Schedule 24 penalties

2.5. It is settled case law<sup>1</sup> that businesses are denied the right to reclaim VAT as input tax when they know or should have known that their transactions are connected with VAT fraud.

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<sup>1</sup> see *Axel Kittel v Belgian State v Recolta Recycling SPRL* (cases C-439/04 and C-440/04)

2.6. Such businesses are regarded in law as participants in the fraud. This approach is often referred to as the knowledge principle (see Annex A). HMRC applies this principle successfully to tackle MTIC (Missing Trader Intra-Community) fraud and to a lesser extent other VAT frauds.

2.7. When applying the knowledge principle to individual cases, it is difficult for HMRC to separate evidence of 'knowledge' from evidence that the business 'should have known' of a connection with VAT fraud. So in most instances we issue a decision covering both eventualities.

2.8. However the relevant civil penalties legislation (Schedule 24 of FA2007) operates on a different basis. This requires HMRC to decide, when issuing the penalty, whether the business's non-compliance is "deliberate" or "careless". This determines the level of the penalty. HMRC cannot choose a combined careless and deliberate penalty: we must choose one or the other.

2.9. This misalignment between these regimes causes practical difficulties. A 'deliberate' penalty implies we think the customer has actual knowledge, whilst a 'careless' penalty implies we think the customer 'should have known' of the connection with fraud.

2.10. Having to make this distinction in behaviour in order to issue a penalty affects HMRC's ability to defend the underlying decision on the primary fraud issue against any appeal.

### **HMRC's current approach – delay issuing the penalty**

2.11 To address this, our current practice is to wait until after the VAT case has been finalised, including any litigation, before issuing the Schedule 24 penalty. This approach causes two problems:

- Firstly, it opens up the opportunity of a second round of litigation, this time against the penalty. Any challenge to the behavioural aspect of the penalty is effectively a re-litigation of the findings in the underlying VAT appeal. This adds to the costs for HMRC, appellants and the courts. 'Knowledge principle' cases are already costly in time and money due to the volume of evidence required.
- Secondly, the delay in issuing the penalty increases the risk that, by the time the penalty is issued, it will be ineffective. This is because the monies to pay the penalty may have been dispersed by those involved in the fraud.

### **Penalty for participating in VAT fraud**

2.12 To address the issue we are proposing a new penalty that aligns with the knowledge principle. The key design features are a penalty that:

- can be issued at the same time as the knowledge principle decision in the underlying VAT fraud case; and

- does not rely on the distinction between whether a business or individual knew or should have known of the connection with VAT fraud.

2.13 We welcome views on the merits of the case for introducing such a penalty. We also welcome comments on the design of the penalty.

**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?**

2.14 In Chapters 3 and 4 we explore two possible design options for the penalty:

- Option A - a fixed rate 30% penalty for all cases where the knowledge principle is applied
- Option B - an ‘early payment’ system with a lower 25% rate for cases where the knowledge principle is applied, 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

2.15 However we are not restricted to these options. Chapter 5 considers other options, including whether there should be a reduction in the level of the penalty for disclosure and whether naming and shaming could be appropriate.

## 3. Option A – a fixed rate penalty

### How would the penalty operate?

3.1. A fixed rate penalty of 30% of the VAT due would be applied when HMRC deny input tax or deny the zero rate for EU supplies using the knowledge principle. The 30% rate would be the same whether the business knew or should have known that its transactions were connected with VAT fraud.

3.2. A flat rate is consistent with the knowledge principle which does not distinguish between whether a business knew or should have known of the connection with fraud.

3.3. The rationale for a 30% rate is that it is within the overlap of ranges of the current Schedule 24 penalty for both careless and deliberate inaccuracies. This is set out in Annex A.

3.4. The proposal is that there would be no reduction in the level of the penalty for disclosure of information to HMRC. This matter is considered separately in chapter 5.

3.5. In addition, the new penalty would also be collectable from company officers such as directors and company secretaries, where the person knew or should have known that the transactions were connected with VAT fraud.

### Advantages

3.6. The main benefit of this change would be to align the test for the penalty with the knowledge principle ensuring that the two can be assessed together. This would remove the possibility of two tribunal hearings (one for the VAT case and one for the penalty) on the same issue. This would save time and costs for appellant businesses, the tribunal service and HMRC. It would also provide earlier certainty on cases.

3.7. HMRC alone would save around £1 million a year in reduced litigation costs. There would be additional internal resource savings of around 500 staff hours a year from HMRC officers. These savings could be reinvested into further HMRC fraud investigations.

3.8. As the penalty is charged sooner than at present, it increases the prospects of HMRC collecting the penalty amount from those that facilitate fraud. It would also ensure greater clarity for customers, and be simpler to understand.

### Applying penalty liability to company officers

3.9. HMRC understands that some taxpayers may have concerns about the application of penalties to company officers where that person has merely been careless, or in 'knowledge principle' terms where they should have known that their transactions were connected with fraud.

3.10. Currently, Schedule 24 penalties can be applied to company officers where there is evidence of deliberate behaviour. That is where HMRC has evidence to demonstrate



that a VAT return was deliberately inaccurate and the company officer was responsible for (or knew about) the deliberate inaccuracy.

3.11. HMRC believes that the new penalty will be more effective if it also targets company officers. Without this the individuals in the business who are responsible for or mastermind the VAT fraud are often able to walk away from the company liabilities and start the process of participating in another fraudulent scheme all over again.

3.12. In the vast majority of knowledge principle decisions made by HMRC the limited companies in question have minimal assets. Therefore, we think there is a good case to also target the individuals behind the fraud i.e. those company officers that knew or should have known of the connection with fraud.

### **Penalty principles**

3.13. This option is consistent with the wider penalties principles outlined in the introduction. We believe a 30% rate is proportionate to the non-compliance, penalises those that participate in VAT fraud and provides a credible deterrent to others.

3.14. Distinguishing between careless and deliberate behaviours can be difficult, so a flat rate penalty would lead to a consistent and standardised approach where the knowledge principle is applied. It would also be more cost-effective than the status quo.

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

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

## Summary of Impacts for Option A

<b>Exchequer impact (£m)</b>	2016 -17	2017 -18	2018 -19	2019 -20	2020 - 2021
	+/-	£0.3m	£0.5m	£0.6m	£0.6m
<b>Economic impact</b>	N/A				
<b>Impact on individuals, households and families</b>	N/A				
<b>Equalities impacts</b>	N/A				
<b>Impact on businesses and Civil Society Organisations</b>	N/A				
<b>Impact on HMRC or other public sector delivery organisations</b>	500 staff hours saved and an additional £1.2 million per annum in litigation costs saved.				
<b>Other impacts</b>	N/A				

## 4. Option B - an 'early payment' system

### How would the penalty operate?

4.1. In the first instance, this option works in the same way as Option A, but with a different percentage. A penalty of 25% of the VAT due would be applied when HMRC apply the knowledge principle, where we have established that a customer knew or should have known that their transactions were connected with VAT fraud.

4.2. Initially, the 25% rate would be the same whether the business knew or should have known that its transactions were connected with VAT fraud. However if the business appeals the knowledge decision, loses the case and a finding of actual knowledge is determined by the courts, then the penalty will increase to 50% of the VAT due.

4.3. The penalty would remain at 25% where the courts find that the appellant merely should have known that their transactions were connected with VAT fraud.

4.4. As with Option A, there would be no reduction of the penalty for disclosure of information to HMRC. This matter is considered further in chapter 5.

4.5. The proposal is that this option would also, as with Option A, apply to company officers; such as directors and company secretaries, providing that the company officer knew or should have known that the transactions were connected with VAT fraud.

### Advantages

4.6. The main advantage of an 'early payment' system is that it provides for a higher penalty in cases where a business is found by the courts to have actual knowledge that its transactions are connected with VAT fraud. The level of penalty is determined by the underlying behaviour.

4.7. Furthermore, this option would act as a disincentive to businesses that are knowingly involved in the fraud to appeal frivolous cases to tribunal.

4.8. There have been several examples where those appealing knowledge principle decisions have taken cases to tribunal despite the evidence against them being overwhelming. In many instances the appeals have been heard in the absence of the appellant. An 'early payment' system would discourage this behaviour.

4.9. Another advantage is that those found to have been knowingly involved in transactions connected with fraud could be punished more harshly, should they appeal. Such variations are consistent with HMRC's penalty principles.

4.10. Most of the advantages of Option A would apply here, such as aligning the penalty with the knowledge principle. This would mean that the two aspects can be assessed together and avoids the risk of two separate appeal hearings, saving time and money. Indeed the savings from an 'early payment' system would be even greater for HMRC and the tribunal service than for Option A. Again, this would allow HMRC to

target these resources into tackling new fraud. It would also allow the tribunal service to focus its resources on other cases.

4.11. As with the fixed rate penalty there would be administrative costs savings for HMRC and increased prospects of collecting the penalty amount.

### **Points for further consideration**

4.12. HMRC recognises there may be a concern that this option discourages legitimate appeals. This is not our intention and we seek views on this matter.

4.13. Our aim is to discourage frivolous appeals by those involved in VAT fraud. These cases waste taxpayer's money and divert HMRC's resources away from tackling new cases.

4.14. There may be a concern about applying penalties to company officers that have only been found to be careless i.e. in knowledge principle terms they should have known that their transactions were connected with VAT fraud.

4.15. Currently penalties can only be levied on company officers, under Schedule 24, where there's evidence of deliberate behaviour.

4.16. Our view is the new penalty will be more effective if it targets company officers. Without this the individuals responsible for the business's participation in VAT fraud can simply walk away from company liabilities with no personal sanction against them.

### **Penalty principles**

4.17. As with Option A this penalty is consistent with wider penalties principles. We believe the 25% rate would be broadly proportionate to the non-compliance. It penalises those that participate in VAT fraud, and provides a credible deterrent to others.

4.18. Distinguishing between careless and deliberate behaviour in the context of participating in fraudulent supply chains is difficult. A 25% rate for the initial knowledge decision provides a consistent and standardised approach. The higher rate would only be applied following a tribunal's determination that a business or individual actually knew their transactions were connected with fraud.

**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?**

## Summary of Impacts for Option B

Exchequer impact (£m)	2016 -17	2017 -18	2018 -19	2019 -20	2020 - 2021
	+/-	£76k	£69k	£70k	£72k
<b>Economic impact</b>	N/A				
<b>Impact on individuals, households and families</b>	N/A				
<b>Equalities impacts</b>	N/A				
<b>Impact on businesses and Civil Society Organisations</b>	N/A				
<b>Impact on HMRC or other public sector delivery organisations</b>	500 staff hours saved and an additional £1.3 million per annum in litigation costs saved.				
<b>Other impacts</b>	N/A				

## 5. Other options

### A. Your ideas

5.1. In chapters 3 and 4 we outlined two potential design options. Our thinking is not limited to these two options and we would welcome any alternative proposals for a penalty to address the problem whilst also meeting HMRC's penalty principles.

**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?**

### B. Rewarding cooperation with HMRC

5.2. Another design feature the new penalty could include is a reduction in the level of the penalty for disclosure of information to HMRC.

#### **How do reductions for disclosure currently work?**

5.3. Schedule 24 provides for reductions in penalties where a person discloses an inaccuracy.

5.4. The level of any reduction is determined by the quality of the disclosure, which is done by telling, helping and giving access to HMRC. It will also be determined by whether the disclosure is prompted by HMRC or initiated by the customer.

5.5. The rates relevant to inaccuracy penalties in VAT cases are outlined below:

- A 30% careless penalty can be reduced to 15% for prompted disclosure and 0% for unprompted disclosure.
- A 70% deliberate, but not concealed, penalty can be reduced to 35% for prompted disclosure or 20% for unprompted disclosure.
- A 100% deliberate and concealed penalty can be reduced to 50% for prompted disclosure and 30% for unprompted disclosure.

#### **A penalty for participating in VAT fraud**

5.6. Our proposed approach is that the new penalty regime would not have any reductions in the level of penalty for disclosure of information or cooperation with HMRC.

5.7. This is because our experience in these cases is that businesses which facilitate VAT fraud rarely make meaningful disclosures. It also helps keep the penalty regime

simple and provides certainty for businesses and individuals about the penalty consequences of participating in VAT fraud.

5.8. However we invite views on this issue.

5.9. The advantage of a reduction in the level of the penalty is that it would recognise and incentivise desirable behaviour, such as co-operating with HMRC.

5.10. Others may consider that having the opportunity to reduce the level of the penalty results in inadequate deterrents and penalisation for those participating in VAT fraud.

### **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?**

## **C. Naming and shaming**

5.11. Alongside the penalty HMRC might consider naming and shaming those that participate in VAT fraud.

### **Why might HMRC consider naming and shaming participants in VAT fraud?**

5.12. Naming those that avoid and evade tax is not something new. HMRC has been doing this for other abusive practices for some time. For example we publish details of deliberate tax defaulters, when the penalty involves tax of more than £25,000.

5.13. As well as acting as a punishment, naming and shaming could have other purposes. An advantage of naming those participating in VAT fraud would be to make other businesses aware of individuals and businesses that are facilitating VAT fraud. This might act as a warning to be cautious when dealing with these businesses and individuals, as there might be an increased risk that they are involved with transactions connected with VAT fraud.

### **Should this be applied to both limbs of the test?**

5.14. We welcome your thoughts about whether naming and shaming is suitable to cases where the participant in fraud 'should have known' of the connection with fraud, as well as those cases where the participant had actual knowledge of this connection.

### **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?**



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

## 6. Summary of Consultation Questions

The consultation asks for your opinion on the following 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?**

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

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

**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?**

**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?**

**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?**

**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?**

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

## 7. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stages 1 and 2 of the process. This consultation document has outlined the problem we are looking to solve. It also identifies some options for a new penalty, however we welcome ideas for other options. We also seek views on the detailed policy design of any new penalty. This will allow for a further consultation on any draft legislation following Autumn Statement.

### How to respond

A summary of the questions in this consultation is included at chapter 6.

Responses should be sent by 11 November 2016, by e-mail to [indirecttax.vatsncfteam@hmrc.gsi.gov.uk](mailto:indirecttax.vatsncfteam@hmrc.gsi.gov.uk) or by post to: Kristian Jarvis, VAT Serious Non-Compliance and Fraud Team, HMRC, 3/36, 100 Parliament Street, SW1A 2BQ

Or by fax to 03000 586921

Telephone enquiries to 03000 585747 (from a text phone prefix this number with 18001)

**Please do not send consultation responses to the Consultation Coordinator.**

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

## Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

## Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles. Given the technical nature of this consultation it was considered that a three month consultation period would be appropriate to allow recipients sufficient time to consider all the options in detail.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk)

**Please do not send responses to the consultation to this address.**

# Annex A: Relevant (current) Government Legislation

## EU Case Law – the knowledge principle

The knowledge principle is outlined in EU case law, the two relevant judgements are set out below:

*Kittel v Belgium; Belgium v Recolta Recycling SPRL* (Joined cases C-439/04 and C-440/04) [2008] STC 1537, [2006] ECR-I 6161, ECJ, is authority for the proposition that (para 62):

“Where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct.”

*Mecsek- Gabona Kft v Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* (C-273/11) [\[2012\] All ER \(D\) 150 \(Sep\)](#), ECJ, is authority for the proposition that (para 66):

“Article 138(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, as amended by Council Directive 2010/88/EU of 7 December 2010, is to be interpreted as not precluding, in circumstances such as those of the case before the referring court, refusal to grant a vendor the right to the VAT exemption for an intra-Community supply, provided that it has been established, on the basis of objective evidence, that the vendor has failed to fulfil its obligations as regards evidence, or that it knew or should have known that the transaction which it carried out was part of a tax fraud committed by the purchaser, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud.”

The above judgments allow member states to:

- a. refuse a taxable person the right to deduct VAT; and/or
- b. refuse to grant the right to the VAT exemption for an intra-Community supply

where the taxable person knew or should have known that their transactions were connected with VAT fraud.

Both ECJ judgements have direct effect in the UK and do not require national legislation to enable HMRC to apply them.

## UK Legislation for penalties – Schedule 24

Schedule 24 of the Finance Act 2007 is the domestic legislation which sets out how taxpayers will be penalised for submitting an inaccurate return.

The degrees of culpability are explained in Item 3(1) of Sch 24:

“3(1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is-

- (a) “careless” if the inaccuracy is due to failure by P to take reasonable care
- (b) “deliberate” but not concealed” if the inaccuracy is deliberate on P’s part but P does not make arrangements to conceal it, and
- (c) “deliberate” and concealed” if the inaccuracy is deliberate on P’s part but P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).

Sch 24, Item 4(2) sets out the amount of the penalty for VAT matters.

“4(2) ,, the penalty is-

- (a) for careless action, 30% of the potential lost revenue
- (b) for deliberate but not concealed action, 70% of the potential lost revenue, and
- (c) for deliberate and concealed action 100% of the potential lost revenue.

Paragraph 19(1) of Finance Act 2007, Schedule 24, it is important to consider the actual wording used in that provision. Paragraph 19 provides as follows:

### ***“Companies: officers' liability***

#### **19**

(1) Where a penalty under paragraph 1 is payable by a company for a deliberate inaccuracy which was attributable to an officer of the company—

- (a) the officer as well as the company shall be liable to pay the penalty, and
- (b) HMRC may pursue the officer for such portion of the penalty (which may be 100%) as they may specify by written notice to the officer.

(2) Sub-paragraph (1) does not allow HMRC to recover more than 100% of a penalty.

(3) In the application of sub-paragraph (1) to a body corporate “officer” means—

- (a) a director (including a shadow director within the meaning of [section 251](#) of the Companies Act 2006 (c 46)), or
- (b) a secretary.

(4) In the application of sub-paragraph (1) in any other case “officer” means—

- (a) a director,
- (b) a manager,
- (c) a secretary, and
- (d) any other person managing or purporting to manage any of the company's affairs.

(5) A reference to P in this Schedule (including paragraph 15) includes a reference to an officer of the company who is liable for a portion of the penalty in accordance with this paragraph.”