

Treasury Committee

Oral evidence: Securing the Tax Base, HC 911

Tuesday 3 July 2018

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[Watch the meeting](#)

Members present: Nicky Morgan (Chair); Mr Simon Clarke; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 1 – 96

Witnesses

I: Daniel Lyons, Partner, Tax Policy Group, Deloitte LLP; Richard Allen, Retailers Against VAT Abuse Schemes (RAVAS); Emma Rawson, Technical Officer, Association of Taxation Technicians (ATT); Stephen Taylor, Chair, VAT Sub-Group, ATT.

Written evidence from witnesses:

– [Deloitte LLP](#), [RAVAS](#), [ATT](#)

Examination of Witnesses

Witnesses: Richard Allen, Daniel Lyons, Emma Rawson and Stephen Taylor.

Q1 Chair: Good morning. Thank you all very much indeed for being here this morning. This is our first oral evidence session in the “securing the tax base” inquiry, particularly looking at VAT this morning. I am going to ask you all to introduce yourselves before we start.

Richard Allen: I am Richard Allen of Retailers Against VAT Abuse Schemes. We are a pressure group representing lots of businesses that are affected by competition based upon VAT avoidance and evasion.

Daniel Lyons: My name is Daniel Lyons. I am head of the tax policy group at Deloitte. Prior to that, I was an indirect tax partner and I have been practising in VAT for about 25 years.

Emma Rawson: I am Emma Rawson. I am a technical officer working for the ATT; that is the Association of Taxation Technicians. We are a membership body with a strong emphasis on the practical aspects of the tax system. Many of our members represent and are themselves small and medium-sized businesses.

Stephen Taylor: I am Stephen Taylor. I am also from the Association of Taxation Technicians. We have a sub-committee specialising in VAT matters; I chair that committee. I have been working in VAT for longer than I care to remember, but pretty well 40 years, or 41 years, actually.

Q2 Chair: Apart from perhaps Charlie—I do not want to talk for others—it is fair to say that members of the panel know more about VAT than we do, but hopefully we can flush out some useful pointers with the questioning this morning. I am conscious that we have four experts. We will try to direct questions to the relevant member of the panel. Of course, people should chip in if there are things they want to say, but we will start with certain people on the panel and then move on. We are also under some time pressure because of Treasury oral questions, which happen later on this morning.

I want to start with the thorny issue of what is going to happen to VAT after the UK withdraws from the EU. Businesses have raised concern about the cash flow consequences of import VAT applying to imports from EU member states after Brexit. In the last Autumn Statement, the Government committed to look at options to mitigate cash flow impacts and the HMRC chief executive wrote to this Committee in January saying that HMRC was “actively engaging with stakeholders to make sure that businesses have their voices heard and have significant opportunity to feed into the Government’s decision-making on VAT accounting treatment”. My first question, perhaps particularly to Mr Lyons and then to representatives of the ATT, is this: are you aware of or have you been involved in discussions with HMRC and/or the Treasury on this?



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Daniel Lyons: Yes, with HMRC. It is quite a well-rehearsed issue. At a fairly recent meeting with them, talking about Brexit and customs duty, they raised the question of import VAT. The problem is that, at the moment, we have acquisition VAT, which means there is no cash flow disadvantage; the tax does not have to be paid; it is effectively self-accounted for. With input VAT, it either has to be paid on import or it has to be paid with a guarantee or, under the deferment scheme, by the 15th day of the next month. I believe HMRC is looking at something called “postponed accounting”, which is slightly different from the current acquisition tax system. The result will be the same, but the VAT will not have to be paid up front. One interesting implication of that is that, if they were to use a postponed accounting system, it would be discriminatory just to use it to import from the EU, so it would apply to imports more generally and would be an advantage for a wider range of traders.

Q3 **Chair:** It would apply to worldwide imports as well.

Daniel Lyons: Yes, that is my understanding.

Q4 **Chair:** Perhaps ATT would answer my question about conversations that you have been having with HMRC and the Treasury on this.

Stephen Taylor: We have not had too many constructive discussions with HMRC about this. We attend the Joint VAT Consultative Committee along with the other professional bodies, and HMRC reports to that committee regularly. But all they have been able to tell us, generally, is what we read in the press. They are in a very difficult position themselves, I believe. Our concern is that, at the moment, it is almost as easy for small businesses to trade with or buy stock from a firm, say, in Germany as it is from Scotland. If we have—I do not know if I should say “a hard Brexit”—more customs formalities, it will become more difficult to trade with Germany. Whether that is right or wrong, I will leave to you to decide.

Q5 **Chair:** Mr Allen, is there anything in particular on the withdrawal from the EU?

Richard Allen: Imports would concern members of RAVAS in relation to mail order. At the moment, VAT is not even collected on every package coming in from the United States, so how it would be dealt with from Europe is something we are waiting to find out. Exports are an issue as well, because there are delays the other way.

Q6 **Chair:** We are going to come on to look at the tax gap, where VAT is not being collected at the moment and what people are doing to get around it. Are there any other potential costs or impacts of businesses being outside the EU VAT area that are of particular concern, Mr Lyons?

Daniel Lyons: Yes. There are a number of existing simplification measures that, if we are to leave the single market and the customs union, it looks very likely that we cannot use any more. About three of



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those prevent UK businesses and supply chains from having to register for VAT in other member states. You might have heard about triangulation, call-off stock, consignment stock, supply and install. All these things could be impacted. There might be a solution or a quick fix, but at the moment it seems unlikely, so there are some costs there.

There is also the very strong chance of leaving a system in which VAT incurred in other member states where you do not have VAT registration at the moment can be claimed back through something called the "VAT portal" via HMRC, so you do not have to translate into different languages. If we leave the single market, we will lose that as well.

Q7 Chair: Just in terms of business awareness or perhaps members' awareness, what are you finding in the way that businesses are preparing, or are they not preparing for this and just hoping that there will be some form of agreement?

Emma Rawson: At the moment, businesses know they need to do something, but without solid facts about what the end state is going to look like it is very hard for them to plan, especially smaller businesses. They are so involved in the day to day of making sure the wage bills get paid and everything comes in on time that planning for a contingency, and not knowing what that might be, even though we are getting near the time, is down the list of priorities at the moment. Until there is a clearer picture of what they need to do, especially at the smaller end of the scale, they will not be able to take concrete steps.

Q8 Chair: Mr Allen, do you agree with that?

Richard Allen: Our business is considering moving its fulfilment hub into an EU location, because it could be beneficial to supply UK customers from inside the EU if you have these problems with VAT on imports. That is certainly what happened when the Channel Islands became a big issue: people started relocating outside the EU in order to remain competitive. My concern would be that that repeats itself.

Daniel Lyons: There is a very clear difference, and Emma made this quite clear, between larger and smaller businesses. Larger business have the capacity; they have instructed advisers. Most of our clients are working to a "prepare for a hard Brexit" scenario.

Q9 Chair: The joint statement the EU and the UK made on 19 June setting out progress on Article 50 negotiations included some agreed positions on VAT. Has that provided any comfort for your clients about the use of the transition period?

Daniel Lyons: Most clients have already factored in the transition period. They already thought that nothing was going to effectively change until the end of that period. One fear is that there could be two changes and nobody wants that. If there is going to be a change, we would like just one change rather than a number of different changes. It was good news, but most clients were unsurprised by it.



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Q10 **Chair:** Will the move for the fulfilment hubs be the main response that businesses will take, potentially, to deal with problems? What other responses would ATT members or businesses be thinking of at this stage?

Stephen Taylor: I am not sure, because our client base is very much in the SME sector and I am not sure how much planning they are able to do without some hard facts. It is all right to say this may happen or that may happen, but they are not really able to do that because, for them, VAT is probably a major irritation, but it is a small part of running their business.

Q11 **Chair:** What would they look for from you, as a members' body? In your experience, at what point will they start making some form of plans?

Stephen Taylor: They are looking for advice from us.

Q12 **Chair:** And you need what to give that advice?

Stephen Taylor: A lead from the politicians, if I may say so.

Q13 **Chair:** Some certainty.

Stephen Taylor: Certainty, yes.

Emma Rawson: Yes, absolutely. We would like to go to our members and small businesses to say, "If you have small business clients, this is what they need to do", and to set out quite clearly the steps they need to take to make sure they are ready for Brexit, whether that is April next year or the end of the implementation period. At the moment, it is a little bit hampered by the fact that there is so much uncertainty. We cannot tell them what to start doing.

Q14 **Chair:** Will the implementation period be sufficiently long for most businesses to make the necessary arrangements? Mr Allen, you mentioned what happened in the past, about moving from the Channel Islands. Is 20 months long enough for people to make changes?

Emma Rawson: In the SME sector, possibly, since they are less likely to be making large changes to business structures, because they just do not have the resources to do that. They will have to take it on the chin, pretty much. In terms of the larger businesses, I am sure Daniel will have some thoughts.

Daniel Lyons: For larger businesses, a lot of this is very difficult. It is very costly. The point that has already been made about uncertainty is definitely true. The other point that has not been raised, so far, is that a lot of businesses are having to relocate part of their business assets for regulatory reasons and that, in turn, has a VAT impact too. If you are moving part of your business to Luxembourg, et cetera, that is extra work as well.

Richard Allen: The people I represent are retailers, so price is a very sensitive issue. They do not have much time to react when, suddenly, they are faced with a big change in prices as a result of an alteration in



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the way VAT operates. It is quite difficult to adjust to that quickly; that is the problem, so unless you know what is happening you are really dealing with it at short notice.

- Q15 **Catherine McKinnell:** Most of the discussion, so far, about Brexit and the VAT implications of it has been in relation to goods crossing borders, but I know Deloitte has raised some implications for financial services, and some of the particular concerns that your business and the companies you work with have. Could you just expand on some of those concerns for the benefit of the Committee?

Daniel Lyons: From a financial services point of view, the main issue is that, at the moment, when they supply services in the UK those services fall to be exempt from VAT; they cannot recover their input VAT. When they make those same supplies to customers in the EU, they cannot recover their input tax, but when they are making supplies to non-EU counterparties they can recover their input tax. They are effectively zero-rated supplies, which, in VAT terms, is the best possible place to be.

When we leave the EU, the initial euphoria, if that is the right word to use in the context of VAT, was around whether making any supply to the EU would be zero rated, which would be a very good thing. Subsequently, the Treasury has dampened down expectations and said, "The other answer is that all supplies could be exempt and you do not get your VAT back at all for supplies made to non-EU as well as EU". The problem is that, from a technical point of view, it is very hard to see how we differentiate between the EU and non-EU customers once we leave.

- Q16 **Catherine McKinnell:** With your use of the term "euphoria", do you mean that in the sense of relief that we are moving into a new era, or in the sense that you are expecting some kind of bonanza as a result of Brexit?

Daniel Lyons: If that initial treatment had applied and supplies made by insurance companies and banks to EU counterparties had a form to be effectively zero rated, there would be a windfall. That is the logical answer, but any gain for business is a loss to the Treasury, so the two have to be balanced.

- Q17 **Catherine McKinnell:** I know that there was a statement issued by the Treasury back in March about the European Commission's decision to issue infraction proceedings against the UK in relation to certain commodities that are being traded on the terminal markets order. That is all very complicated. Could you explain in more simple terms what that means and what you think the implications might be?

Daniel Lyons: I can try. The terminal markets order is an exception to the normal VAT rules. You have a lot of commodities being traded on a wholesale basis. The best known are the London Metal Exchange and oils; I also found out that there is a London potato futures exchange. There is a whole range of these terminal markets and, for ease and to prevent fraud, all the supplies at the wholesale level in the terminal market are



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treated as being zero rated, from a VAT point of view. They do not have to charge VAT. That is quite sensible.

We had a derogation to allow us to continue doing that, because the EU does not like zero rates, but we have extended the number of exchanges that are party to that. The argument the Commission is making is this: "You are in breach of the principal VAT directive and these supplies should be treated as they normally should", which means that most of them should fall to be standard rated. That is the challenge. It would have an impact, I guess, on the UK's terminal markets; we have a lot of wholesale trading in things like metals and oil, and in other products.

The result will possibly be that they simply have to charge VAT, so there will be lots more VAT swishing round in the system and, as we know, the more VAT there is in the system, the more danger there is of tax loss if, say, a major trader becomes bankrupt or something, and the VAT could be lost. I hope we can keep our zero rate.

Q18 Catherine McKinnell: What is the reaction among the sector to that decision?

Daniel Lyons: There was some surprise, because the Commission must have been aware of this for some considerable time. Some people have said, and I am not giving any credence to this at all, "They are only doing it because we are leaving". Infraction proceedings tend to take a very long time, so they certainly will not be finished by the end of March next year and probably not by the end of 2020, so it may well be that the whole thing fizzles out. But it obviously has to be treated seriously.

Q19 Catherine McKinnell: Do you not think there is any connection at all with the decision to leave the EU in terms of the Commission's focus on this issue? No, you do not. Is it not some kind of warning that the EU will take quite a concerned view of the UK potentially behaving in a way that is anti-competitive once we leave the EU?

Daniel Lyons: The EU would be concerned if it thought it was anti-competitive. I suppose, thinking about it, the only anti-competitive element might be that these exchanges are based in London and, possibly, without that favourable VAT system they might decide to relocate. I do not think there is any politics behind this. The sort of people who are involved in infraction proceedings are highly technical VAT people like us; they are not politicians.

Q20 Catherine McKinnell: I am not necessarily suggesting it is politically motivated but, in terms of getting the house in order prior to Brexit, could there be something of that nature here?

Daniel Lyons: I would be speculating. I suppose it is possible. As I said, I do not think there is any particular VAT saving. The terminal markets order really is a facilitation measure that means less tax has to be charged. Ultimately, when the metals or the potatoes are sold, VAT is charged if relevant, so there is no overall tax loss involved.



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Q21 **Catherine McKinnell:** Okay, so the main concern in relation to financial services is clarity on what the VAT situation is going to be.

Daniel Lyons: That is certainly the biggest single issue, but there are others around the fact that, from a regulatory point of view, a large number of players with customers in the EU have changed branches into subsidiaries in different member states. There has been a move, in certain cases, to places like Paris, Luxembourg and even Brussels. As a result, they now have VAT registration there. If there are supplies going backwards and forwards between, say, the London hub and the subsidiary in Brussels, there could be VAT on those, so there could be an extra VAT cost.

Q22 **Catherine McKinnell:** I have focused on Deloitte, on Mr Lyons, purely because it is to do with financial services, but do any other panel members have comments on the questions I have asked?

Stephen Taylor: Over the years, there has been a developing market where it has been easier for businesses to sell services, whether financial or other services, into other EU countries. Alongside that, the European Commission developed the principle that VAT should be payable in a country at consumption, which means that many small businesses have to consider what VAT is chargeable where their customer is located. That might become more complicated. At present, we have a one-stop shop system whereby, via the HMRC portal arrangements, you make one return to HMRC and it feeds out the tax to the various countries. That is a Europe-wide facility and if we lose that, it will become more difficult for UK businesses that sell services into the EU and they may have to have multiple VAT registrations within the EU. It gets more complicated for them in that way.

Q23 **Charlie Elphicke:** Mr Allen, you mention in your evidence to this Committee that you have worked with the campaign group VATFraud to expose VAT fraud by sellers on eBay, Amazon and other online marketplaces. Changes were brought in, in the Finance Act 2018, to start to crack down on this. How effective do you think they have been so far?

Richard Allen: They improved when the changes were made in 2017, but the initial legislation that came in was not very effective, because it did not do what it said on the tin. It said it made the online platforms liable, but it did not, because they had the option to avoid any liability by removing the trader from the platform. The new measures that were brought in are tougher, because they say "knew or should have known". The thing that still concerns us, more than anything, is that there seem to have been no prosecutions and no confiscation of stock from warehouses. We had confirmation from Amazon that there had been no request to confiscate stock.

Interestingly, about three weeks ago, we were contacted by a German lawyer who was defending Chinese traders that had been prosecuted. He told us that the German tax authorities had threatened directors at



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Amazon with criminal action if they did not hand over data and they were confiscating stock with no warning whatsoever. In our view, there is much more of an incentive to not behave like that if that kind of action is taken. It has been effective, but the voluntary arrangement is the bit we do not understand. Why should it be voluntary to hand over data on people who are effectively evading VAT?

Q24 Charlie Elphicke: Is it your understanding that, in Germany, Amazon is, in fact, handing over the data?

Richard Allen: Yes. We have been given information to prove that they were told, "Hand it over or we will prosecute you". There is a piece of German legislation that is slightly tougher than here, to do with being involved, in any way, with a fraudulent transaction, which the Germans were arguing Amazon was. That was very interesting.

Q25 Charlie Elphicke: Compared with Germany, our taxpayers are still being taken for a ride and Amazon is still in a position where it does not have to hand over information.

Richard Allen: It seems very relaxed. Small traders get rather annoyed when they find themselves being investigated for VAT in a fairly tough manner, when big companies do not seem to get the same kind of attention. You are right; it is not really tough enough at the moment.

Q26 Charlie Elphicke: Do you think that small businesses get the book thrown at them while big combines, like Amazon, get off lightly because the Treasury have a secret direction to HMRC not to be too hard on the big boys?

Richard Allen: I was told by a senior official that HMRC had been instructed not to go too hard on Amazon yet. I do not know what the reason for that is. It might be political. There might be some reason for it, but it seemed odd, that statement, because I cannot believe a small business would ever be given that kind of slack.

Q27 Charlie Elphicke: Would you agree that it is very troubling if that is the case, because all taxpayers, big or small, should be treated the same under the rule of law?

Richard Allen: Yes. This seems to be something that has been happening in the States as well. I am in contact with people in America who say that Amazon is getting favourable treatment from the tax authorities in various states. It could be due to providing employment; I do not know. I do not know what the reason for it would be, but I agree with you.

Q28 Charlie Elphicke: Do you think there is a concern that the tax conditions in which online retailers like eBay and Amazon operate have an unfair competitive advantage over high street businesses that pay business rates, that pay their taxes, that employ people in Britain, whereas these enterprises do not?



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Richard Allen: Yes, and the reason for that is because the regulatory environment in which those online businesses operate is not as tough as the regulatory environment of the high street retailer. You could not sell dangerous products in a shop; you could not openly sell goods with no VAT charged on them in a shop. There are other issues to do with business rates and other advantages: warehouses are not charged the same as a high street shop. There is a huge imbalance between online retail and high street retail, but the reality is that online retail is nothing other than mail order, which has been around for a very long time, over 100 years. A big myth has built up around online retail that it is some kind of magic business when, in fact, it is just mail order.

Q29 **Charlie Elphicke:** Looking at that, there are a lot of people who say we must save the high street. Do you think what we really need to be doing is ensuring that there is a level competitive playing field between high street retailers and online or mail order retailers?

Richard Allen: Yes. There needs to be a toughening of the regulations for online retailers. Specifically, in my view, the biggest problem with online retail is that these are private marketplaces operated by one company and there is no regulation of the ownership of a private marketplace. The owner of a private marketplace online gets to see the sales data of everybody selling on that platform and can use that to their advantage in selling products themselves. The only example I have found similar to that is a container port and I understand that there is regulation in place to prevent owners of container ports abusing their position.

There needs to be legislation that controls private marketplaces, because to call it a marketplace is misleading. It is nothing like a car boot sale. Amazon is not like a car boot sale; neither is eBay. There is a big legislative gap that needs to be filled, in my view, and that would correct a lot of these issues. These are the symptoms of that.

Q30 **Charlie Elphicke:** If I were to ask you for a menu of reforms, what would your top three be?

Richard Allen: One would be to bring in some kinds of controls over what can be done by an owner of a private marketplace. I have always been surprised by the data that is handled by these marketplaces. For example, if you are a retailer, they can see all your sales, whom you sell to, everything about your business. I am surprised there is no data protection legislation dealing with that, and also the way in which they can manipulate prices on their own marketplace. I have seen Amazon selling loss leader products at prices below the price at which it is buying it, just to obtain the market share in a particular product sector. It will produce a product that is a copy.

For instance, there have been huge battles over things like data cables on eBay and Amazon. Amazon brought in its own range of products, but I know for a fact that some of those products have been undercutting



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people who were market leaders in that marketplace. There need to be rules about private marketplaces, because otherwise the danger is that there is nothing stopping somebody manipulating their position.

- Q31 Charlie Elphicke:** Do you think that we ought to consider maybe a VAT surcharge for overseas retailers who sell into Britain and do not contribute to our tax system, business rates or jobs?

Richard Allen: It is an interesting point. The Australians have done this already; it comes in on 1 July. I subscribe to a fairly obscure website that sells records and I was surprised to receive an email the other day saying, "If you are selling in Australia, from now on 10% of your price will be paid directly to the Australian Government", so it is working. I understand Sweden has done it as well. That would immediately solve two problems. It would stop the avoidance of VAT, if VAT was collected in that manner. It would also introduce an extra cost on these cheap imports, which would protect British retailers from an avalanche of cheap stuff that is coming in, for other reasons, such as the postal issues with China, which is another problem. That would definitely be a step forward.

- Q32 Charlie Elphicke:** Finally, you mentioned that VATFraud helped the Belgian tax authorities when they were unable to get help from HMRC. Can you give any further information about what help Belgium wanted from HMRC and why that help was not forthcoming?

Richard Allen: Yes. I read with interest in one of the presentations the attitude of HMRC towards people who try to check whether or not their business is tax compliant. They were not getting a straight answer: "Yes, that arrangement is okay". Similarly, from a lot of our members' and my own experience, when you write to HMRC and say, "I am being affected by an abusive arrangement" or someone not charging VAT, you do not really get any response or any assistance at all. We were contacted by the Belgian tax authorities, which were extremely interested in what we were doing. They had seized a container load of goods from China that they had worked out were being sold on Amazon. They asked one of our members to go over there and look at it. They showed them all the stuff and then they asked them, "Can you help us spot it online?" We have never had any interaction like that with HMRC whatsoever. It is one-way communication.

- Q33 Charlie Elphicke:** Do you think HMRC is "big digital business" captured?

Richard Allen: They need to think more creatively when dealing with people coming to them with information, treat them not as some kind of threat but more as potential assistance in resolving this issue. I am surprised that there is no dedicated online VAT team of people. You need a mixture of trading standards and VAT people, because you have two issues mixed in: dangerous products, no tax. I think it would finance itself as well. A more gregarious attitude to people who are trying to assist would result in a bigger tax take. I do not know whether there are



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any legal implications of being too close to somebody giving information, but I cannot believe that there would be.

Q34 **Chair:** Does anyone else on the panel have anything to say about evasion before we move on?

Daniel Lyons: Yes, I have a couple of points. One of the fundamental problems with VAT is that the underlying legislation has not changed very much in the last 50 years. It certainly was not envisaged by the people who wrote the original VAT directive that there would be such a thing as the internet. You make a very good point that mail order has been around for a long time, but the globalisation of business to consumer trade has grown hugely in the last 10 to 20 years, so it is difficult for HMRC and, indeed, the law to keep up.

HMRC has done a number of things over the last few years. There is the joint and several liability. The new fulfilment house regulations place duties on the businesses that store these goods before they are distributed. There are some signs that it is beginning to work. Mr Allen makes some excellent points and we are absolutely not there yet, but the normal HMRC approach is to let things bed down so you can see what the impact of those has been and then, if further measures and law changes are necessary, to do that. We probably need to allow a period of time for those changes to bed down. There are a lot of extra registrations, with lots of traders apparently being kicked off platforms, so those look like positive signs.

Emma Rawson: We would echo what Daniel said about letting things bed in. The worst thing you see in policy design and in tax policy is often kneejerk reactions to things that are ill thought out and then have to be revised or do not operate in the way intended. From ATT's perspective, we are moving in the right direction. Let us see how it works.

Q35 **Stewart Hosie:** I want to follow on from some of Charlie's questions but, before I do that, you are right when you say that online is no different from mail order and it has been around for a long time. But thinking back, apart from niche suppliers—records would be one of those—and the large catalogue companies, is the difference not that so many more people can now legitimately trade online without the cost of bricks and mortar and, indeed, legitimately, in many cases, under the VAT threshold? Does that not confuse the situation a lot?

Richard Allen: You are right. Online made mail order more accessible, because you can have an instantly updatable catalogue; it is available 24/7. Usually, people did not use to buy mail order from, say, Germany, but now you can just translate a website and buy something from Germany. You are right: it has grown because of that; it is easier. It has also become more attractive, though, because people have got used to prices not including VAT. There was a very long period when this fraud was going on and was not being dealt with.



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I was discussing this before we came in. I remember, when the Channel Islands was huge, *Which?* magazine ran an article on the best places to buy CDs and DVDs, and it was promoting a massive VAT avoider in Jersey as the best place for consumers to go. People came to this expectation that online is cheaper, and it is cheaper, but they did not realise why it was cheaper.

- Q36 **Stewart Hosie:** I am going to come back to the Jersey and Guernsey stuff first, and that point you made about VAT not being paid. You describe RAVAS as representing the interests of anonymous retailers who are unable to publicly speak out against VAT avoidance due to the fact that VAT is perceived by some customers as optional. Can you tell the Committee what you mean by “perceived as optional”?

Richard Allen: It is seen as a tax that the consumer can avoid, by either paying cash to somebody or going to a website that does not charge VAT. When I was running my business, I recall an employee asking if they could order 15 packages and have them delivered to the office. When they turned up, I said, “What is this stuff?” It all came from Jersey, and they said, “It is VAT-free; it is fantastic”. It was seen as a benefit and it was promoted as such for a long time; I have plenty of press cuttings. HMRC did a presentation at the Public Accounts Committee, in which I was involved, where it had looked at the possibility of having consumers police VAT. There is absolutely no chance that is going to happen. A mindset has developed that you can somehow get around having to pay it.

- Q37 **Stewart Hosie:** Is it not more insidious than that? People are not going to search out the VAT-free option, but when something is substantially cheaper than one might expect—

Richard Allen: It appears in the search engine, exactly. That is why price is such an issue online. If something is cheaper, it will be high in the search engines, so if you can get the cheaper product you will dominate the market.

- Q38 **Stewart Hosie:** Surely it is not for the consumer to identify that, is it?

Richard Allen: Many consumers do not even understand what VAT is, how it operates or the detail behind it. In fact, I recall dealing with customers who were saying, “You are a rip-off; you charge VAT”. I had customers say that a number of times. How do you get around that problem?

- Q39 **Stewart Hosie:** Would your judgment be that public attitude remains a major part of the problem?

Richard Allen: It has changed a huge amount, because when RAVAS started tax campaigning did not exist. I can recall ringing round major national newspapers and one of them said to me, “VAT is not a story; everybody avoids that”. That was their attitude. It has changed now because people can perceive that public services are being affected by



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the loss of tax, but they tend to point their finger more at big corporate companies avoiding corporation tax rather than at people avoiding VAT.

Q40 Stewart Hosie: Is not the real issue here the unfairness between those traders who play by the rules, those in this country who choose not to and those in certain jurisdictions for whom it is just not an issue at all, because they simply do not pay it?

Richard Allen: Yes, which is why it is very important that VAT is policed very strongly. The underlying thinking behind VAT is that the system must be fiscally neutral and, therefore, it must be policed not merely in terms of cost. I was concerned to see HMRC talking about the cost involved in raiding a warehouse. I do not think they are looking at the cost properly. There might be a cost involved in getting a warrant and going to a warehouse, but the cost of not doing that is distortion in the market, businesses getting put out of business. It is not just the loss of VAT; it has an effect, as you describe. The blast radius, if you like, is bigger than just the loss of the VAT.

Q41 Stewart Hosie: I am sorry I am focusing on you, Mr Allen, but a number of these questions are quite specific. You also described LVCR abuse as rife between 2004 and 2012 and that it went back as far as 1996. You have spoken about the role of Jersey and Guernsey in seeking to prevent changes to the law. The EU now plans to remove VAT exemption for small consignments by 2021. Why, in your view, has it taken so long for this to be dealt with properly?

Richard Allen: When we first raised it with the European Commission, it was low down the list of its priorities. Out of interest, at the time, I knew absolutely nothing about the European Commission. RAVAS does not have a political agenda. Obviously, everyone has their own individual view on it, but our agenda has always been to stop the use of VAT to undercut your competitor. When we first went to them, in 2006, it was not high up on their agenda. When we showed them the size of the industry in the Channel Islands, they were quite horrified. That was the turning point, because they then started looking seriously at the low value consignment relief exemption, the way in which it was being abused by online retail.

I would say around 2004 to 2006 it took off at an exponential rate, hugely—I have seen the figures on it—because of the internet. Online retail was starting to really take hold big time around about that period, and they bumped it up their agenda and made it a major priority. They employed Ernst & Young, which did a major survey and discovered that it was a problem Europe-wide. They then put proposals in place to completely abolish that and change the way in which VAT would be collected. Essentially, they want to introduce VAT MOSS on physical goods. We have VAT MOSS on services now; it was described earlier. To me, that makes perfect sense, because the VAT will then be charged at the point of sale, in the checkout, to the customer and handed to the member state.



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Presumably, that will have an advantage, in that VAT will be collected in the member state where the sale is being made. For the UK, that is quite significant, because we are one of the biggest internet markets in the world. Germany has taken over recently.

- Q42 **Stewart Hosie:** Ms Rawson, if someone is not VAT registered because their turnover is genuinely low, how would that work? Would they have VAT automatically applied to their sale, even though they should not have? How would it work?

Emma Rawson: That is a difficulty. They would not, would they, if they were not VAT registered?

Daniel Lyons: No, the mini one-stop shop should not apply to businesses below the VAT registration threshold.

- Q43 **Stewart Hosie:** It would still require, in essence, a small consignment exemption for VAT being collected from the sale.

Stephen Taylor: No.

- Q44 **Stewart Hosie:** How would it work? Mr Taylor, explain.

Stephen Taylor: There is a different principle that applies to a business that is not bound to register VAT. Where small businesses are below the VAT threshold, they are not registered, they do not charge VAT and, therefore, they will just carry on trading without charging VAT. You can have someone, as we are talking about, who avoids VAT through online sales. Essentially, we are talking about businesses that are based outside the EU selling into the EU and selling into Britain. I live in Devon. If I want to start up an online business selling goods and I sell to someone in Scotland, I am going to charge VAT. That Scottish buyer may have done some research on the internet and found there is a supplier based somewhere in China, who is going to offer a cheaper price, because it is not concerned with paying UK VAT.

Daniel Lyons: Perhaps the key point is that for a non-EU seller there is no VAT registration threshold. On any sales at all, they should register for VAT.

Emma Rawson: You have the UK market where you have to be over the VAT threshold to charge VAT. If you are a seller outside the UK, there is no threshold.

- Q45 **Stewart Hosie:** That clarity is really important and that is helpful. Mr Lyons, this exploitation using the Channel Islands went on for a long time until the law was changed. There is no suggestion that any of this activity was necessarily fraudulent, but would routing supply chains through the Channel Islands to exploit LVCR have been seen by the profession as VAT avoidance when it was going on?

Daniel Lyons: That is a good question. One of the problems around this is that we have lots of different words for it. It probably would have been



described as “VAT planning” and the approach at the time—and it was a number of years ago—would have been that there is a legitimate relief here as long as we abide by the rules. Particularly—and it is a point Mr Allen has made a few times—when your competitors are doing it, clients think they do not have any choice.

Q46 Stewart Hosie: I have heard that argument in relation to lots of businesses and I have never been dreadfully convinced by it. Let us call it VAT planning or avoidance. If that sort of planning was viable today, would it be in breach of professional conduct in relation to taxation standards for tax planning to propose it to a company?

Daniel Lyons: I think it might be and I wrote it down here: “Not to create, encourage or promote arrangements that are contrary to the clear intention of Parliament and/or are highly artificial or contrived”.

Emma Rawson: It is that “artificial or contrived” element that applies.

Richard Allen: I can answer that, because I have sat with senior people at the Commission and discussed this issue. There is really no such thing as a legitimate VAT avoidance scheme. The reason is that, if there was, it would completely distort the market. The VAT directives specifically obligate member states to prevent evasion, avoidance, abuse and market distortion. There are differences in VAT rates, obviously, between different products and different countries. That has been through the courts and is not regarded as avoidance; you are just in a different part of the EU. But say you are taking something, for instance an import VAT exemption, and you are abusing it. Obviously sending goods to Jersey to have them sent back again, no matter how complicated you make the arrangement, is abusive.

The issue is VAT avoidance, the definition of which was decided in a case called *Direct Cosmetics and Laughtons v Commissioners of Customs and Excise*. The definition is that where there is an objective loss of VAT it is avoidance. If you can see the VAT being lost as a result of the arrangement, it is avoidance. The Channel Islands ticks two boxes: it is abusive and it is avoidance.

Q47 Wes Streeting: Good morning. I want to ask about the issue of VAT avoidance in relation to the NHS. Before I do, I want to pick up on a similar theme to Stewart and Charlie, and turn to another example of VAT avoidance in the gig economy, which is Uber. There are two issues that strike me, so I am interested in getting the tax advice and then the perspective on fairness from across the panel.

First, it seems to me that Uber does not pay VAT on fees it charges drivers because of a loophole in how tax is collected in business-to-business sales across EU borders. Because of where Uber’s company is based, which I think is Belgium, off the top of my head, it manages to get away with not paying VAT on the fees it collects from its 40,000 drivers in the UK. Are you familiar with this loophole or with this



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case, and is my reading of the challenge and the loophole correct?

Daniel Lyons: I am less familiar with that aspect of Uber's VAT affairs. If that is the case and they are based in either the Netherlands or, as you say, Belgium—

Wes Streeting: It might be the Netherlands; you are right.

Daniel Lyons: It might be because there is no VAT reverse charge, since the individual cab drivers are all trading below the VAT registration threshold. That might be why there is no VAT charged on the supply made from the Netherlands. Do you think that is it?

Stephen Taylor: I would agree with that. I do not know what they call the fee Uber charges drivers based in the UK. Because Uber is based in the Netherlands, and the drivers are in the UK and are consuming a service, Uber would not pay the Netherlands VAT on that service. They would expect VAT to be accounted in the place of consumption, which is the UK, and if the Uber driver is VAT registered that would happen.

Q48 **Wes Streeting:** This is the point Mr Lyons is raising and that is what I wanted to come on to. That clarity around the border issue is helpful, because it seems to me that Uber is treating its 40,000 drivers as separate businesses, requiring them to pay VAT where they reach the VAT threshold, which of course, as minicab drivers, they do not tend to do, so we have a significant degree of VAT avoidance. Drawing on Stewart's analogy about online traders and, effectively, modern mail order services, as far as I am concerned, Uber is a minicab company with an app and this idea that it simply connects customer with driver is ludicrous. If I phone Redbridge Radio Cars, it is providing the same service, but I imagine that it would be paying its fair share of taxes and, if not, the tax authorities would be on to it in the way they are simply not with Uber.

Daniel Lyons: There have been a number of VAT cases over the years where small cab firms have used that same approach, and have argued that all the drivers are self-employed and they are simply providing them with a radio and administrative service. It has been done on a much smaller scale.

Q49 **Wes Streeting:** Have they got away with that, in your experience?

Daniel Lyons: It depends. They are all very fact-specific cases, so some of them have been successful and some have not.

Q50 **Wes Streeting:** Mr Allen, I will bring you in at this point.

Richard Allen: This is interesting. I mentioned the case that defined what VAT avoidance was. That was to do with businesses that were not intentionally avoiding VAT, but they had agents. One of them was selling cosmetics. Those agents were below the VAT threshold, and HMRC obtained a derogation to make the main company supplying these agents



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pay VAT on the basis that it was a VAT avoidance arrangement because each one was below the threshold and did not have to pay VAT.

I do not understand why they are not applying that to that arrangement, not least because you can obtain a derogation. You can go to the European Commission and you can essentially say, "We want to change our VAT rules because we want to stop avoidance". They are allowed to change their rules.

Stephen Taylor: That particular case was all to do with the amount upon which VAT was payable, the value of the independent sellers' services, and whether it should be based upon the value of the product they had to buy from Avon instead of being paid, or whether they took their remuneration in cash. It is a different principle than in the case of Uber drivers.

Richard Allen: The point I was making is that they went to get a derogation and they argued, "We need to stop VAT avoidance". That was the basis upon which they went to get a derogation. While the example is different, the principle is not. If there is VAT being avoided, why not just change the rules to bring it within the scope? I also understand that Uber recently had problems with arguing that its drivers were not employees.

Q51 **Wes Streeting:** Yes, I was going to mention that: once by an employment tribunal, once by an EU advocate general. The debate has been whether Uber is simply a technology platform or a transportation company and whether its drivers are employees. Rulings in both of those cases would make it much harder for Uber to genuinely argue, on principle terms, that it should not be paying VAT here in the UK.

Daniel Lyons: To be fair to Uber, I suspect the UK ruling classified them as workers, which is an intermediate category between employed and self-employed. The most difficult thing about VAT is the facts. VAT law can be relatively clear; it is a fact. There are two different interpretations: is this a company that employs a lot of drivers and, therefore, it is supplying the services of those drivers? In that case, it must be way above the VAT registration threshold and should be charging VAT. Is it, rather, a network of drivers and Uber is simply providing a management charge?

Q52 **Wes Streeting:** Do you think HMRC's approach to either this case or cases like this is fair and consistent?

Stephen Taylor: Can I just check back? You asked whether taxi drivers are getting away with it because they are self-employed and not earning enough to be VAT registered. They are not getting away with it, because the principles that are operating were decided by the British courts in VAT cases many years ago. They looked at some taxi firms and the way in which they operated, and decided, as Daniel has tried to describe, that there was a core business at the centre that offered services to these independent drivers and the drivers should be treated, for tax purposes,



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as self-employed and separate businesses. It is the courts that have decided that, not HMRC, not Parliament.

- Q53 **Wes Streeting:** My question is not about whether drivers are getting away with it, because clearly they are earning too little anyway and I am certainly not trying to drive down their wages any further, quite the opposite, in the case of the way Uber drivers are treated. It is more about whether the company is not paying its fair share of VAT, as Uber, to the Exchequer to fund the public services that our constituents rely on.

Stephen Taylor: Everyone should pay their fair tax and the tax that is due, because we need that to fund public services. I do not know too much about Uber, but if it has only enlarged the model that has been operated for taxi firms in the UK, which has been endorsed by the British courts, it is very difficult for us, as tax advisers, to—

- Q54 **Wes Streeting:** The issue of courts is an interesting one, because in the case of Uber there was a massive crowdfunding appeal, which raised over £100,000, but in the end that case is not progressing in the way that lots of us would like, probably including HMRC, in terms of getting that clarity from the courts, because of the liabilities on people who bring the cases and the potential personal risk involved. Simply saying, “Do not worry, because this is for the courts to resolve” is not very satisfactory. We have the Revenue saying, “We are not too sure about where we stand on this and clarity from the courts would be helpful”. The courts, ultimately, will not be able to make a judgment because of the risk involved in bringing a case, so Parliament does have to have some oversight of this, because, first, we write the tax laws, secondly, we want to make sure they are working well and, thirdly, we want to make sure that taxpayers are being treated equitably. This is absolutely within Parliament’s remit.

Stephen Taylor: That is my point. It is not for us to do it, but Parliament has the power to change the legislation.

Daniel Lyons: It is quite an interesting case, because the case you refer to is being taken by a very well-known tax barrister, and he is seeking to recover the input VAT on the invoice he got from an Uber driver, on the basis that Uber should be VAT registered. What has not occurred is that, thus far, there has been no assessment from HMRC on Uber for the VAT. That is the case you are referring to.

- Q55 **Wes Streeting:** That HMRC assessment would be helpful, would it?

Daniel Lyons: We can only assume that HMRC must have formed the view that the supplier is not subject to VAT.

- Q56 **Wes Streeting:** Getting an answer from HMRC on a specific case is like trying to get blood out of a stone, despite the obvious public policy interest.

Richard Allen: Going back to core principles, I am not an expert on Uber’s structure, but this is the question that needs to be asked: is there



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an objective loss of VAT? Is there an avoidance of VAT that is distorting competition in any way? From the perspective of our group of people, if there are taxi drivers who are effectively at a competitive disadvantage as a result of that arrangement, it should be dealt with.

Q57 Wes Streeting: That is the nub of the issue. There are other digital platforms that do pay VAT in the way I have described.

I am very sorry to digress on my hobbyhorse. I am chair of the All-Party Parliamentary Group on Taxis, as opposed to taxes, but I find the overlap between the two is quite significant.

Finally, there is a fairly well-publicised issue about NHS trusts employing agency locums or temporary workers on contracts, for sometimes as short a period as a shift, in order to save the VAT they might otherwise have paid. All of us around this table, in any conversation we have on NHS trusts, are hugely sensitive to the financial pressure they are under. However, we are looking at the tax rules, how they are applied and whether they are being used fairly or abused. Is there still an issue with hospital trusts using VAT planning in this way? Are you aware of similar schemes being used elsewhere in the public sector, and is this something that we ought to be concerned about?

Daniel Lyons: Yes, this sort of planning is still taking place. It relies on a very simple principle, which is that salaries and wages are not subject to VAT. If you employ temporary staff and they are treated under the VAT rules or HMRC's view as being employed by an employment agency, you pay VAT on the agency's fees, but you also pay it on the underlying wages, which you would not pay if they were your employees. This planning, which in my view is not really planning at all, is saying, "Put the staff on your books, NHS trust, and then they will be your staff and there will be no VAT cost". There is a series of consequences to that: you are governed by employment law; you have various obligations towards them, et cetera, which you would not have if they were temps.

To my mind, if you are putting people on your books, treating them as full-time employees, albeit I take your point that sometimes these periods of work can be quite short, and accepting the full legal consequences, that probably falls outside the definition of VAT planning.

Q58 Wes Streeting: Are there any other views from the panel on that?

Richard Allen: I do not know enough about that case, but I did have somebody tell me that, in their view, it was abusive.

Q59 Wes Streeting: Abusive in terms of VAT rules?

Richard Allen: It is essentially restructuring something to make it appear to be something that it otherwise would not be.

Q60 Wes Streeting: As tax advisers, how much of your time is spent looking at public sector tax planning and tax management?

Emma Rawson: I do not have any experience, really.



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Daniel Lyons: It is a very small amount; it is less than 5%, or possibly less than that.

Stephen Taylor: I would think even less than that.

Q61 **Wes Streeting:** It is not something that should be exercising us relative to other issues. Is that the message?

Stephen Taylor: No, not from our perspective.

Wes Streeting: I am sure the NHS and others will breathe a sigh of relief.

Q62 **Stephen Hammond:** Good morning. Mr Lyons, in your written evidence to the Committee in terms of international VAT arbitrage, you said, "It is unclear what proportion of the VAT gap is attributable to international VAT planning. Defining this part of the VAT gap is, itself, problematic". Later on, you said, "We consider that businesses which do not account for VAT in the UK which might reasonably be expected to do so make up a reasonably material part of the VAT gap". Notwithstanding the fact you described it as "problematic", you obviously agree that that is where it is coming from. I wonder if you could give the Committee some idea of what you think the size and scale of that gap is.

Daniel Lyons: It is always very hard to measure these things. To put the whole thing in perspective, the estimated total amount of VAT lost through avoidance, out of a total of £12.6 billion, is only £100 million. I should not have said "only" there, because that is still an enormous amount of money. But there are certainly opportunities, particularly if you already have a business that is established offshore, particularly outside the EU, to mitigate VAT.

Those things fall broadly into two categories. One is that you already have a business, you apply the correct VAT treatment and you obtain a VAT windfall. The other one is that you deliberately decide to relocate your loan-broking business in Jersey, as was the case with the Ocean Finance case—that was a matter of fact—and therefore you get a VAT advantage from structuring in that way. It is relatively significant within the remit of the fact that VAT avoidance of itself is quite a small, niche industry.

Q63 **Stephen Hammond:** You described the international broking business in that answer, but in layman's terms could you describe the sort of international arbitrage schemes we should be aware of?

Daniel Lyons: Yes. The most well-known one is probably the Ocean Finance arrangement, whereby there was a loan-broking business in the UK. It bought a lot of advertising. It was charged VAT on the advertising. Loan broking itself is exempt, so they suffered an irrecoverable VAT cost on the VAT charged to them. They moved the loan-broking business to Jersey. There is no indication in the evidence in the case that they skimmed on that. They properly moved the business there; it was



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established in Jersey. Therefore, the advertisers made their supplies out to Jersey, and there was no VAT on those. The loan-broking business made its supplies back to the customers in the UK, and there was no VAT there, so the input VAT simply disappeared. One of the challenges brought by HMRC was that that is abusive; it is avoidance and therefore should fail.

Q64 Stephen Hammond: In that particular case, what was the size of VAT that was avoided?

Daniel Lyons: We are talking about low millions. It was a relatively small business. We are not talking about an enormous amount. I do not have the exact number here, but it was not hundreds of millions.

Q65 Stephen Hammond: Notwithstanding the fact that it is a relatively small amount, it is there; it is discernible; it is identifiable. Under the current international treaties, is international tax arbitrage something that could be addressed? Are we going to be better or worse off as a result of leaving the EU? Are there things that should be done to strengthen international rules?

Daniel Lyons: It is largely a matter for the courts, because everything rests on its own facts. The Halifax case, which is the lead case on VAT avoidance from about 12 years ago, sets out the rule. If something is outside the scope of the VAT legislation and was done to obtain a tax advantage, it should fail under the Halifax rule. That is almost like a general anti-abuse or anti-avoidance rule in VAT. If the courts decide a particular arrangement is abusive, it will fail. We already have the judicial mechanism there to attack these schemes where they do not work. The Ocean Finance scheme is still being litigated and it is possible that the courts will find it does work.

Q66 Stephen Hammond: How many cases is HMRC actively trying to push to the courts under those rules for international tax arbitrage?

Daniel Lyons: There is a relatively small number. There are other forms of arbitrage that do not apply in the UK but relate to things like yachts and private jets, where some member states have slightly more generous rules than others. There has been a focus on places like Cyprus and Malta. But there is generally quite a small number of cases. They tend to be quite high profile because of their subject matter. The Pendragon case a few years ago on the sales of demonstrator cars was another case that involved a Jersey or a Guernsey link.

Q67 Stephen Hammond: I am just going to widen this out a little more generally now. Notwithstanding that £100 million is not a large sum on the scale of £12.6 billion, it is still a decent sum of money. I wonder if I could ask this of everybody on the panel. Given that the *Measuring tax gaps* publication was suggesting that £100 million is a rather small amount of money and they may not even include it as an estimate in future, first of all, does the £100 million sound about right? Is it a good or a bad thing that they are not even going to include it in the estimates in



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the future? Is it of concern?

Stephen Taylor: I am going to dodge that question, if you do not mind, because I have no way of knowing whether it is a reasonable figure or not. I am not an economist. As the Association of Taxation Technicians, we do not employ economists. We rely on other people's data.

Q68 **Stephen Hammond:** Whether or not it is the right figure, is it a good or bad idea that HMRC is now likely to exclude it from its estimates of what the gap might be?

Stephen Taylor: What, on tax avoidance?

Q69 **Stephen Hammond:** No, the international tax arbitrage element.

Stephen Taylor: The information is probably useful, but if it is not accurate or measurable perhaps we should forget about it.

Q70 **Stephen Hammond:** I do not know whether anyone else wants to proffer a view.

Daniel Lyons: We should continue to measure and monitor. Compared to the overall VAT gap it is a relatively small number, but it could grow, and it should be looked at. The underlying point, and the reason it is so low, I believe, is that there is virtually no appetite for VAT avoidance among major businesses in the UK at all, none whatsoever. No business is interested.

Q71 **Mr Clarke:** Mr Lyons, HMRC attributes about £3.5 billion of the 2014-15 VAT gap to what it calls "avoidable taxpayer mistakes" in their VAT returns. It is obviously very difficult to put a quantum on these things, but is that broadly a reasonable figure?

Daniel Lyons: It is the biggest single number in the VAT gap, and I would think it is reasonable, because VAT is complicated. There are lots of special schemes and special arrangements, particularly for smaller businesses. I am sure ATT will have a lot to say on this point. It is hard to manage. I would be surprised if it was not the biggest single number.

Q72 **Mr Clarke:** Is that the ATT perspective?

Emma Rawson: Yes. Within that £3.5 billion there is a whole range of errors. The problem we have is that we are not quite sure what is driving that figure. There are technical errors, which might be incorrect classification of goods for VAT or incorrect claiming of input tax. There are technical things where you are just getting VAT wrong, through to arithmetical or transposition errors. It is not quite clear how much those different elements are contributing to the tax gap figures. There is a whole range of behaviour in there.

Stephen Taylor: It is not reasonable for us, even as a professional body, to justify that figure or endorse it. This is my simple analogy: if I am building a new house and I want to know how much it will cost, I am going to employ a quantity surveyor. I do not ask the builder. If you want



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to know whether that tax gap is accurate, please go and ask an economist or the Office for National Statistics.

Q73 Mr Clarke: Presumably, ATT members have had clients who have inadvertently made these errors. This is perhaps a more practical question in terms of how we might try to prevent those errors occurring. Short of major changes to the VAT system, what practically could be done to help businesses avoid making those errors in the first place?

Stephen Taylor: It would be better if HMRC was more willing to engage with small businesses. At the moment, there is a great distinction between the way HMRC deals with large businesses and small businesses. Large businesses are allocated a customer relationship manager, and I do not question the reason for this at all. If large businesses have a VAT issue, they have a contact in HMRC and they go along and discuss it.

If small businesses want to engage with HMRC to obtain advice or reassurance from HMRC, they have a number of options. One is to ring the national advice service, which they do. That national advice service will normally guide them to the information that is available on the website. As we quoted in our submission, HMRC's policy is to encourage people to find the information on their website, and that should be sufficient for them to answer their query. If you want to take it further as a small business and you want a clear, reliable ruling from HMRC in writing, you have to make use of its non-statutory clearance procedures. You write to them, give them all the information, and set out all the facts and the material that you have looked at. If they agree there is uncertainty, they will give you a ruling.

That sounds like a very good service, but let me just give you some HMRC statistics that give an insight into that service. If I want a ruling or clearance from HMRC in writing that I can rely on, I write to its non-statutory clearance team. We have about 2.5 million VAT-registered businesses at the moment. About 2.2 million are SMEs or microbusinesses. They have to use this system, because they do not have a customer relationship manager. There are over 2 million businesses that can use this procedure.

I asked HMRC for the statistics on how many applications it receives per annum. They willingly gave them to me, which I am grateful for. Let me get this right. In the year to March 2017, they received a total of 688 applications. That is all. In the following year, the year to March 2018, they had 544. You have to look a little deeper to see how useful that was. Of those clearances, in about 50% of cases they refused to give a positive ruling or decision. Instead of that, their response was to take the person to the section in their guidance that gives them the answer, because they say they are not there to provide "comfort letters". What is comfort for one is uncertainty for another.

Q74 Mr Clarke: You would want to see a much more interactive approach to their dealings with small businesses.



Stephen Taylor: I was at a CIOT tax course recently where one of the speakers on VAT was a corporate lawyer from Lincoln's Inn. He had written to HMRC using this procedure because he was dealing with the transfer of a going concern—I know no more about it than that—and the response he got was, "Sorry, we do not have to give you a ruling. The answer is in our guidance". The whole point is that we, as professionals, know that system is not used because it does not suit the customer's needs. HMRC may come along and say, "It is not being used because they do not need it", but that is not so.

Daniel Lyons: One fundamental point about VAT is that it is a self-assessed tax. That is wonderful from the tax administration's point of view, because every businessperson is their own tax collector, but it means that it is very important to have proper guidance.

Q75 **Mr Clarke:** Indeed, and a sufficiently welcoming approach to those who genuinely have queries.

Daniel Lyons: Yes.

Emma Rawson: Yes.

Q76 **Mr Clarke:** I am conscious that time is a pressing issue. We have the Making Tax Digital initiative, which we are told is going to make a big difference to the ease of making sure we avoid error. The pilot for this started in April. Ms Rawson, do you have any feedback at this point, or any early impressions about whether it is making the difference that was hoped?

Emma Rawson: From my understanding, the pilot is still very limited in size. We are talking about tens of businesses rather than hundreds. It is still in a private phase. We do not have any direct feedback from HMRC at the moment on that pilot. I understand the first returns have been filed under Making Tax Digital. The one point I would make about Making Tax Digital, in terms of errors, is that I referred earlier to the fact that the figure we have for errors in VAT returns encompasses a whole range of different kinds of errors. Making Tax Digital will address things like errors in record keeping, transpositional errors or manual errors like that. However, if people were wrongly classifying a supply before Making Tax Digital, they are still going to be doing that with Making Tax Digital. That is not going to be impacted. It is quite hard to say how much of an impact Making Tax Digital is going to have on that figure without knowing what makes it up.

Q77 **Mr Clarke:** Have you seen anything at all in the pilot so far that will help businesses?

Emma Rawson: The record-keeping elements will help in terms of those errors around people not keeping their records correctly, or making errors when transferring things from one spreadsheet to another or in completing things for the VAT tax return. That aspect will help. In terms of other ideas, I am not certain. At the time MTD was first mooted, there was talk about having nudges and prompts built in so there would be



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feedback from HMRC to say something along the lines of, "Are you sure that is right?"

Q78 **Mr Clarke:** Have they been built in?

Emma Rawson: From my understanding, no, they are not at this stage.

Q79 **Mr Clarke:** The BCC has released some pretty concerning figures, showing that 24% of businesses have not even heard of Making Tax Digital and 66% only know it by name or have very slight detail. Without sufficient preparation by business, is there a danger that we end up inadvertently making the situation worse?

Emma Rawson: There is definitely a concern. That 24% figure did not particularly surprise me. We have been doing quite a lot of work with our members to raise awareness among them, but even among some of the agent community there is still a lack of knowledge of what they need to do practically. That is hampered by the fact that, as I said earlier, the pilot is still in the very early stages. There is no publicly available information as to what software will work for VAT for MTD. My understanding is that HMRC is going to bring that out once it has moved into the public phase of the trial.

At the moment, we are telling our members that they need to start getting software in and to get ready, but we cannot tell them exactly which software to use or what practical steps to take, which is hampering us slightly.

Q80 **Mr Clarke:** That is a very British expression: "It is hampering us slightly". That is a significant understatement. It is significantly suboptimal.

Emma Rawson: I am translating what our members say into slightly more political terms here. There is a problem with the wider population outside of the agents. HMRC has been doing quite a lot of work with the agents. There have been some publications; there have been webinars. But to my knowledge it has not done any direct communication with businesses. As Daniel mentioned earlier, that is a self-administered tax. A lot of businesses still do it in house. There is also an untapped section of business that is really not going to be prepared for this because, if they do not have an agent telling them to get ready, they are not getting ready.

Daniel Lyons: MTD on its own will not close the VAT gap.

Emma Rawson: No, it will not.

Q81 **Mr Clarke:** I have one final question. Mr Lyons, in your written evidence to this Committee you mention that the use of an "application programming interface", which is a nice user-friendly term, between traders and HMRC will help avoid clerical transposition errors. Is it fair to say that, other than preventing those relatively simple errors, you see



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little in Making Tax Digital that would help to prevent meaningful errors in VAT returns?

Daniel Lyons: I will give a very short answer. I do not think it will make an enormous amount of difference. The transpositional errors are a very small part of the whole. As Emma said, it is the technical judgment issues where people are making errors.

Emma Rawson: The one point I would make about errors is that errors can work both ways. Just because an error is being made, it does not necessarily mean less tax is being paid. It could be that tax is being paid that does not need to be.

Q82 **Mr Clarke:** Mr Allen, I am sorry; I have been leaving you out.

Richard Allen: I had an experience of this in my own business. I discovered a bug in a major piece of accounting software in relation to sales to mail order customers within the EU who were not VAT registered. It incorrectly produced VAT returns. When I discovered the error—of course, it was a huge unexpected bill—I tried to find out whether HMRC endorsed, inspected or made sure that these pieces of software worked. To my amazement, they do not. They do not do it on VAT software. They do it on PAYE software. I could not believe that their attitude to me was, “It is your problem. It depends what software you are using”. I assumed that a major brand of accountancy software would have been checked. If that is going to be repeated on this thing, everyone who uses it will be responsible for the error.

Mr Clarke: That is a cautionary note.

Q83 **Catherine McKinnell:** I wanted to ask a very quick question about Making Tax Digital. There has been a lot of concern expressed, certainly by the North East England Chamber of Commerce, that businesses are just not ready for this. Since I touched upon Brexit earlier, the two are not unrelated in the sense that there is an awful lot of uncertainty and change for small businesses. One thing the chambers seem to be calling for is for the full rollout to be rolled back in order to give more time to businesses. They produced some quite worrying figures: 24% have never heard of Making Tax Digital and only 10% seem to have the details. Do you have thoughts on that suggestion?

Stephen Taylor: Can I just talk about my experience last week at a client? This was a firm in the West Country. One thing their bookkeeper raised with me was what she should do about Making Tax Digital. She had been in touch with the software firm providing the accountancy package. They did not know; they said, “Ask the VAT adviser”. I said, “I do not know. You had better go and ask somebody else”. There is not enough information around at the moment to act upon.

Emma Rawson: You are right that there is an unfortunate juxtaposition, in that April 2019 is also when Making Tax Digital is coming into effect. There is a real lack of awareness out there among small businesses,



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which needs to be addressed. We and the other professional bodies are doing as much as we can to get our members prepared and get them ready, and they will feed this down to their clients. But there is a section that I worry about, which is the unrepresented taxpayers who are going to have deal with this. They do not have that advice.

Daniel Lyons: To be completely fair to HMRC, it has said that for the first 12 months there will be what it calls a “soft landing”, where it will take a reasonable view on penalties.

Emma Rawson: Yes, and that is going to be needed.

Chair: Taking a reasonable view on penalties sounds like something from the World Cup, but there we are.

Q84 **Alison McGovern:** There is no situation in politics in which a football analogy is not appropriate. I have some further questions on some of the practicalities. In evidence, you all talked about the way tax rules connect with Parliament. I wanted to clarify whether it is fair to say that, even for fairly everyday transactions, it would be very difficult for business to navigate its way around the VAT rules with reference solely to the legislation.

Emma Rawson: To the legislation, yes, certainly.

Alison McGovern: When it comes to VAT, do businesses have to rely much more on guidance than, say, for income tax or corporation tax?

Daniel Lyons: Yes. Most businesses never look at the black law legislation. They look at HMRC guidance or HMRC manuals that are published online. They very rarely look at the law.

Emma Rawson: The problem with guidance is that it gets out of date and it can be incomplete. The CIOT and the ATT have been doing large projects, along with HMRC, to identify the guidance that is inadequate.

Stephen Taylor: It is not just that it gets out of date, but it can be interpreted in different ways by different people. I have seen examples of where two reasonably minded people, as the courts would have it, have read the guidance and come to different conclusions, looking at the same information.

Q85 **Alison McGovern:** Just to turn to the non-statutory clearance process, is that just another layer of process that makes up for the lack of clarity?

Stephen Taylor: It should help with clarity. It should give small businesses certainty. They should be able to write to that, setting out the facts: “This is what we are doing and this is how we think we should account for VAT”. They expect HMRC to write back and say, “Yes, you are doing it correctly”. What HMRC will not do is write back and say, “You are doing it correctly”. They will write back and say, “What you should do is explained in our guidance”, or they will write back and say there is a clear uncertainty, but I have reached the stage where I am not sure what



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HMRC means by “clear uncertainty”. That is a bit ambiguous, but there is definite uncertainty.

Alison McGovern: There is certain uncertainty.

Stephen Taylor: There is certain uncertainty, yes.

Daniel Lyons: We tend to pass the letter around to see whether people decide it is a yes or a no, because sometimes it can be quite delphic.

Q86 **Alison McGovern:** Okay, wow. Are there any other tactics that people employ to fathom HMRC’s letters?

Emma Rawson: Lots of people would like to have face-to-face meetings with HMRC, because that is often the quickest way to reach an agreement on something that is not a black and white or yes and no issue. But they are finding it increasingly more difficult to get HMRC to agree to meet.

Daniel Lyons: HMRC has a demographic challenge. A very large proportion of officers are over 50. In five or 10 years’ time, there will be even fewer people who have experience and deep, technical knowledge of VAT. I know they are trying to recruit now, but it is quite hard to find an experienced technical officer.

Stephen Taylor: It is difficult to actually speak to one, either across a table like this or even on the telephone.

Q87 **Alison McGovern:** Say a little more about that. Why would people not want to go and be tax officers? Why would people not want to do that job?

Daniel Lyons: I do not know, really. Most people from the outside who are not involved in the world of tax and VAT probably think it is quite dull. My children do.

Richard Allen: My experience was that I worked in the freight industry for 10 years, and when I met customs people then I felt they had come from an industry that I understood. When I was in online retail, I was meeting people from HMRC and I felt they did not have any real background or understanding of this whole new kind of business area.

Emma Rawson: It is fair to say there is not much movement from industry into HMRC.

Stephen Taylor: There is probably more movement—

Emma Rawson: The other way, yes.

Stephen Taylor: Having worked as a VAT inspector a long time ago, first of all, tax can be interesting and fun, believe it or not.

Q88 **Alison McGovern:** We are the Treasury Select Committee. We all think tax is fun. You have all alluded to this, but I want to get it clear and on the record. It seems like we are saying that it is easier for larger



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businesses to get advice from HMRC without necessarily becoming involved in a dispute, whereas for smaller businesses that is harder. That is what you are saying, is it not?

Daniel Lyons: It is.

Emma Rawson: Yes.

Stephen Taylor: Yes.

Q89 **Alison McGovern:** Mr Lyons, I wanted to ask you a specific question. In your evidence you mentioned alternative dispute resolution, which means you can get the right technical specialist to look at an issue. Presumably, that implies that you cannot get that specialist advice from the word “go”.

Daniel Lyons: No. You sometimes end up with a technical position where you are entrenched on both sides. By going down the ADR route you can get everybody in the room. You can get the right technical policy people from HMRC, not the people on the front line, and you can have a conversation about the underlying technical issues. Many times you can reach an answer.

Q90 **Alison McGovern:** There is a quality issue.

Daniel Lyons: Yes. It is more about making sure HMRC takes this dispute seriously and gets the right people in the room, because, if not, you end up in the situation where you have to troop off to court. That takes a long time and costs a lot of money for both sides.

Q91 **Alison McGovern:** That is helpful. Mr Allen, you say in your evidence that VAT policy is made by HMRC without reference to Parliament, which comes back to this issue of whether or not the law is sufficient. Does that mean HMRC does not really report to Ministers or Parliament about whether VAT policy is actually working as we might have intended it to?

Richard Allen: The situation you have at the moment is that people forget that the whole of the VAT system is based upon higher EU law. The parts of EU law that you do not see are not written into the statute book in this country. For instance, the thinking behind the way the VAT system operates is at a very high, esoteric level there. This seems to be an area—the Channel Islands was an example of it—where HMRC was applying the law as it stood in the statute book, but not looking at the higher-level part of it.

What would concern me and members of RAVAS would be if something like that came up in the future and we were outside the EU. Based upon the experience I had, if you go to HMRC it is a dead end. We had the advantage of going to the Commission. This is not a political point I am making, but it would be good if there were some separate organisation that oversaw HMRC on those higher-level issues, so you at least had some kind of second opinion you could go to. If we had not had that, we would have been pretty much dead in the water.



Daniel Lyons: Could I make a slightly controversial point?

Q92 **Chair:** Please do—always.

Daniel Lyons: I am not sure to what degree parliamentarians read all the secondary legislation that is laid.

Q93 **Chair:** We were going to ask that, yes.

Daniel Lyons: I feel you are probably missing out on quite a lot of detail. You might look at the primary legislation when it goes through in the Finance Bill, but the secondary legislation is where a lot of the detail is, and where a lot of the problems and challenges are. Most of it is probably negative. There is a resolution; there is no debate; it just becomes law.

Emma Rawson: VAT is different from other taxes in that respect. For many of the direct taxes, most of the detail is in the primary legislation. In VAT, most of it is in the secondary or even tertiary legislation, in the notices.

Stephen Taylor: I also make another distinction with VAT. With direct tax, you have two parties involved: HMRC, the tax collector; and the business or taxpayer. The trouble with VAT receipts is that you often have three parties involved. It is a transactional tax, and in that transaction you can have three different points of view. You can have the view of the seller, of the buyer and of HMRC. Unless you get them all singing from the same hymn sheet, you have difficulties.

Q94 **Alison McGovern:** I have two very brief questions to finish. You will be pleased to know that the first of those is about Jaffa Cakes.

Mr Clarke: There are not any.

Charlie Elphicke: Is it a cake or a confection?

Alison McGovern: Exactly, yes. It is an example all philosophy students know well, because it is used to describe whether something is a thing because of what you call it. But the Jaffa Cakes issue is the classic example of some of the boundary and definitional issues that arise in VAT. Could you say for the record why each of you thinks it is such a complicated exercise to categorise?

Daniel Lyons: Over the last 45 years or so, we have had VAT in the UK. This is not a European complication; it is home grown. The reason chocolate milkshake powder is zero rated and strawberry is not is that they rely on the old purchase tax rules, and there was a move towards providing a special treatment of hot chocolate at the end of the Second World War. There are lots of social reasons why we have these various distinctions, but the complexity has now become so great that we really just need to start again.

Richard Allen: The pasty tax was the other one. That was trying to correct the unfairness where chip shops were getting charged VAT and high street hot food sellers were not, but the way it was sold was that



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people were being unfairly taxed on pasties, when in fact the reverse was true.

Stephen Taylor: I sat in on a lot of those discussions on the pasty tax. I could brag about this. If you read the ATT submission on the pasty tax, HMRC largely followed our suggestion.

Alison McGovern: You were to blame for the “omnishambles” budget. Is that what you are saying?

Stephen Taylor: I remember particularly one discussion with HMRC that I sat in on, about how you distinguish between hot and cold food. Cold takeaway food should be zero rated; hot food should be liable for 20% VAT. One HMRC official said, “All we want to know is whether it is above the ambient temperature; if so, it is hot”. How do you know it is above the ambient temperature? “We will not be too hard on it. If you touch it with your finger and it is hot, that is above the ambient temperature”. I sat there thinking, “Do I want my pasty touched by them?”

Q95 **Charlie Elphicke:** On that point, when I was a practitioner, I had an organisation like Subway that would heat the food on bread and then serve it to the customer. By the time they served it to the customer, it was not above ambient room temperature. I had a whole row with the VAT authorities, because it should be zero rated, and we won.

Stephen Taylor: The solution we came to, really, was that if food is hot because it has been freshly cooked and it is cooling, it is a zero-rated product and it should be zero rated. If you make any attempt to retard the cooling process, to keep it heated or to heat it, you therefore charge VAT.

Charlie Elphicke: It is the same difference.

Q96 **Alison McGovern:** In the end, we can all laugh and joke about Jaffa Cakes and pasties. As you said, Mr Lyons, these are some underlying social things, some of which are outdated and some of which are not. Who knows? My estimation would be that these are not substantial changes in terms of the tax base. To finish on a more constructive note, could each of you say what the top of your to-do list would be in terms of securing the VAT tax base?

Stephen Taylor: I am going to stick to the small business sector, because that is our client base. The top of my to-do list would be to ensure they make fewer errors. I do not know what sorts of errors they are making, but they make errors. They need better help and assistance from HMRC to ensure they do not make those errors in the first place.

Emma Rawson: Yes.

Daniel Lyons: I would have more fully trained VAT inspectors and better education for taxpayers.



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Richard Allen: Mine would be specifically to do with retailers. It would be to ensure that online retail platforms are responsible for the VAT, if it is not paid, and are collecting the VAT. The problem is basically solved then.

Chair: Thank you very much indeed for your very constructive, concise and helpful evidence this morning, which has got our inquiry off to a very good start. We are really grateful to you for giving up your time in preparing for this session and for being here with us this morning. Thank you very much indeed.