

VAT - ENFORCEMENT POWERS

Although some of the penalties for VAT infringements have been less severe in recent years, there is still an alarming array of enforcement powers to trap the unwary. By being aware of the problem areas and planning carefully, it should be possible to avoid becoming an unwitting victim of the system.

Late registration

You must notify Customs and Excise if your turnover exceeds £60,000 in twelve months, or if you believe it will exceed £60,000 in the next thirty days (2005/06 figures)

The penalty for failing to notify liability is a specified percentage of the net tax (output tax less input tax) for the penalty period (subject to a minimum penalty of £50):

Delay in registering	Penalty
9 months or less	5%
9 - 18 months	10%
Over 18 months	15%

After registration

Every VAT registered business needs to ensure that it is organised to deal with VAT correctly and on time:

- Is there someone in your business who controls VAT accounting and ensures that new products etc. are properly dealt with for VAT purposes?
- Do your business systems ensure that all output tax and input tax are properly recorded?
- Are systems in force to ensure that proper evidence is obtained to support VAT input tax claims?
- Where VAT is not charged on supplies made, is this correct in law and is proper evidence retained?
- Are there systems in force to ensure that non-deductible input tax is not reclaimed, e.g. most VAT on motor cars, or business entertaining?
- Is VAT always considered before contracts are made?

Default surcharge

A default occurs if Customs and Excise has not received your return and all the VAT due by the due date. The relevant date is the date that a cheque is *received*. If the due date is not a working day, payment must be received on the last *preceding* working day. As a general guide, the payment (normally accompanying a return) should be posted first class at least two working days before the due date. It will help if you obtain a form P326 (certificate of posting) from the Post Office.

A cheque must be correct in all respects and not post-dated, otherwise payment will not have been made.

Consequence of default

You receive a warning after the first default - the Surcharge Liability Notice. Do not ignore this notice. If you fail to pay the VAT due on the due date within the next five quarters, the surcharge will be 2% of the outstanding tax. The surcharge increases to 5% for the next default, and then by 5% increments to a maximum of 15%. Lower rate (2% and 5%) surcharge assessments will not be issued for less than £200. At rates of 10% and 15% the surcharge liability becomes subject to a minimum charge of £30.

Each default, whether it is late submission of the return or late payment, extends the surcharge liability period, but only late payment incurs a surcharge.

Disclosures of errors in previous returns

Net VAT errors of £2,000 or less discovered during a VAT period may be included in the VAT return for that period, and will form part of the Gross Amount of Tax (GAT). The GAT is the total VAT on purchases plus the total VAT on sales in the period. This counts as a voluntary disclosure and will avoid both a misdeclaration penalty and interest.

Net VAT errors over £2,000 *must* be notified either by letter or on a special form (VAT 652 - The Voluntary Disclosure of Errors). This avoids a misdeclaration penalty, but interest will still be charged. Entering such errors on the normal VAT return could lead to prosecution.

The opportunity to disclose voluntarily ceases once a trader has reason to believe that Customs and Excise is making enquiries into his or her affairs.

Serious misdeclaration

If previous errors are *not* voluntarily disclosed, a Serious Misdeclaration Penalty may apply. The penalty is 15% of the misdeclaration, and is triggered if the underdeclaration equals or exceeds either £1 million or 30% of the GAT.

The underdeclaration used in applying these tests is the net underdeclaration for the period concerned, taking account of errors in favour of Customs and Excise. Therefore, if a trader omits a month's figures, with output tax of £2,400 and input tax of £1,500, the underdeclaration is the £900 difference between the two and not the £2,400 of output tax omitted.

This penalty may equally apply if a trader received a VAT assessment that understates the liability to tax and does not bring this understatement to the attention of Customs and Excise within 30 days. However, in this case the test relates to the True Amount of Tax (TAT), which is the difference between input and output tax that should have been shown on the return.

Persistent misdeclaration

Following a serious misdeclaration, Customs and Excise has the power to issue a penalty liability notice (PLN) stating that a penalty of 15% of the tax lost will be levied if there is more than one *material inaccuracy* in any of the next eight accounting periods. A material inaccuracy is a net underdeclaration, which equals or exceeds the lesser of £500,000 and 10% of the GAT.

Conduct involving dishonesty

If Customs and Excise suspects conduct involving dishonesty, it can invoke a civil penalty of up to 100% of the tax at risk. It may also pursue criminal penalties where the circumstances warrant it. These can lead to unlimited fines or prison sentences of between six months and seven years.

Retention of records

The period for retaining records is six years. There is a fixed penalty of £500 for breaching this requirement.

Breaches of regulations

The amount of the penalty varies with the type and frequency of the breach involved. The basic penalty is £5 per day while the breach continues. This is increased to £10 per day if there has been an earlier breach of the same regulation within the previous two years, and £15 per day if there has been more than one earlier breach.

In some cases, this basic daily penalty is increased to a daily percentage of the tax involved, if this is greater. The percentage rises in line with the number of previous breaches, in exactly the same way as the basic daily penalty. The possible percentages are 1/6%, 1/3% and 1/2%.

Daily penalties are subject to a maximum of a hundred times the daily amount.

Default interest

Interest on tax will arise in certain circumstances, including cases where:

- An assessment is made to recover extra tax for a period for which a return has already been made (this includes errors voluntarily disclosed)
- A person has failed to notify his or her liability to register (or made late notification), and an assessment covering a period longer than three months is made to recover the tax due
- An invoice purporting to include VAT has been issued by a person not authorised to issue tax invoices

Where an assessment covers a period exceeding three months, Customs and Excise is required to break it down into return periods. This is necessary to establish the period for which interest is to be charged. Normally, interest accrues from the due date for submission of the return for the period concerned. However, the maximum period is three years, although interest will continue to run on assessments remaining unpaid after thirty days from the date of issue. The rate of interest is set by the Treasury and is broadly in line with commercial rates of interest.

Appeals

Appeals may be made to the VAT tribunal against penalties. The tribunal now has powers of mitigation in appropriate circumstances. Where the appeal is against the imposition of interest, penalties, or surcharge, the tax must be paid before an appeal can be heard. The tribunal is given the authority to increase assessments that are established as being for amounts less than they should have been. A formal procedure is now established for appeals to be settled by agreement. This agreement must be in writing, and there is a thirty-day cooling off period during which the taxpayer may cancel the agreement.

Access to information

Customs and Excise has extensive powers to obtain information. It can enter premises and gain access to computerised systems and remove documents.

The sting in the tail

None of the above penalties or interest is allowable as a deduction when computing income for corporation or income tax purposes.

Action points

- Remember that discovered errors in excess of £2,000 must be separately disclosed on form VAT 652, and *not* incorporated in the VAT return
- Default interest applies to such errors and the Serious Misdeclaration Penalty may apply if you do not declare errors voluntarily *before* you have reason to believe that Customs and Excise is making enquiries into your affairs
- If you receive a VAT assessment (because you have not submitted a return), you must check it and notify Customs and Excise within thirty days if it understates your liability
- Make sure your systems and records are adequate to enable you to establish the gross amount of tax relating to a VAT period. The preparation of annual accounts cannot be regarded as a safeguard against penalties
- Make sure you get your VAT return and payment in on time. A certificate of posting could be useful evidence
- Some of these penalties may not apply if there is a *reasonable excuse*, but the scope is limited and should not be relied upon

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