EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (AMENDMENT OF SECTION 77A OF THE VALUE ADDED TAX ACT 1994) ORDER 2007

2007 No. 939

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs (HMRC) on behalf of the Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Description

This Order amends section 77A of the Value Added Tax Act 1994 (c. 23) (joint and several liability of traders in supply chain where tax unpaid). It extends the list of goods to which the section applies to include various types of electronic goods commonly used in missing trader intra-community VAT fraud (also known as MTIC fraud). It also amends the section to confirm that certain goods may fall within more than one of the listed categories.

3. Matters of special interest to the Select Committee on Statutory Instruments

This is the first exercise of the power to make an order provided by section 77A(9) of the Value Added Tax Act 1994.

4. Legislative Background

4.1 Section 77A of the Value Added Tax Act 1994 (VATA) was inserted by section 18 of the Finance Act 2003 (c. 14). It was part of a package of measures designed to combat MTIC fraud.

4.2 Although there are a number of variations in its simplest form, the fraud works in the following way. Trader A, who is based in another member State, supplies goods to trader B, who is based in the UK. In accordance with the relevant European legislation concerning VAT, the supply is VAT-free in the member State of dispatch. Trader B supplies the goods to a consumer, C, in the UK. B should account for VAT on the acquisition of the goods from A (although he may claim this back as input tax) and should also charge VAT on the onward supply to C. Instead trader B charges VAT on the supply to C but disappears without paying any VAT to HMRC.

4.3 A more complex version of the fraud is known as "carousel" fraud. In this version of the fraud, the missing trader sells the goods through a series of "buffer" companies (inserted to make detection of the fraud more difficult) to a "broker" who makes a zero-rated dispatch of the goods back to another member State. As the supply is zero-rated the broker is able to make a, normally very large, VAT repayment claim to HMRC. In the crudest version of the fraud, the broker will sell the goods back to trader A and the cycle will start again, hence the term carousel fraud.

4.4 Section 77A VATA was part of a package of legislative and operational measures introduced to combat such fraud. The provision is designed to make the "buffers" or "broker" jointly and severally liable for the unpaid VAT due from the missing trader where they knew, or had reasonable grounds to suspect, that VAT would go unpaid elsewhere in the supply chain. Although assessments are made and notified to missing traders, in the majority of cases the trader either cannot be found or has few, if any, assets.

4.5 Section 77A only applies to specified goods. Broadly speaking these are telephones, computers and accessories made or adapted for use in connection with telephones or computers. These include, historically, the goods most commonly used in MTIC fraud, as they are high value, portable goods with low transport costs.

4.6 This Order extends the list of goods to which section 77A applies to ensure that the tools available to HMRC remain effective in tackling future mutations of the fraud.

4.7 Technological developments mean that electronic equipment is increasingly capable of a range of functions. To take account of this, the Order amends the definition of telephones and computers to include goods made or adapted for use as a telephone or computer and confirms that certain goods may fall within more than one category. For the avoidance of doubt, it also confirms that positional determination devices for use with satellite navigation systems (commonly referred to as "satnavs") fall within the definition of a computer for the purposes of section 77A.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom

6. European Convention on Human Rights

The Paymaster General, Ms Dawn Primarolo MP, has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Amendment of section 77A of the Value Added Tax Act 1994) Order 2007 are compatible with the Convention rights

7. Policy background

7.1 The joint and several liability provisions were introduced in 2003 to counter MTIC fraud, which is an organised criminal attack on the VAT system. Attempted MTIC fraud in 2005-06 was estimated at between £3.5bn and £4.75bn, with an impact on VAT receipts in 2005-06 estimated at £2bn to £3bn.

7.2 These provisions allow HMRC to direct that another trader in the supply chain is jointly and severally liable for the VAT where they know or have reasonable grounds to suspect that the VAT payable on the specified goods will go unpaid.

7.3 The extension of section 77A to include other electronic goods and their related parts and accessories will allow HMRC to use the joint and several liability provisions to deal with future mutations of the fraud.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is nil.

9. Contact

Joan Gay at HM Revenue and Customs Tel: 0207 147 0289 or e-mail: Joan.Gay@hmrc.gsi.gov.uk can answer any queries regarding the instrument.