

This Information Sheet includes extracts from HM Revenue and Customs Notices 726, 700/52 and the Input Tax Statement of Practice. The contents of these Notices are subject to crown copyright.

HMRC have provided examples of the due diligence checks they require in various public. Some of the action HMRC state they require is duplicated in the Notices but each Notice also raises new points.

HMRC have made it clear that you need to maintain a record of the due diligence carried out:

“6.3 Is there anything else I can do to help avoid security being required from me?”

You should record the checks you have made to establish the legitimacy of the supplier/customer to prevent being caught up in a supply chain where VAT will go unpaid. We will take into account what you know about the nature of the supply and your suppliers/customers and how you made a judgement that they are legitimate.”

DDE MTIC services have been designed to take account of these varied requirements by HMRC and also to provide you with a comprehensive written record of due diligence checks and visits.

For your information the following are the due diligence sections from HMRC’s Notices.

Notice 726 provides some detailed guidance about HMRC’s due diligence requirements:

“4.4 How can I avoid being caught up in MTIC fraud?”

It is in your interests to check carefully who you are dealing with. In order to help you avoid being unwittingly caught up in a supply chain where VAT goes unpaid, this notice contains some examples of reasonable steps you can take to establish the integrity of your customers, suppliers and supplies.

4.5 What are “reasonable steps”?

It is good commercial practice for businesses to carry out checks to establish the credibility and legitimacy of their customers, suppliers and supplies. These checks will need to be more extensive in business sectors that are commercially risky or vulnerable to fraud and other criminality.

Such checks will also assist you to avoid being involved in supply chains linked to the theft of VAT and the possibility of becoming jointly and severally liable for VAT unpaid elsewhere in your supply chain.

HMRC does not expect you to go beyond what is reasonable. However, HMRC would expect you to make a judgement on the integrity of your supply chain and the suppliers, customers and goods within it. Factors you may wish to consider include:

- The type and level of checks you carry out to establish the integrity of the supply chain and the action you take as a consequence of those checks;*
- The nature of the supply;*
- Payment arrangements and conditions; and*
- Details of the movement of goods involved.*

4.6 Can HMRC tell me exactly what checks I should undertake?

No. The examples contained in this notice are only guidelines for the kind of checks you could make to help avoid dealing with high-risk businesses and individuals. The checks you will need to make, and the extent of them, will vary depending on the individual circumstances of your trade and you are free to ask the most appropriate questions required to protect yourself in the particular circumstances of your individual transactions. A definitive checklist would merely enable fraudsters and those willing to turn a blind eye, to ensure that they can satisfy such a list.

6.1 What checks can I undertake to help ensure the integrity of my supply chain

The following are examples of indicators that could alert you to the risk that VAT would go unpaid:

1) Legitimacy of customers or suppliers. For example:

- what is your customer's/supplier's history in the trade?*
- has a buyer and seller contacted you within a short space of time with offers to buy/sell goods of same specifications and quantity?*
- has your supplier referred you to a customer who is willing to buy goods of the same quantity and specifications being offered by the supplier?*
- does your supplier offer deals that carry no commercial risk for you – eg, no requirement to pay for goods until payment received from customer?*
- do deals with your customer/supplier involve consistent or predetermined profit margins, irrespective of the date, quantities or specifications of the specified goods traded?*

- does your supplier (or another business in the transaction chain) require you to make 3rd party payments or payments to an offshore bank account?*
- are the goods adequately insured?*
- are they high value deals offered with no formal contractual arrangements?*
- are they high value deals offered by a newly established supplier with minimal trading history, low credit rating etc?*
- can a brand new business obtain specified goods cheaper than a long established one?*
- has HMRC specifically notified you that previous deals involving your supplier had been traced to a VAT loss and/or had involved carousel movements of goods?*
- has HMRC specifically notified you that HMRC date stamps have been present on goods offered for sale by your supplier, or that there is evidence of HMRC date stamps being removed from packaging. This would strongly suggest that the goods had been subject to carousel movement, which should alert you to a significant risk that the transactions entered into with that supplier may be connected with the non-payment of VAT;*
- has HMRC specifically notified you that other MTIC VAT fraud characteristics (such as third party payments) have occurred in transaction chains involving your supplier?*

2) Commercial viability of the transaction. For example:

- Is there a market for this type of goods – such as superseded or outdated mobile phone models or non-UK specific models?*
- What research have you done to test whether these goods are available as described and in the quantities being offered?*
- Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?*
- Have normal commercial practices been adopted in negotiating prices?*
- Is there a commercial reason for any third party payments?*
- Are normal commercial arrangements in place for the financing of the goods?*

3) Viability of the goods as described by your supplier.

For example:

- Do the goods exist?*
- Have they been previously supplied to you?*
- Are they in good condition and not damaged?*
- Do the quantities of the goods concerned appear credible?*
- Do the goods have UK specifications yet are to be exported?*
- Is your supplier unwilling to provide IMEI or other serial numbers?*
- What recourse is there if the goods are not as described?*

HMRC recommends that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.

6.2 Checks carried out by existing businesses

The following are examples of specific checks carried out by businesses that took part in the consultation exercise in 2003 when these rules were introduced. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer:

- obtain copies of Certificates of Incorporation and VAT registration certificates;*
- verify VAT registration details with HMRC;*
- obtain signed letters of introduction on headed paper;*
- obtain some form of written and signed trade references;*
- obtain credit checks or other background checks from an independent third party;*
- insist on personal contact with a senior officer of the prospective supplier, making an initial visit to their premises whenever possible;*
- obtain the prospective supplier's bank details, to check whether:*
 - (a) payments would be made to a third party; and*
 - (b) that in the case of an import, the supplier and their bank shared the same country of residence.*
- check details provided against other sources, e.g. website, letterheads, BT landline records.*

Paperwork in addition to invoices may be received in relation to the supplies you purchase and sell. This documentation should be kept to support your view of a transaction's legitimacy. The following are examples of additional paperwork that some businesses retain:

- purchase orders;*
- pro-forma invoices;*
- delivery notes;*
- CMRs (Convention Merchandises Routiers) or airway bills;*
- allocation notification;*
- inspection reports.*

Again this is not an exhaustive list, but does show some of the more common subsidiary documentation.

6.3 What will HMRC look out for when considering the extent of my checks?

In each case, HMRC will be seeking to identify what actions or precautions you took in response to any indicators of risk. This will focus on the due diligence checks you undertook and, most importantly, the actions taken by you in response to the results of those checks. In each case, HMRC will consider:

- What due diligence checks were performed? This includes any checks designed to address the specific risks of a specific case;*
- To what extent were your checks appropriate, adequate and timely in relation to addressing the risks identified?*
- What did the results of the checks indicate?*

□ Did you take appropriate action in response to the results of the checks? If you have genuinely done everything you can to check the integrity of the supply chain, can demonstrate you have done so, have taken heed of any indications that VAT may go unpaid and have no other reason to suspect VAT would go unpaid, the joint and several liability rules will not be applied.”

In Notice 700/52 the following due diligence requirements are included:

“6.2 What should I do to help avoid dealing with these high risk businesses?”

(a) You should take reasonable commercial steps to establish the legitimacy of your suppliers or customers - for example:

- what is your supplier/customer’s history in the trade?*
- what do you know about the financial standing of your supplier/customer?*
- how many staff does your supplier/customer employ?*
- how many staff does your supplier/customer employ indirectly (eg self-employed/ labour agency)?*
- what affiliation does your supplier/customer have with trade associations?*
- does your supplier/customer work in accordance with national agreements, if so which?*
- does your supplier intend to use subcontractors, if so who and for what activities/services?*
- what other work has your supplier undertaken (eg names and details of work carried out for other customers)?*
- can you visit your supplier/customer’s premises and/or other sites?*

(b) You should take reasonable steps to ensure the commercial viability of the transaction - for example:

- have normal commercial practices been adopted in negotiating prices?*
- are normal commercial arrangements in place for the financing of the goods/services?*
- is there a commercial reason for any third party payments?*
- is there a market for the type of goods - such as superseded or outdated goods?*

(c) You should take reasonable steps to ensure the goods/services will be as described by your supplier - for example:

- are the goods/services adequately insured?*
- are the goods as described?*
- what recourse is there if the goods/services are not as described?*
- do goods exist?*

*□ have the same goods been previously supplied to you?
These are only guidelines for the kind of checks you could make to help avoid dealing with high risk businesses and individuals.”*

In the Input Tax Statement of Practice further limited due diligence guidance is included:

“Why were changes needed?”

These changes were made to address the increasing threat to VAT receipts by the use of invalid VAT invoices and are part of the Government's strategy to address fraud, avoidance and non-compliance in the VAT system.

If you are a VAT registered business, and you have been issued with an invoice that is invalid, you should be able to return to your supplier and ask them for a valid VAT invoice that complies with the legislation. If for some reason you cannot, this Statement of Practice sets out whether or not you may be entitled to input tax recovery. In most cases, provided businesses continue to undertake normal commercial checks to ensure their supplier and the supplies they receive are '*bona fide*' prior to doing any trade, it is likely they will be able to satisfy HMRC that the input tax is deductible.

HMRC will need to be satisfied that:

- The supply as stated on the invoice did take place
- There is other evidence to show that the supply/transaction occurred
- The supply made is in furtherance of the trader's business
- The trader has undertaken normal commercial checks to establish the bona fide of the supply and supplier
- Normal commercial arrangements are in place- this can include payment arrangements and how the relationship between the supplier/buyer was established

Questions* to determine whether there is a right to deduct in the absence of a valid VAT invoice

1. Do you have alternative documentary evidence other than an invoice (e.g. supplier statement)?
2. Do you have evidence of receipt of a taxable supply on which VAT has been charged?
3. Do you have evidence of payment?
4. Do you have evidence of how the goods/services have been consumed within your business or their onward supply?
5. How did you know that the supplier existed?
6. How was your relationship with the supplier established? For example:

- How was contact made?
- Do you know where the supplier operates from (have you been there)?
- How do you contact them?
- How do you know they can supply the goods or services?
- If goods, how do you know the goods are not stolen?
- How do you return faulty supplies?

This list is not exhaustive and additional questions may be asked in individual circumstances.