



A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY
AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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PRIVATISING LAND IN RUSSIA

Summary of a talk given by the Honourable Sir Kenneth Jupp, MC to members of the Economic Research Council on Wednesday 24th November 1993

Russia – its land and people

I will tell you, to set the scene, something about Russia that you can read in any book. It is a vast land. It is two and a half times the size in area of the USA. It is 94.7 times the area of the UK. It stretches from, in the north, 800 miles from the Arctic Circle down, to the south, 800 miles from the Tropic. If you fly across it from east to west or west to east, you pass through eleven time zones. This is the vast country where the land is to be privatised. And what variety! All that land contains land with as good fertility as any land in the world, particularly in the Black region of European Russia where the earth practically, as they put it out there, will grow something if you spit on it. It has mineral resources on both sides of the Urals stretching from gold right down to chalk and everything you can think of in between. In Siberia alone, they claim to have coal deposits which are sufficient to provide the whole world market, it is said for 1000 years. I am prepared to say at any rate for a long time. In Siberia, too, there are 12 million square miles of good timber forests. I need not mention the enormous oil fields, some of which are only coming to light right now. It is a colossally rich land but of course it is not a colossally rich people. In fact it is a poverty-stricken people. You have to notice the variety of this. That is the first point in privatising the land – the enormous variety from the best in all those fields I have mentioned, down to the worst. You also have to bear in mind the colossal variety of people. Some stupid people think that in economic circumstances all men are equal there is nothing further from the truth. First of all, people are either intellectually biased or emotionally biased and there is every degree between the stupid and the clever in all those three parts of the so-called classless society. The people then are as diverse as is the land.

The Problem

What is the object of privatising land? Well, very simply, it is to bring the right sort of person or group of persons into active conjunction with the right kind of land because not any piece of land suits all people: some are suitable to dig and build, others are suitable to buy and sell, others are suitable to think and so on. You have got to marry the people with the land. Both systems, the command system which the communists had and which has now been abandoned in Russia, and the capitalist so-called system which is running into such trouble in the West generally, have failed utterly to achieve that object of getting the right people settled on the right land. The Communist system rigidly forced people to go on to the land that is allotted to them and as a result the wealth produced was quite insufficient to provide for the population and they were poor. The so-called “free” economies of Western Europe produce much more than anybody could possibly want and it stands piled in lakes and mountains and the like, and land is kept

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out of use and you are paid to keep it out of use so far as agricultural land is concerned. Meanwhile, the people cannot afford to buy the products of this ever-productive society and, in that even there, there are millions in all countries of the West, who are unemployed, some of whom are past working because they have been too degenerated by their dependency on the State, but many of whom (and I like to think that it is a majority of whom) would gladly work if only they had the opportunity to do so. And to keep that sort of system going, the people are taxed so heavily in both the command economies and the so-called free economies that unless they happen to have the control of land, then they are either poor or so destitute that they have to be helped out by more and more taxation and as the help increases the taxes increase and the whole thing is strangled. That is the situation we are in. The trouble in both types of economy is that the revenue naturally belonging to Government is simply not collected and taxes are raised instead. This is what we have been pointing out to the Russians, and they have accepted it gleefully because fortunately they are an extremely well-educated people. I will give you a small example. I happened to quote Virgil in one of my addresses there, and my interpreter told me that she didn't have to translate it into Russian – they all understood it. That wouldn't happen in this country!

The Proper Solution

Well now, Russia, and this is what we are emphasising to them, is in a position of superiority to the whole of the rest of the world at the moment because she is at a crisis point when she can choose what to do because of this tremendous revolution that has happened and has been happening in these last three years. *And the people own the land.* The legal title to it is invested in the State and that is of course vital. Land of course, by natural law, is the common property of a community. The Red Indian doesn't have any difficulty, nor the aborigine, nor the maori, nor the African tribesmen, in telling you that. And if the community lets a man into possession of any particular parcel of land, then of course the community assures him of undisturbed use of that land, together with the extensive use of three things – strange how all comes in three's – first of all the resources not made by man, that is to say the natural resources of climate, fertility, the sun, the air, the water and so on. Secondly, the infrastructure built by others (not by the man who has the land) usually at public expense (the roads, the railways, the sewers, the drains, the electricity cables, all the rest); he enjoys the exclusive use on that land of those advantages. And thirdly, the availability around him of the population with whom he can co-operate. And he does that by buying his supplies from them, by employing them in his business, by using them as customers very often, and of course by social intercourse which is a vital thing for human beings.

Thus with the enormous diversity of land (so that any one parcel is utterly different and subtly different too, from every other parcel) and the enormous diversity of people, you somehow have to marry them. And of course the way to marry them is by charging rent, because rent is the measure of the difference between the land I have (I am quoting Tolstoy when I say this) and the land that you have. Our different lands vary in their benefit to us, but if we all pay up-to-date rent then of course there is a level playing field

because we are all to be on the level by, as it were, a handicap in sport. You can get different people playing sports in great competition so long as you handicap. So in trade you can have people in equal competition so long as you handicap them so that the advantages you get from being in any particular position is diminished by the handicap. What is the handicap? The handicap is rent and of course trade in Britain would be greatly improved if the Duke of Westminster were the landlord of the whole of Britain instead of being only the landlord of an immensely small, tiny, little bit of it! (I am afraid the Government's idea of clobbering the Duke of Westminster is just about as silly as any I have heard in the whole of my life. A landlord is a good thing so long as it is the right landlord and he is taking the full up-to-date rent to keep the race properly handicapped.) Now, that is the first point. The second point is that all this is for ever changing and changing with immense rapidity. Yesterday's end piece of desert is, through new science and technology, today's rich oilfield. Moreover, the community helps man's productive capacity. The Channel Tunnel is a case in point. All the people who have provided funds to get that Channel Tunnel going have done an enormous service (I am assuming it is going to work!) to people who own land, for example, in Liverpool who one day, if all goes as expected, will be able to put things on a train bound for St Petersburg without any intervening unloading or loading. Just think of it. And of course, they ought to pay for that.

So diversity is the first point to watch, diversity of land and diversity of people, and the second is the constant change. Somebody here must know the story of the building of Canberra, Australia. Canberra was built with a system which we are suggesting to the Russians whereby they let the land at rents which were to be revised frequently, just as happens in England with every good landlord. In Canberra the same thing was done, but they had the first revision after ten years, and so enormously quick was the uprising of this poor land into a capital city that at the end of ten years the land was worth a mint of money, which owners wished to keep and so there was sufficient rumour to stop the review of rents being put into effect. People from Denmark have been telling the Russians, we in Denmark revalue the land every twelve months and after you have got going, there is no reason why you shouldn't do the same.

Application in Russia

Well, what is to be done? It is very simple. It consists of the registration of land. That is vital. Thank God they have got down to that in several places, and I have actually seen some of the land maps. Large scale land maps, the proprietor being marked, the general description of land. It is very easy. Of course, typically Russian, in Moscow they have set up a thing to do this, but before our advice, and they are doing it – down to counting the knives and forks and spoons in each apartment virtually and what they have done is to buy a huge computer system and they have an enormous number of bureaucrats working on this, down to the last knife and fork and spoon, and have filled up the computers, and now they are stuck! It is called the Bureau of Economic Technology or some such phrase. They have now come to a halt until they can find a computer system and buy it which will take all this and sort it out for them.

Of course, we were telling them that you don't need to do anything like this. All you need to register is the area of the land which is measured in no time at all, the building that is on it, a general description – office block, hotel apartments, residential – and of course the number of storeys, so that you can see the kind of thing it is. That is all you need. And that can be done very quickly. You don't even have to go into the building. And strangely enough, that is what was done in our country in 1086 when at Christmas William the Conqueror ordered the Domesday Book to be prepared, and as I am sure you know, before the Christmas session of the following year, and within twelve months, it was completed – the Book wasn't, the book was brought in later, but the actual survey was all done in less than twelve months, and so far as I am aware, they didn't have computers, telephones and so on! So there is no difficulty about that.

The second thing is they want a Register of Titles and of Covenants governing the land, and then last, and this is rather vital, they must have an equivalent of the English Law of Trespass. You see a Russian looks over his shoulder, as I understand it, and says, well I am just waiting for the police to come and take it all over so I had better not do too much. So I suggested it is vital that there is no fear of anyone lawfully in possession of land being disturbed, dispossessed or in any way interfered with, especially by Government agents, and I set out the English Law of Trespass, including if the entry is by soldiers, policemen or other servants of local or national government, he should be entitled to punitive damages for any oppressive, arbitrary or unconstitutional conduct on their part. The next thing is to have rent auctions. You have got to have rent auctions so that you find the person who is prepared to stake his reputation and his abilities on paying the highest rent and that rent must always have a revision clause so that with all the changes, inflation, new technologies, building of a new railway line, the opening of a new airport – there are stacks of things that change entirely the rental value of land and are reflected in the new rent. So there must be a clause drafted to cover the rent as revised with forfeiture in the case of non-payment. You say, all right, let someone else have the land if you don't pay the rent, which is the way it works in England as far as the law is concerned.

Russian Mistakes

Now one of the difficulties that is troubling Russia is that they have already given away a lot of their land. Let me tell you the story of Moscow apartments. The Moscow Council a couple of years ago, said, we must privatise, we must make people the owners of their apartments, and so they let them have their apartments as owners for 350 roubles. I don't know what the exchange rate was then, so I can't tell you how much that was, but it wasn't very much! The exchange rate now is about 1500 to the pound, but it was less then. A year later, after a great debate in the Council, they decided that they had been most unfair, they hadn't really got hold of the job at all, and so they passed a Resolution that everybody should have their money back! And so there are people who have now got an apartment, (to be fair they are much smaller than anything you see in most places in England) for nothing!

And this is what is happening also in the commercial field. A huge American organisation has taken a vast site of land in St Petersburg and it has been given to them because they have promised to develop it with housing, sewers, the lot. That is splendid for as long as it takes, say five or ten years. What happens in 50 years or a hundred years? There is a piece of land that is not "for ever England", but for ever belonging to an American corporation. They really don't understand land.

Here is a picture of the Astoria Hotel in St Petersburg. It has got a beautiful corner site on St Isaac's Square, which is pretty close to the middle. You can see what kind of a place it is. We ought to have a competition – guess how much the local government have sold it for? I will tell you. They have sold it for \$80,000, which is something between £55,000 and £60,000.

What are you going to do about the land which has already been allotted for nothing? They are very keen to let things on 49-year leases at absurd rents, \$1000 for example, without any change of rent for the next 49 years. It is pathetic. At the press conference in St Petersburg, one of the Mayor's Office people attending asked if town land was very much more valuable than country land. One felt, what is the use of coming, they don't understand anything! What I have suggested is that they should set up an arbitration court to decide in the cases of those lands which have been given away already or sold already, what is the proper way to deal with the new so-called owner's position.

The Hong Kong Example

Of course what they ought to have done is what was done in Hong Kong. That is one of the reasons Hong Kong has been so mightily successful. They didn't give away the land. It was all owned by the Government of course. They let it on leases. There is no land in Hong Kong which is not let on lease. They made some mistakes. We had a Hong Kong valuer on the team and he was quick to point out the mistakes they have made over the years and telling the Russians not to make the same mistakes, but the principle was there. At one very small meeting, I said, look here, one of the richest men in England is said to be the Duke of Westminster. In fact he only owns a few ten thousand acres of country land which is not worth much anyway, and he owns about 300 acres of land in the Victoria area and some elsewhere. He owns very little of England, but he is said to be extremely rich, probably has at one time been named the richest man in England. I said, if you can imagine a lawyer like me telling the Duke of Westminster he ought to give away his land or let it on 49-year leases for \$1000, or sell it at these absurd figures and all that sort of thing, I would be subject to an action for negligence! You must not give away the land.

England and Russia

You must understand that the law of England is exactly the same as the law of Russia. Let me read you from McGann's Law of Real Property. The basis of English land law is that all land in England is owned by the Crown. A small part is in the Crown's actual

occupation, but the rest is occupied by tenants. That is exactly the position if for the English Crown you substitute the Russian State. Land is not the subject of absolute ownership but of tenure – either direct from the Crown or under some intermediary holder. Under King William all users of land owed duties, rents and tithes to lords who in turn owed rents and service to the King.

Unfortunately, in England, things went wrong – and the process is documented in volume IV of the Oxford History of England 'The Thirteenth Century'. Soon after Magna Carta the English head tenants – lords – who were (and still are) tenants of the Crown, gave up paying rent to the Crown and now call themselves owners, in spite of the fact that by law they are not.

So Russia today has a marvellous opportunity – as we had in 1066 – to set about the establishment of a proper structure of rent collection on land and thus to base the revenue of the State in large part, on "rent surplus" rather than "tax disincentive".

VAT: WHOSE FRAUD?

*A Talk given to members of the Economic Research Council on 27 October 1993
by John Davison, FTII, AIITP, AIMgt*

VAT, as many of you will know, is something of a problem child. It is easily misunderstood and the consequences of transactions are not always predictable. Why should this be so? There are several reasons. VAT is not taught in accountancy examinations. Trained accountants can qualify knowing little about VAT and they may well have no incentive to learn about it. VAT has numerous grey areas, areas of doubt and uncertainty, and it is constantly being changed – which is good for me because it keeps me employed! The principles of VAT are also very different from those of direct tax: VAT is based upon supplies of goods and services, not on cash flow. VAT is also a European tax and the impact of that I shall consider later. Finally, a major problem about VAT is the attitude of Customs & Excise and it is this aspect I shall discuss first. Before doing so, however, I must define fraud.

What is fraud? It is being knowingly concerned in the evasion of tax through an act of omission or commission. This is the offence taxpayers are charged with. But what about fraud by the Customs & Excise? How about knowingly collecting too much tax, putting obstructions in the way of business, or, perhaps, a callous disregard for the consequences of their actions? These could be interpreted as fraud by Customs & Excise on the taxpayers. A recent highly-publicised example of the actions of Customs & Excise is illustrative. Although not a VAT case, it must be borne in mind that it involved the same people – and the same approach – as those who deal with VAT.

Everyone will recall the Iraqi Supergun affair. I was involved in the defence of one of the companies charged and also a friend of one of the investigating officers, so I have some insight into what went on. Let there be no doubt that Walter Sommers & Sheffield Forgemasters were making parts for a very large gun. The descriptions of the goods, the treatment of the metal, and the plans, leave no doubt about that. The attitude of Customs was simple: a licence to export was required; none had been obtained; an offence had therefore been committed; so a number of directors were arrested and briefly imprisoned. The companies' actions, however, were undertaken with the knowledge of the authorities and the directors felt confident in assuming that what they were doing was legal. In this case, political pressure was put on Customs to drop the case but this was no compensation for the ensuing human tragedies. For example, a self-employed lorry driver who was transporting tubes to Iraq was stopped on the Greek border on the instructions of Customs & Excise and imprisoned. He was totally innocent of any crime. Owing to the length of time he was incarcerated, he lost his job, his truck, and his house.

One thing one quickly learns in dealing with Customs & Excise is that, once started, they like to get a result. As they had failed with the Supergun they moved on to a similar case: Matrix Churchill, which, as you will no doubt recall, came to particularly ignominious end. The Rt. Hon. Alan Clark, said that his reason for allowing the export was to increase British business. In the event, this has not happened. The directors involved became unemployed and another UK machine-tool manufacturer ceased production.

Turning now to VAT, it has been interesting to note that recently Customs & Excise have issued a press release and a consultation document concerning evasion and avoidance. For those unaware of the difference, evasion is illegal but avoidance is legal; it means arranging one's affairs in such a way that a tax charge does not apply. For example, when VAT is imposed on domestic fuel bills next year, VAT can be avoided quite legally if an individual prepays the electricity and gas boards.¹

Last year the National Audit Office undertook a review of VAT avoidance and lambasted Customs & Excise over their allegedly lax attitude to avoidance. This merely demonstrates the Audit Office's total misunderstanding of the nature of the tax and perhaps also, the Government's desperate need to raise money. It has, however, goaded Customs & Excise into action. Their consultation document has identified several areas that they regard as unacceptable avoidance. It is in these areas that Customs & Excise will concentrate to stop what is regarded as large-scale unacceptable avoidance. But it is disappointing that Customs & Excise has selected areas which, in broad terms, are acceptable business practice. To take one example: Customs & Excise are to examine the doctrine of Composite or Mixed Supply. The question that has to be answered in such cases is whether an item is one supply attracting one VAT liability; or whether it is a number of supplies bundled together, each with their own (and possibly different) VAT liabilities.² Customs & Excise fear that taxpayers will artificially join supplies together to gain a VAT advantage. This is ironic because Customs & Excise are the greatest offenders in trying artificially to split or join supplies. Take the recent VAT Tribunal relating to United Biscuits. United Biscuits was selling biscuits in a tin. It would be imagined that these could be happily zero rated as a supply of biscuits, but no;

according to Customs & Excise this was a mixed supply of zero-rated biscuits and a standard-rated tin. After all, the tin was decorative and could be used afterwards for storage.

There are many other such instances. Perhaps one of the most ludicrous concerns mushroom spore. This is often sold in Do-It-Yourself, Grow-Your-Own mushroom kits. Now, if the kits are sold in cardboard boxes the whole kit is zero rated. If the spore is sold in a plastic bucket, VAT is due on the value of the bucket; the bucket might be useful afterwards and so has to be regarded as a separate supply. No notice is taken by Customs & Excise that the cardboard boxes leak when watered so that buckets are better suited to growing the mushrooms. It is disappointing that no mention was made in the consultation document of the part played by Customs & Excise in avoidance. For example, raising assessments without foundation, charging VAT on what are essentially charitable donations that fall outside the scope of VAT (as in the recent case of Tron Theatre), and attempting to raise VAT when cash has not been received when the taxpayer is operating a retail scheme (as in the recent case of Courage).³

I should now like to turn to the powers of Customs & Excise, an arm of government that is well known for having more powers than the police. This is because Customs & Excise has access to what is called a Writ of Assistance, the origins of which go back into the dim and distant past. The Writ is like a search warrant but it is permanently available and can be used at any time anywhere in the United Kingdom without the need to seek anyone's approval. It is limited to investigations concerning restricted or prohibited goods such as alcohol, pornography, and drugs. It cannot be used in VAT cases for which a search warrant is required. However, no warrant is required to search the premises of an arrested person so it is always handy to arrest somebody as a means of acquiring the power to make a search.

Just over ten years ago, concerns were voiced at the overzealous nature of the taxcollecting authorities and a review was launched (Committee on Powers of Revenue Departments, 1980-83). It is believed that the intention was to relax controls and to create a better environment in which business could operate. There is a story that when asked who should lead the review, Baroness Thatcher said, 'Let Keith do it', meaning a well-known businessman of the time. The civil servant, however, appointed Lord Keith of Kinkel, a Lord of Appeal in Ordinary. He took the review very seriously but not with the aim of relaxing controls. As their powers were under attack, Customs & Excise also took the review seriously and presented a cogent and well-argued case for strengthening their powers. The report that was produced was a great victory for Customs & Excise. Some of the powers it was given and the penalties that were introduced are as follows.

Default Surcharge: This is a fixed-rate penalty for failing to submit a VAT return on time. It was necessary because, when introduced, two-thirds of taxpayers failed to make returns on time. The application of the penalty has, however, been draconian. Initially, the first two late returns were not penalised; a third late return incurred a 5% penalty. The penalty then rose by increments of 5% to a maximum of 30%. A penalty of 30% could be imposed even if the return was only a few days' late and that proved enough to put many businesses into liquidation. The regime has now been recognised as being

too harsh and the maximum penalty has been reduced to 15%. However, one of the 'free-goes' (one of the non-penalty defaults) has been removed. Thus there will be more penalties but for smaller amounts, which is of only limited help to business. It is a bit like a parasite limiting the amount of blood sucked in order to keep the host alive - just.

The Serious Misdeclaration Penalty: This was a 30% penalty for large errors. The 'large error' could be as modest as £10,000 or 5% of the tax due. It is easily incurred and there is no way of mitigating the penalty even if the authorities lost no tax (e.g. because the Vat was paid late and claimed early). Again, it has been recognised that the penalty of 30% is too harsh and it has been reduced to 15% and the trigger-point for the levying of the penalty has been significantly raised. It is worth noting that VAT and its penalties must comply with the European doctrine of proportionality: the penalty must be in proportion to the offence. It is clear from these reductions that the original penalties for default and serious misdeclaration did not comply with that doctrine. It is disappointing that the independent VAT tribunals did not agree with this doctrine because they had earlier refused to refer a case to the European Court on this ground. What hope is there for the small taxpayer if the arbiters of tax disputes can so fundamentally misjudge the situation?

Civil Fraud: The Keith Committee also introduced the offence of Civil Fraud. Anyone who has been involved in criminal or even civil court litigation will know how costly this is. In order to mitigate such costs, this offence was introduced - though 'civil fraud' thus sounds a contradiction in terms. The attempt to reduce costs proved not to benefit the taxpayer but Customs & Excise. It also had an added benefit: it was quick so that more cases could be pushed through.

Civil fraud attracts a 100% penalty but with the possibility of reductions in mitigation. This potential for mitigation has been used by Customs & Excise as a blunt instrument to force confessions from taxpayers anxious to avoid the threat of criminal prosecution. In order to allow any reduction in mitigation, Customs & Excise usually want a full admission, full disclosure, and payment. Taxpayers often comply even when they believe they have not acted fraudulently. Usually the taxpayer is ill-advised, unwilling to submit to the vagaries of the judicial system, and anxious to avoid the publicity of a trial. Even in cases where legal aid is available, most VAT practitioners do not have access to legal aid and most lawyers do not employ VAT experts - and they are essential in most such cases. Consequently the taxpayer is at a disadvantage.

One of the most disturbing features of civil fraud mitigation is that if the confession reveals more than the Customs & Excise already knew, the taxpayer renders himself liable to criminal action. This must be the only circumstance in which inducements can be offered to obtain evidence which is admissible in Court. Normally, if there is any hint of duress or inducement, the evidence will be thrown out. On the other hand, not offering enough to Customs & Excise will mean no reduction in the penalty. Negotiating with Customs & Excise is like playing poker but at stake is not money but the client's liberty.

One of the main criticisms of these penalties, with the exception of that for civil fraud, was that there was no possibility of mitigation. Mitigation was originally included in the proposed legislation but was removed for reasons of simplification. It is

remarkable how such simplifications work to the benefit of Customs & Excise! After complaints, together with criticism of Customs and Excise by the Courts, this was put right this year. Well, it was nearly put right. Mitigation was specifically excluded if the reason for mitigations was:

- an insufficiency of funds;
- there was no tax loss;
- the taxpayer had acted in good faith.

This is perverse. It is for just these reasons that mitigation should be allowed. Even worse, Customs & Excise intends to defy Parliament and not allow mitigation to a zero penalty. The minimum penalty Customs & Excise intend to permit is 25% of the original penalty.

This is by no means the end of the powers of Customs & Excise. They can offer in criminal cases to compound the offence. This is like an out-of-Court fine and is often incorrectly used by Customs & Excise when they have suspect or insufficient evidence; it is too often accepted by ill-advised taxpayers. Customs & Excise can also charge people under s39(3) of the VAT Act. This states that persons can be imprisoned for up to seven years if their conduct in a period must have involved an offence whether or not details of the offence are known. This is called the single conspiracy offence and is fairly all-encompassing. Failing this, a taxpayer could be charged with the common-law offence of cheating the Revenue and that is always difficult to argue against.

To understand Customs & Excise it is essential to understand the culture of the organisation. It is an organisation that is obsessed with efficiency, reviews, and targetsetting, chiefly so that it cannot be criticised by external bodies such as the Audit Office, the Public Accounts Committee, and the Press. Anyone who thinks the Sheehy Report on the Police is good, should take a long, hard look at Customs & Excise and ask if we want a police service to have hit rates for arrests, league tables for convictions, and targets for fines collected. These are the norm in Customs & Excise.

Customs & Excise seeks – and achieves – increases in VAT collected of nearly 10% per annum in real terms. Is this the right attitude for a department administering a self-assessing tax? Are league tables appropriate? Apparently they are not because Customs & Excise deny that they exist but there were such tables when I served at the Wolverhampton VAT Office: I know because I once came top of the table! It also encourages the raising of assessments⁴ for non-sticking tax – VAT that can be claimed back by the assessed business or an associate; such assessments can still be subject to penalties. Customs & Excise also makes incorrect assessments and these may well be paid by ill-advised taxpayers, who, after all, are not tax experts. Is it right that targets are set for the collection and enforcement of debt especially when those targets may depend to a great extent upon how short the Government is of money?

The culture of Customs & Excise does not encourage its officers to find overpayments of VAT; it is up to the taxpayer to do this on the grounds that he is hardly likely to overpay willingly. However, I can guarantee that if I or most other VAT consultants reviewed VAT payments of most businesses of any size, they would more

than justify their fees. This is not a sales pitch as I no longer earn my living in this way as I am fully employed by Nationwide Building Society. As an example of what can be recovered, however, I can tell you that although Nationwide thought it had its VAT affairs in good order, in the two years I have been with the Society, I have saved them an additional £4,000,000.

The attitude of Customs & Excise is often clouded by the amount of money at stake, especially in today's climate of budget deficits. They are a revenue-raising department, quite wrongly in my opinion, because they are dealing with a self-assessing tax. Their attitude can, and does, cost jobs and adversely affect Britain's competitive position. For example, Customs & Excise have, over the past five years, twice attacked holding companies, attempting to restrict unfairly their right to recover VAT. This could have applied a serious brake on merger and acquisition activity which, given the UK corporate structure, would have been damaging. Many companies considered relocating to Continental Europe because of this but, fortunately, Customs & Excise, after considerable pressure, relented.

Customs and Excise are also a jealous department. As they cannot have company parties, yachts, cars, or horses, they see no reason to allow them to others. After losing a string of cases in the Courts as to whether VAT on such expenditure was recoverable, they instigated a change in the law. VAT used to be recoverable if there was a business use, such as advertising, arising from such expenditure. But now a VAT Tribunal can only allow a taxpayer's appeal if Customs & Excise can be seen to be acting unreasonably. This is a much harder case for the taxpayer to win and it is of no moment if that Tribunal thinks VAT should be recoverable. I believe that this is contrary to European law because under that law, because VAT is recoverable on business expenses, whether or not Customs & Excise have acted reasonably is irrelevant.

The ultimate expression of Customs & Excise as bad losers must be the case of 'The Chewy Cereal Bars'. Customs & Excise were very concerned about the revenue loss on these oatmeal bars. They decided they must be confectionery and therefore subject to VAT and not, as food, zero rated. After losing two or three times at Tribunals, Customs & Excise had the law changed to effect 'a clarification'.

Customs & Excise takes a hard line with taxpayers. Three brief examples will suffice to illustrate this.

1. A dress shop was assessed. It did not believe the assessment was correct but, unfortunately, failed to act. Customs & Excise seized all the stock and sold it at auction for about 2% of the retail value. Such auctions are good places to pick up office equipment very cheaply.
2. An accountant completed a client's VAT return incorrectly. When he realised this he attempted to rectify the mistake but only compounded the error. Customs & Excise ignored his explanations, arrested him and charged him. In the two years the case took to come to trial, the partnership to which he belonged lost clients. He was removed from the partnership and suffered a nervous breakdown. The case was dismissed in Court, the judge directing that there was no case to answer.

3. The third case involves an importer of essential oils who had all his goods and stock seized, was verbally abused, and had his trade information passed to business rivals. He had made an error in the valuation of his imports. It was an obscure and technical error, so obscure, indeed, that Customs & Excise's own advice in their Public Notice repeated the error. This case was dealt with successfully by the client's advisors.

The moral is clear: if in dispute with Customs & Excise, get good professional advice immediately.

Finally, I should like to deal with an aspect of VAT that affects us all: the fact that it is a European Tax.

Customs & Excise ignore the fact that European legislation, in particular, the 6th Directive on Turnover Taxes, exists. It does exist and it is this legislation and *not* UK law on VAT that must be complied with. Customs & Excise also ignore the fact that there are other European languages as well as English. If it is advantageous to the taxpayer he can use any one of the translations he wishes; several cases have been won over the past few years on this basis, yet Customs & Excise still seem disinclined to accept the principle. Until recently they would ignore EC Court cases unless a UK national was involved. The UK, as had other countries, had to be instructed to put into effect a ruling in the case of Gaston Schul. That ruled that an input VAT paid in another EC country had to be taken into account. Unfortunately, Customs & Excise still blithely ignore difficult EC Cases.

The worst failing of Customs & Excise is their failing to comprehend the Continental European tradition. Customs & Excise and its lawyers still take a literal approach to legislation, even to EC legislation. They look at each and every word and seek its ordinary English meaning in order to interpret the law. This is one reason why we have such lengthy and tortuous legal arguments. It is much simpler on the Continent. There the aim is to seek what was meant and what was intended by the legislators. I believe that this is a more sensible approach when dealing with a self-assessing tax. It is, in any case, a mandatory requirement for European legislation. Since the landmark Inland Revenue case of *Pepper v. Hart*, which looked at what was said at the Committee stage of the legislation to deduce the meaning of the law, I hope that the UK is beginning to move in this direction.

What can we conclude about Customs & Excise? I know that they do try to deal with problems in a fair and pragmatic way, yet it is plain that all is not well. I do not have simple panaceas, but I think I can identify some problems.

1. The staff are inflexible and are governed by regulations and instructions giving them no leeway – this is in stark contrast to the Inland Revenue where officers are allowed to exercise discretion.
2. Customs & Excise are target-driven and a revenue-raising department; I believe that is an inappropriate way to administer this kind of tax.
3. The staff are ill-trained; the ordinary officer has no access to the legislation; the training is short and mainly through experience. Good staff leave early so little experience is built up.

4. The staff are poorly paid and unmotivated; they are paid less than Inland Revenue officers and there are few opportunities for progression. Many of the better jobs at the ports and in Excise have gone. Salary scales are a disgrace. An unqualified accountancy technician at a Building Society will be paid more than a Senior Officer in Customs & Excise at the top of his salary scale.
5. EC legislation is ignored.

Questions

If VAT is such a bad tax, shouldn't it be abolished?

VAT in itself is not a bad tax, although it is regressive in that it tends to impose an undue burden on those with least. The problem with VAT is the way it is administered. In a survey of business problems throughout Europe, only UK businessmen thought VAT presented problems.

Do Customs & Excise collect VAT in other countries?

VAT is mainly collected in other countries by the equivalent of the Inland Revenue but each country has its own system. Customs usually become involved with VAT on imports.

VAT was imposed on us owing to our accession to the EC. Would matters improve if we left the EC?

Not really. The Government is too dependent on this tax. It is increasingly popular with governments throughout the world. It is being introduced in East European, African, and Pacific countries. I have friends who have left the UK to be VAT practitioners in Singapore, Uganda, and Canada.

With all its problems, is VAT very expensive to collect?

No. One of the attractions of VAT for governments is that it is very cheap to collect. It costs the government less than 1p in the £ to collect. This is less than any other major tax. The real cost, however, is to the taxpayer, who acts as an unpaid tax collector.

How much VAT is collected?

VAT now comprises 25% of all government revenue and the net take is £37 billion. It is not inconceivable that within the next few years VAT will be the major source of revenue to the government.

Is not VAT distortive?

One of the chief aims of VAT is to avoid distortion. Distortions in the UK VAT system are of our own creation. It is certainly less distortive than was purchase tax and selective employment tax (which it has replaced). These were applied to a narrow range

of good and services and were levied on only a relatively few people. The tax could easily be avoided by changing specifications of goods. It is also less distortive than the old German system of a 'cascade tax'. That involved a low rate of tax which applied to each transaction (like VAT). Unlike VAT no deductions of the tax were allowed so that even a low rate of tax brought in large amounts of revenue if goods went through a chain of transactions – hence the creation of conglomerates in Germany to avoid the tax being incurred. Also, VAT is less prone to avoidance than a sales tax as VAT is collected all the way down the chain of supply; a sales tax can be completely avoided if a retailer does not disclose sales.

Should not a deduction be allowed for wages?

No deduction is allowed for wages because no VAT is incurred on salaries. To allow a notional deduction would change the nature of the tax from a turnover tax to a tax on profits and from a tax on the final consumer to a tax on the business (like corporation tax). It must be remembered that VAT is not actually borne by a business but by the consumer (other than exempt businesses such as banks and insurance companies, which are treated as consumers for purposes of VAT). A business incurs VAT on its purchases but can reclaim this VAT from Customs & Excise. It collects VAT from its customers which it then pays over to Customs & Excise. In the main (though there are some exceptions), the effect of VAT on a business is neutral. To allow a notional deduction of wages would destroy this neutrality and would be a significant drain on the Revenue.

As VAT is such an unpopular tax, should it not be abolished?

All taxes are unpopular!

Notes

1. The VAT liability of any supply is determined by its tax point. This is normally; the date the goods are delivered or the service is completed, the invoice date or the date cash is received. In order to advance the tax-point to forestall the effects of an imminent change in VAT rate, the customer will normally prepay his supplier (note – an invoice does not create a tax-point for a zero-rated supply). Thus, if a member of the public pays the electricity or gas board an extra £500 in March 1994 for future supplies of fuel or power, the next £500 worth of fuel will be supplied VAT free – even if VAT has been imposed on fuel by that date. It is important to make it clear that the payment is a prepayment otherwise the payment may be returned or not treated as a prepayment by the electricity or gas board. No doubt the gas and electricity boards will be contacting their customers in due course.
2. Composite Supply occurs when a number of items which have different VAT rates are supplied together as an indivisible supply. Thus, a tin is standard rated; baked beans are zero rated; a tin of baked beans is an indivisible supply and is zero rated. A Mixed Supply is when two or more supplies of goods or services are supplied together but retain their individual VAT rates. Thus AA Membership is a standard-

rated service but the AA Handbook is zero rated. It is often very difficult to distinguish Composite from Mixed Supplies.

3. Normally, VAT is due on the supply of goods and services whether or not money has been received, but if a taxpayer is operating a retail scheme, VAT is not due until cash is received. The cases of Tron Theatre and Courage were discussed by the late Victor Durcatz in *VAT Intelligence*, December 1992.
4. *Assessments*: If an error is noted by Customs & Excise, or if it is thought tax has been underpaid (for example, by failure to submit a return), an assessment will be raised. This is, as the term implies, 'an assessment' of the tax due, made to the officer's best judgement. The taxpayer has the right to appeal but the emphasis is on him to prove the assessment is incorrect, not on Customs & Excise to show it is right.

OUR PRESENT DISCONTENTS

On Wednesday 29th September 1993, Stephen Hill, Managing Director of LICA Development Capital, author of "Lions led by Donkeys" and editor of "Visions of Europe" (to mention just two recent titles) spoke to members of the Economic Research Council.

His wide ranging address touched upon the recession and then discussed some underlying causes – causes as widely drawn as corrupt attitudes, inappropriate use of inaccurate statistics and the misinterpretation of economic cycles.

Unfortunately, no full record of the meeting is available but one section was noted.

"There are two Primary Factors of production. The first is Land, a concept that can be expanded to include property generally and other securities which yield returns. The second is Labour – the application of human effort, skill and initiative. 'Land' can be said to be used rationally because its use is a matter of calculation whilst 'Labour' might be said to be an irrational factor insofar as the effects of emotions and motivations affect each of us.

The incidence of taxation in a modern mixed economy can only fall on one or other of the two primary factors. There is nothing in the man-made world that is not created from the two primary factors.

For example, payroll taxes are a tax on labour; council tax and business rates are a tax on land and buildings; Value Added Tax is a tax on both land and labour. Politicians, such as our Chancellors from 1979 to the present time, love Value Added Tax as it is hard to organise lobbies against it.

The incidence of taxation is of absolutely vital importance in a modern mixed economy. This is because taxation, public expenditure and public borrowing are

inflationary forces if carried beyond Degree.

Secondly, taxation is an affliction on whatever is taxed. If you tax consumption, you reduce demand; if you tax employment, you will foster unemployment; if you tax property, you will reduce its value; if you tax stock exchange transactions, there will be less of them; if you tax capital gains, you will discourage investment.

This fundamental law of economics should be seen in the context of the two primary factors of production. This is the single most significant failure in modern economic practice.

I shall attempt to demonstrate this by pointing out how HM Treasury, and its foreign counterparts, have built completely unsustainable economic fiscal structures through nescience, or forgetfulness, of this fundamental economic fact of life.

When we look at the UK economy – I am looking at the 1992-93 Red Book which sets out Britain's 1991-92 budget – we begin to see some alarming figures. General Government Receipts were £226.5 billion for that year and the PSBR – wait for it – was the princely sum of £8.3 billion, giving a Planning Total of £234.8 billion.

The first obvious structural flaw involves the second largest expense – the largest after Social Security of £58.3 billion is Central Government Support for Local Authorities of £52.5 billion. This hand-out to Town Halls is only marginally less than the total take from Income Tax of £59.6 billion.

In 1990 Local Authorities themselves only raised £13.9 billion. In effect Local Authorities are raising in taxation under 20% of their expenditures, of which about £20 billion are admittedly for education. Nevertheless, the simple fact is that we are taxing employment in industry in order to subsidise Local Authorities, or more precisely under-taxing property values. That is how the failure to observe the two primary factors of production, land and labour, as regards the incidence of taxation boosts property values and decimates real production.

It is hardly surprising therefore that we have endured the longest and deepest post-war recession, with record unemployment along with record debt secured on properties of all types."

IMAGINATIVE SOLUTIONS – NO 2: MORAL DECADENCE

By Christopher R. Havergal

The problem

The rapidly growing moral decadence of British society during the last half century from World War II has led to a massive loss of belief in personal reliability and integrity, a loss which continues to erode and threaten the very existence of our political, industrial, and family institutions.

Also the continual riddling of the electro-magnetic sphere with 'radiations' of permissive intellectual material of all kinds is continually enfeebling the soul of man, without which no imaginable civilisation can survive. The dire and growing effects of this process are evident everywhere, and they are typical of how this Country tends to win her hot wars by irresistible morale, only to lose the inter-war peaces by internal strifes and moral decay.

Consequently, in industry there are few of today's businesses in which those who work on the shop floor can trust those at the top not to run away with often much more than their fair desserts and perks; while those at the top, for their part, cannot trust their employees not to run away with the jobs and savings of their fellows, by forever pressing for more and more money for less and less work. Such money can of course only be found, either by increasing mechanisation, and/or by proportionate currency devaluations; and the latter also react against the poor and thrifty, by robbing the purchasing power of their savings not to mention other inflationary spin-offs. All such social evils are eating away at the disciplinary fabric of British society as never before.

The Solution

It would appear that effective reformation can come only from an espousal of one or other of the following options:-

OPTION (1): A return to a powerful moralising Faith which demands that for the love of our Creator (instead of for the love of self or wealth) we have a duty to love and therefore to work for our neighbours as much as we love and work for ourselves. All others than ourselves are of course our neighbours. Reduced to crude simplistic terms this means that, irrespective of remunerations, and because we are human, we have a primary obligation to divide our twenty-four-hour days so that we devote: about eight hours to supplying our neighbours' wants and needs, about eight hours enjoying our own devices and recreations, and about eight hours in sleep. Result: Health, Wealth, and Happiness for all.

OR

OPTION (2): The somewhat unlikely possibility of being able to acquire the commanding services of a removable, beneficent Dictator, who would drive everyone into exemplary living by wielding the most savage reprisals and punishments on: (a) parents who will not bring up and discipline their offspring so that they become tolerable to their teachers, their elders and betters, and themselves. (b) Schools which will not punish or expel or rusticate any pupil (aged six or more) who threatens to take, or takes, or mars, the lives of his teachers, or of his elders, or of his peers. (By 'his' is also meant hers.) (c) Industrial owners and administrators who award themselves high increments and perks while holding down the rewards and remunerations of those who have helped to fund them, or when dismissing the latter altogether. (d) All others in organised industry who allow Trade Unions and similar associations or shop stewards to harass their employers for more real money in exchange for no more real work.

OR

OPTION (3): So largely motivated by unbridled selfishness envy and greed as we are at the present time, we continue to career implacably onwards towards an annihilation of all life on earth by an exponential progress through poisoning the environment to eventual nuclear warfare.

Looked at More Generally

Although a will to target Option (1) should by rights spring from the heart and soul, history and sheer expediency suggest that Great Britain should give a lead, by presenting to the world at large a more enlightened motivation for our civilisation, and should do so urgently.

It may perhaps be of some interest to recall that the age of the world is 4.5 thousand million years, and that a period of ten thousand years will more than cover the recorded (as distinct from the biological) history of man. When these two periods are scaled down to what might be called the Twenty-Four-Hour Clock of Creation, the whole recorded history of man occupies barely a fifth of a second before that clock strikes midnight – hardly a flicker in geological time. Surely we in our far more minuscule generation must not allow our baser motives to become the destroyers of what may well be the most recent and finest flower of the whole vast universe in which we humans have the honour to live and move and have our being.

It would appear therefore that Option (1) offers almost the only promising path for us to walk in, during the next several billion years before the sun is expected to wane as the earth's energiser.

We need great moral strategic leadership much more than mathematical or empirical adjustments. Let us hope that such leadership will appear before it is too late.

THE EU AND THE DOMINIONS 1994

Sometimes one finds in small circulation publications, assessments which merit expression and debate elsewhere. The following passage, written by R.H.W.Cox for the New Covenant Times is surely such a case.

To enter the Common Market we had to withdraw from a potentially massive Commonwealth market in which we were being given preferential treatment for our manufactured goods in return for allowing the free and unfettered entry of various vital food products.

Our action in joining the Common Market brought disaster to many producers - our own kith and kin - in Canada, Australia and New Zealand. Further damage was seen at airports and seaports where travellers from Common Market countries were treated like

Britons returning home and often invited to use the same Customs and entry facilities, whereas *Dominions nationals* - many of whom had risked everything to defend Britain in World War II - were treated in the same way as foreigners.

The reaction of the great Dominions to such revolting treatment was varied. The people of New Zealand, the most demonstratively loyal dominion, have retired into a hurt silence; Canada has sent Britain into a kind of political Coventry and tightened her political links with the United States. She has, for example, joined with Mexico and the United States to form a North American Common Market considerably larger in area and population than the EEC.

Australia has shown her justified contempt for Britain by launching a movement which would exclude the Crown from Australian public life by making Australia a republic. At the last count nearly fifty per cent of Australians, many of them born in the United Kingdom, appear to be in favour of Australia becoming a republic.

CHINA - THE NEXT ECONOMIC SUPERPOWER

William H. Overholt, Published by Weidenfeld & Nicolson 1993. Price £18.99

On China, we all have problems of perspective. The land is vast and we can compare it in size to the USA. The population is yet larger - something like the USA, the EU and Japan combined - or, more simply, about 10 times Japan. Climate, terrain and raw materials favour the production of both wealth and power.

But how is one to see China's current economy and recent growth? How is one to assess China's foreign policies - particularly with regard to Hong Kong? Will China be a force for stability or for instability in Asia?

We need an informed guide who can assess and interpret events convincingly. A scaremongering guide could prove dangerous whilst an unrealistic guide, worthless. Overholt has written the book we need.

A main thesis is that there are alternative routes from 'socialist dictatorship' (ie communist countries and third world dictatorships) to 'market democracy' (ie OECD type countries). One route is to reform first the political structure and then expand the economy, and the second route is vice versa. Overholt shows that whilst Russia is failing via the first, China is succeeding beyond the wildest dreams via the second.

Meanwhile Governor Chris Patten in Hong Kong comes in for withering condemnation for his handling of Hong Kong-China relationships. Patten seems to have just two aims - to enable Britain to extract as much as possible of Hong Kong's wealth before 1997 via lucrative contracts for ill-judged construction projects awarded to British firms, and to maximise political tensions between Hong Kong and China and within China itself by naively demanding political reforms in Hong Kong before 1997. The problems do not originate at the professional level - Britain's Civil Service, Colonial Service and 'Sinologists' are, it seems, as horrified as the author. Rather, top level

political decisions are being taken *against* professional advice – political over-ruling onto a dangerous course.

The author's view is clear. In policy towards China we should take a "steady as we go" approach. We must not expect too much but we can applaud change and progress. China will make mistakes but it will only make matters worse to over-energetically criticise. In general terms, events within China are moving dramatically in the right direction. And those events are being borne along on a rushing tide of economic development just as they did, on a far smaller scale in the 1960s in Taiwan, South Korea and Malaysia. For investors, the message is if you can find the right introduction, forget Tianenman Square and invest in China, NOW!

J.B.

LETTERS

A Response to Imaginative Solutions No 1: Unemployment from Mr William Armstrong

Dear Sir

I have been a member of the Economic Research Council for many years and was a friend of the late Edward Holloway.

Your approach to the unemployment situation was novel and interesting. Undoubtedly there are many jobs which might be viable at £100 per week (£50 + £50) which are non-starters at the moment.

However two points occur to me:

1. I do not follow your arithmetic. If every participant (including the unemployed) gets £50 per week surely the clawback will be only 25% (ie tax) of £50 for those now in "normal" jobs, leaving a shortfall of 75% of £50 multiplied by say 20 million from said "normal" participants.
2. Without wishing to offend the Equal Opportunities Commission I am not sure that attracting more women into the workforce is a good idea. There is a school of thought which suggests that married women with children should stay at home releasing jobs for people presently unemployed. We may just have to make do with less cars, dish aerials, etc. Hardly the end of the world!

Bill Armstrong
17 Deepdale Avenue
Scarborough
YO11 2UQ

The suggestion implied raising tax rates such that the average earner pays extra tax equal to the suggested £50 he receives. Editor

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