file

10 DOWNING STREET

From the Private Secretary

15 April 1982

<u>VAT ON GOLD COINS</u>

Thank you for your letter of 8 April, in which you gave a fuller explanation of the decision to impose VAT on gold coins.

The Prime Minister has considered your letter. She believes that it was a mistake to impose VAT on sovereigns. She has further commented that this was an unnecessary move to make; and, further, that there is something dishonourable about it. We had a word about it this morning, and you undertook to provide a further note on the reasons for imposing VAT on sovereigns. I would be grateful if you could arrange for this to be sent here before close on Friday 16 April.

M.C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury

CONFIDENTIAL

CONFIDENTIAL

You have made a mistake in imposing VAT on Sovereigns. It was unnecessary and I think it is quite wrong and there is something totally dishonourable about it. MT

(1)

Prime Minister

In the light of this explanation, agree to allow matters to rest?

(Please see attached letter of apology)

MCS 8/4

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 April 1982

Michael Scholar, Esq.,
Private Secretary,
No.10, Downing Street

Dear Michael,

Thank you for your letter of 2 April, in which you asked for a fuller explanation of the decision to impose VAT on gold coins, on its reception, and on the future prospect.

The immediate and pressing reason for imposing VAT on legal tender gold coins is to stem the serious loss of revenue through VAT frauds, which have been organised systematically by known criminals. There has been a largescale and highly successful investigation by Customs and Excise, which has made clear the existence of a major gap in the defences against VAT fraud, and which called for decisive and prompt action.

The practice has been to purchase large quantities of tax-free legal tender gold coins and melt them down to convert them into gold bullion bars which are liable to VAT. These are then sold through secondary dealers to arrive eventually on the London Gold Market or in the hands of gold jewellery manufacturers. The next step has been for one of the secondary dealers, himself registered for VAT, but an associate of the criminals, to charge his customer VAT on the gold bullion bars and abscond with the VAT before payment is due to Customs and Excise. The customer is able to recover that VAT as input tax in the normal way, but as the seller of the gold has disappeared, the Exchequer loses 15% of the value of the gold - often a considerable sum. In the six cases of this type so far uncovered by Customs and Excise the loss of VAT is estimated at £23.5 million.

Other frauds involved the importation of genuine gold bullion bars, on which no tax was paid at importation because the fraudulent importer used the postponed accounting facility (PAS). Again, the trader, with the VAT collected from his customer, disappeared. The total VAT loss in four detected frauds was estimated at £17½ million.

The annual loss of VAT, if these frauds continue unchecked, is estimated at £120 million. After studying all the possibilities Customs & Excise concluded that the only satisfactory way of stemming these very serious frauds - of which the ones discovered represent the tip of the iceberg - was by applying VAT to legal tender gold coins, which would mean the operation was no longer profitable.

Why?

To prevent frauds involving the importation of taxable gold bullion bars or taxable gold coins without paying VAT at the time of importation, limitations have been imposed on the use of the postponed accounting facility in a way which should not harm genuine traders. The effect is to require tax to be paid at the time of importation of gold bullion and gold coins (other than antique gold coins). These restrictions do not apply to importations by the Bank of England and members of the London Gold Market, nor to consignments below £50,000 in value. This figure was agreed with the British Numismatic Trade Association.

There could have been two other approaches to the problem. One would have been to re-impose some form of licensing or control on gold dealing. But this would have been much less acceptable to the trade, as they have made clear in the past, and highly unwelcome to the Government. The other would have been to zero rate all supplies of gold. But this would involve a larger loss of revenue, and would have been clearly contrary to the provisions of the EC 6th Directive. Existing zero-ratings for gold transactions are not affected by the Order. These are for supplies of gold, including gold coins held in the UK, made between central banks or between central banks and members of the London Gold Market, and also for supplies of goods or services in the course of dealings on the London Gold Market.

The exemption of legal tender gold coins was only allowed under the transitional provisions of the EC 6th Directive, and these are scheduled for review at the end of this year. Only Luxembourg also took advantage of these provisions. Since all other Member States apply VAT to legal tender gold coins we would have come under very heavy pressure to come into line with the basic provisions of the Directive.

Customs and Excise met the British Numismatic Trade Association's VAT Committee on the morning of 31 March, shortly before the Order was laid in Parliament. They were clearly expecting the imposition of VAT and were grateful for being given even short notice of the change. Apart from one member, (who subsequently appeared on television) they made no suggestion that the charge would severely damage their trade. They were fully aware of the likelihood that at the end of the year the transitional provisions would lapse anyway.

It is worth noting that Germany imposed a 13 per cent tax on legal tender gold coins in January 1980. Dealers there protested strongly at the time, but it is reported that their fears proved to be greatly exaggerated. South African producers say there has been a steady rise in the demand for Krugerrands in Germany after an initial decline which is invariably associated with the imposition of tax on goods that were previously not taxed.

The Bank of England were consulted in confidence about the position of sovereigns. There could possibly be some impact on sales of bullion sovereigns, and hence loss of some of the small income (currently running at around £5 million a year) for the official gold reserves from the modest premium over the value of their gold content charged on the price of new sovereigns. But this is not at all certain. The bulk of bullion sovereign sales is overseas and is zero-rated for VAT. So far as purchases by UK residents are concerned, there would be no change in the competitive position of the sovereign against the Krugerrand, and purchasers would know that when they came to sell the 15 per cent VAT would be reflected in the selling price. There would also be a loss to the Royal Mint from their sales to collectors of 'proof' sovereigns. The profit margin on these is much higher than for bullion sovereigns, and the Mint think that in current conditions they would probably have to absorb the VAT, reducing their profits by the order of £½ million. There would be an additional loss to the Treasury of a probably rather greater amount through loss of seignorage fees. However, neither the Bank of England nor the Treasury thought these concerns were sufficient to delay action, when set against the loss of revenue through fraud.

Unless it is offsetting that loss

As to the future, it is of course possible that those involved will turn to smuggling in an effort to obtain gold (or other valuable items) VAT free. But this is a far more hazardous operation involving them in far greater financial risks than the present type of VAT frauds in gold transactions. Moreover counter-operations would not involve so many specialist investigators as enquiries into complex commercial frauds, which are a long and complicated process. Customs and Excise Investigation Division's resources have been diverted as a result from other important areas of work; for some time now over half of their VAT effort has been directed at these frauds.

The Economic Secretary has spoken to Government backbenchers who have experienced either interest or concern about this question. Without exception all have accepted that we had no choice but to act as we did, even if they did not like the decision.

Yours ever,

Peter

P.S. JENKINS

PERSONAL AND CONFIDENTIAL

2pps

Prime Minister (2)

MCS 8/4

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 April 1982

M. Scholar, Esq.,
Private Secretary
10, Downing Street

Dear Michael,

VAT ON GOLD COINS

Thank you for your letter of 2 April reporting that the Prime Minister would have wished us to consult her before deciding to impose VAT on gold coins. I am sorry that we did not think to do so.

The matter was one which Treasury Ministers felt should be handled with despatch. They were first informed on 2 March of the scale - some £120 million a year - of VAT frauds involving transactions in gold. They were clear that early counter-action was required.

At the Chancellor's request, the Economic Secretary - whose portfolio of course covers Customs, the Mint, and banking matters - took the lead in the inter-departmental analysis of the appropriate response. His conclusion was that there was an overwhelming case for quickly ending the VAT exemption of legal tender gold coins: for the reasons described in Peter Jenkins' separate letter today, this was identified as the only satisfactory way of stopping the loophole which made substantial and systematic frauds temptingly easy.

The Chancellor was consulted throughout. On 26 March the Economic Secretary reported that he thought it right that an Order be laid on 31 March: the Chancellor agreed. The Economic Secretary also suggested that the Prime Minister should be informed: the Chancellor authorised the issue of Peter Jenkins' letter of 29 March to you.

Clearly that letter should have been fuller and earlier; and the point has been carefully noted. But I hope that the facts set out in Peter Jenkins' letter today will persuade the Prime Minister that the substantive decision was infact right.

Yours ever,

John Kerr

J.O. KERR