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MTIC Fraud: An Innocent Explanation?

MTIC fraud

Hammad Baig

is a Tribunal Advocate and legal consultant and can be contacted on either 07946 878708 or baig.hammad@gmail.com

Phil Rimmer

is a Director at M&R Tax Advisers Ltd. and can be contacted on either 07590 047545 or phil@mandrtaxadvisers.com Website: www.mandrtaxadvisers.com

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What is MTIC Fraud?

Missing trader intra-community ("MTIC") fraud can arise in a number of permutations; however, the essential elements are that a taxable person acquires goods from another European Union Member State free of VAT, fails to fulfil

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his obligation to self-assess and remit VAT to HM Revenue and Customs (“HMRC”) and subsequently disappears (becoming a “missing trader”, in HMRC parlance). The missing trader deliberately disrupts the smooth running of cross border VAT systems in place to implement the destination principle in cross-border intra-community sales.

In such inter-Member State trades, a zero rate is applied to the transaction by the seller's Member State, but the purchaser's Member State requires a reverse charge, by the purchaser, to re-establish the VAT (at the destination jurisdiction's rate). Missing traders exploit this situation by reporting the purchase (upon which no net VAT is due), quickly making a re-sale of the goods with VAT, collecting the amounts due, and then vanishing without remitting the VAT that has been received.

According to HMRC estimates, MTIC fraud has caused billions of pounds worth of tax loss within Member States, at times disturbing the balance of payments between states. This resulted in a significant crack-down by HMRC during the mid-2000s in the wholesale mobile telephone and computer component industries in which MTIC fraud was deemed to be rife, giving rise to large-scale investigations by HMRC in the UK and by the tax authorities of other Member States.

Redhill Checks

To combat the fraud, HMRC established a team at Redhill to concentrate on the trading activities of alleged MTIC mobile phone and computer component traders. The traders were asked to provide copies of detailed due diligence material relating to businesses with which they proposed to trade, together with details of the transactions themselves, in advance of any proposed deal. This provided HMRC with the opportunity to recreate supply chains either in real time or subsequently, establishing the full route of trading both in the UK and overseas. HMRC have, however, maintained that monitoring these supply chains in real time has not always been possible because of the shortage of resources.

The Circularity of Payment in MTIC Supply Chains

The line of argument often adopted by HMRC in MTIC cases is that money can be shown to have moved in a circular manner between and around the businesses within the supply chains, both in the UK and overseas. That is to say, the money, and also at times the same goods, travel in a circle, often repeatedly. This apparent circularity previously gave rise to the term “carousel fraud” in relation to what is now known as MTIC fraud. The only plausible explanation for this circular movement, according to HMRC, is the knowing participation in the fraud by each trader within the supply chains; an allegation which, coupled with the “should have known” limb of the legal test for proving knowledge or means of knowledge of the fraud in MTIC cases (as established by the European Court of Justice in July 2006 in the key case of *Axel Kittel v. Belgium and Belgium v. Recolta Recycling SPRL*), unsuspecting innocent traders may find near impossible to refute.

The model propounded in this article seeks to provide an alternative explanation both for the apparent circular movement of funds and in relation to MTIC fraud more generally. Before we talk about the alternative, it is important to point out here that in many cases, the money does not in fact travel around in circles: the funds may end up back where they started but this does not mean that they necessarily repeatedly circulate.

The alternative model is based upon the age-old economic principle of demand and supply. To explore the alternative, we use the very facts HMRC rely upon to prove their case; however, by contrast, we seek to establish that the fraud can be perpetrated and funds can move in a circular manner without the knowledge of all traders in the supply chains.

The Alternative Model

To put the model in simple terms, we focus upon a short hypothetical supply chain. It involves a foreign trader (“FT”); an importer, usually the missing trader (“UKT1”); a buffer trader within the supply chain in the UK (“UKT2”); and an exporter of the goods from the UK (“UKT3”).

Since UKT1 is a missing trader, we invite you to consider that FT and UKT1 are conspirators in the fraud or indeed, that they are for all intents and purposes one and the same entity. To develop this theme further, it is possible that, in order to defraud the UK tax system, FT registers a dummy company in the UK, namely UKT1. UKT1 then advertises its involvement and availability in the grey market in (for example) mobile phones or computer components, using a variety of online forums, posing as a supplier of a specific product (“P”). Simultaneously, FT places an advertisement in the grey market as a purchaser of identical product P. This allows FT both to sell P into the UK marketplace and to collect the price of the product plus VAT through UKT1 which it controls, without there being any knowledge on the part of UKT2 and UKT3 that a supply chain is being established for fraudulent purposes. In this model, trading in fact moves in the opposite direction to that contended by HMRC: it moves from the top downwards in the schedular analysis upon which HMRC typically rely in MTIC cases, that is from FT to UKT1 as opposed to from UKT1 to FT, as in the HMRC version.

By contrast, it is usually HMRC’s position in MTIC cases where the circularity of money can be proved that all of the traders in the supply chains are in cahoots with each other and therefore have actual knowledge of the fraud. Other factors such as rapid payments made between traders through online bank accounts and the conduct of back to back transactions are also cited by HMRC as providing further evidence of the fraudulent intent and knowledge of all traders concerned.

This HMRC analysis, we submit, infers and requires a very high degree of planning and participation on the part of potentially very numerous UK and international businesses in committing the fraud; businesses which may have been established over many years rather than merely springing up overnight for the sole purposes of a fraudulent scheme. Such a scheme would necessarily require a “ring leader” to recruit traders and convince them to take part in the fraud, at the personal risk of being identified as such to the tax authorities by his potential recruits. Such a ring leader would also have to convince one UK-based trader within the supply chain to export the goods and request a repayment of VAT from HMRC in order for the fraud to work, a prospect which would surely put off many, given HMRC’s hostile attitude to the relevant trade sectors and their “extended verification exercises” of VAT repayment claims over many years in the mid-2000s. He would also have to convince the importer to go missing.

The Nature of the Grey Market

The grey market combined with the power of modern technological advancements in communication generates and shapes the modern trading market. This modern market is buyer/demand led (namely FT, in our model), and the supplier in the UK (UKT1) in possession of the product that is consistent with the demand (which we refer to as the “product dimensions”, ie. the specification, quantity, price and timing of supply of the product) controls the market.

In this market, suppliers such as UKT1 would be contacted by a large number of traders (such as UKT2 and UKT3 in our model), all simultaneously attempting to find the supplier with goods that meet the exact product dimensions required by the fraudulent FT. We submit that it would only be a matter of time until such a trader would establish the availability of

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the required product P with UKT1 and the supply chain would inevitably form as required by those participants within it who are fraudulent.

The fraudulent traders may also encourage unsuspecting participants within the supply chains to open bank accounts with the same offshore bank, on the basis that this will facilitate the smooth transfer of funds.

Traders such as UKT2 and UKT3 are able to increase their chances of successful trading by expanding the number of traders on their books. They seldom carry stock and their business model is based upon brokering a deal between two parties. Therefore, the more regular business contacts they have, the more likely it will be that they will be in a position to successfully match a supplier with a purchaser. It is essentially a numbers game in which there are more brokers/purchasers than suppliers. To be a supplier, it is necessary to have sufficient funds to acquire, store, insure and advertise the product P. By contrast, to operate as a broker, all that is required is a purchaser who is interested in a good deal.

The broker's role is to find a supplier who can meet the product dimensions required by his purchaser. The purchaser increases his chances of success both by seeking the supplier himself and by informing as many brokers as possible of his demand requirements. The brokers then contact other brokers, suppliers and purchasers, to establish whether they can either meet the demand themselves or are otherwise able to locate the supplier. This process gives rise to the formation of supply chains as participants utilise their business contacts in search of product P required by the ultimate purchaser.

The participants within the supply chains, assisted by today's instantaneous communications capability, are able to readily adjust their profit margins by negotiation with their immediate customer and supplier in proposed deals, where a further trader joins the chain during the process described above. However, the supply chains do not go on indefinitely, due to the price and quantity constraints placed by the ultimate purchaser. Often, leads or chains may simply fall by the wayside, uncompleted. These processes play out in a short time span, at most perhaps one or two days. Furthermore, one active trader may be involved in several potential supply chains at the same time, thereby having very little time to note down actual details and generate transactional documents until the deal is finally struck. In response to HMRC requirements generated (inter alia) by the Redhill office, traders therefore tended to produce template packages of deal information and documentation.

The moment P is found, the supply chain can be completed. To reiterate, a specific product P is made up of specification, quantity, price and timing of supply.

These attributes — the product dimensions - become the tool by which FT can infiltrate the market and defraud the Treasury without ever stepping foot into the country. Consider P again: it can be any product. For ease of demonstration, we refer to wholesale trading in mobile phones. A consignment of mobile phones will have all of the attributes defined above, but to this we add an extra dimension, that of the location of P. It is our contention that at any given time, it is more likely than not that there is only one consignment of P within the grey market which is available in quantity A, with specifications B, of price C, being sold at time and date D and located at warehouse E.

FT is able to determine with precision that the mobile phones which are being offered to him for purchase have the same attributes A, B, C, D and E as that consignment which he ostensibly sold to UKT1 at the beginning of the supply chain; and therefore comprise the same mobile phones. Specifications may include the make, model, colour, IMEI number (effectively, the serial number) and any other quality related to the physical and software nature of the mobile

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phone. Location refers to the physical location of the phones, in many cases a freight forwarding agent. Quantity, price and timing are self-explanatory.

Even in the (we submit) unlikely event that the availability of two or more consignments of P with the same attributes A, B, C, D and E arises, nevertheless there is no loss to FT if his mobile phones are sold into a different supply chain in such circumstances. This scenario is only likely to arise where UKT1 is concluding a deal with an unrelated purchaser and FT is simultaneously purchasing in another supply chain. The end result is the same: UKT1 receives the cost of P plus VAT and FT purchases the product that he has ordered, even if it is not the original product. UKT1 would not sell without first obtaining funds: such is the nature of the market, the purchase follows the sale; therefore, UKT1 inevitably obtains the sale price before releasing P. Further, consider the position where FT purchases phones from UKT3, which in turn bought the phones

from UKT2, which had bought the phones not from UKT1 but from the unknown quantity UKTX. In this scenario, FT has obtained phones at market value or below, although the money has not in this case circulated back to it; nevertheless, it has the phones to resell; and UKT1 has sold the intended consignment of phones on to another, collecting the sale price of the phones and VAT, thereby completing the circle.

The alternative model therefore demonstrates how the fraud may be perpetrated without the knowledge, actual or deemed, of certain traders involved in the supply chains.

With recent cases heard in the Tax Tribunal and HMRC's success in acquiring more data from the computer servers of banks such as the First Curacao International Bank, it has become apparent that at times, the same computer IP addresses have been used by different companies involved in the same chain of supply. This indicates that at the time of the money transfers, the perpetrators of the fraud (FT and UKT1, in our model), were often operating from the same premises. We submit that this is a highly significant discovery which tends to confirm the alternative model which we have propounded in this article.