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The Changing Face of MTIC VAT Fraud

Missing Trader Intra-Community Fraud

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This is the third and final instalment of our three part article examining the foundations of Missing Trader Intra-Community VAT fraud ("MTIC" fraud); an alternative view of how the fraud may be perpetuated without the knowledge (actual or deemed) of certain traders involved in the supply chains; developments in MTIC fraud since the days of the proliferation of carousel fraud in mobile telephone and computer component wholesaling; the steps HMRC are taking to attempt to prevent it from expanding into other industries; the

possible future mutation of the fraud; and, in this instalment, the practical and legal remedies available to an unfortunate business caught up in an HMRC extended verification exercise.

In the previous instalment, we discussed the position of the exporter who has had his VAT repayments withheld while HMRC conduct an extended verification exercise with regard to his claim. To recap: the exporter may, for example, be a motor car dealer who is exporting high value cars to Singapore. The car dealer purchased the vehicles from suppliers in the UK and having been charged VAT on his purchases, he is entitled to reclaim the

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VAT from HMRC since his onward supplies constitute zero-rated exports, subject, of course, to the business providing HMRC with all necessary export evidence. In our scenario, the motor car dealer — “Company A” — may have been exporting a large number of vehicles and submitting monthly VAT repayment returns to HMRC. Company A received notification from HMRC that they intended to conduct an extended verification exercise which would involve supply chain checks on both Company A's suppliers and customers. As we have seen, an HMRC verification exercise may be very lengthy where the checking of supply chains in the UK is involved and even more prolonged when it is necessary to check supply chains outside the EU. We are aware of some exporters who have had their monthly repayments withheld for over a year while HMRC continue to conduct their extended verification exercise. This article examines both the practical and legal remedies available to the unfortunate business subject to an HMRC extended verification exercise.

Initially, in all likelihood, such a business will be unaware of the HMRC enquiry since the first notice it may receive from HMRC will be a lengthy, standardised letter from a HMRC Specialist Investigations Team. This HMRC letter generally commences with the wording “*I have recently received your VAT repayment return for the period ending.... This return has been selected for verification and I am writing to you to explain the reason for this, how long the process might take, what you should expect from HMRC, and what HMRC expects from you while the verifications are taking place*”. The HMRC letter will then go on to point out that the losses to the UK Exchequer from MTIC VAT fraud remain significant. It is important to note that the HMRC letter appears to be a generic one and it may be unclear to our Company A why it has been deemed appropriate to send it to them when their exports are made outside the EU. However, they should be under no illusion that HMRC are investigating both supplies within and outside the EU. Certainly, in the days of mobile telephone and computer component MTIC VAT fraud, Dubai was often used as a convenient landing point for exported goods, to enable the goods to be re-sold to a business back within the EU. HMRC would allege that the goods never left the freight agent's premises in Dubai before being reimported into the EU, thereby enabling the carousel fraud to continue.

HMRC will point out in their generic letter that they are under no statutory obligation to complete verifications within any fixed timescale; and that MTIC fraud continually mutates, so that the nature of the fraudulent transaction chains becomes more and more complex. This inevitably means that it can take HMRC Officers considerably longer to verify chains that may be tainted by fraud.

HMRC state that their Case Officer responsible for conducting the verification of the repayment claim will shortly be in contact. However, they advise that delay may arise in the progress of their enquiries when for example:

- There are problems in securing relevant documentation or where the volume of information to be collected and collated is unusually large;
- Foreign enquiries are involved and that in consequence, further time will be required to enable the relevant overseas authority to respond;
- Enquiries are underway to obtain information relevant to the claim from third parties;
- A physical examination of a sample of the goods is necessary;
- Material has been submitted to policy or legal colleagues for further assistance in the matter; or

- HMRC seek other expert help.

HMRC clearly state that a business should not expect weekly updates on the progress of the verification exercise since this would merely delay the verification activity itself; but they will endeavour to respond to all written enquiries within 15 days.

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It is apparent that Company A will experience delays in receiving its VAT repayment not only with regard to the first return subject to HMRC enquiry but also in relation to subsequent returns. Built-in delays naturally arise between the appointment of the HMRC Case Officer and subsequent contact with the business to arrange a meeting to review and uplift business records. For example, Company A submitted its repayment return for the month ending 30 April 2012 on 10 May 2012. It received the standardised HMRC letter on 10 June 2012 and the Case Officer contacted the company on 11 July 2012 to arrange an appointment. The proposed meeting may not take place until early August 2012 by which time Company A has submitted three further VAT returns for May 2012, June 2012 and July 2012. Company A will already be starting to experience severe cash-flow problems and the HMRC extended verification exercise is yet to commence!

Company A will next receive further letters from HMRC to advise it that the VAT repayment returns for May 2012, June 2012 and July 2012 have also been selected for extended verification. At this stage, the HMRC Case Officer will commence the exercise of conducting supply chain checks; requesting further documentation from the business; and undertaking any further checks which he/she considers necessary. Soon, the total of outstanding VAT repayments due from HMRC will increase considerably and the business will be in the awkward position of considering whether it can continue to trade or has the facility to borrow money to enable it to do so. So what in practical terms can a business do to attempt to resolve the matter? Certainly it should respond to all HMRC requests for information as quickly as possible and try to accommodate the Officer when he/she requests an appointment. What else can it do? We consider some potential action below.

1 Security

While the verification is taking place, HMRC will consider releasing the repayment on a “without prejudice” basis, subject to the provision of security (under paragraph 4 (1A) of Schedule 11 to the Value Added Tax Act 1994) in the form of an acceptable guarantee from a bank or other financial institution approved by HMRC and for a sum agreed by HMRC. This on the face of it would appear to be an impractical arrangement for HMRC to suggest since any business approaching a financial institution for security while under scrutiny by HMRC is unlikely to receive a favourable response.

2 Interim Payments

However, HMRC may also be willing to make interim payments. They will consider:

- Repaying VAT on general expenses;
- Paying “VAT credits” claimed on the VAT returns upon receiving security, as referred to in the previous paragraph;
- Interim payments in the case of hardship. HMRC will request the provision of extensive financial information, including the most recently filed business accounts; management accounts; a cash-flow forecast; copies of bank statements; details of any investments held by the

business; details of any current overdraft/loan facilities; evidence that a bank has been approached for a loan; evidence that the shareholders have been approached for further investment; the value of current trade debtors and trade creditors; and any other information which the company can provide for HMRC consideration. Businesses should however be aware that even the submission of this information and documentation may not resolve the issue and may instead generate a further “paper trail” as HMRC seek additional information before deciding whether to make interim payments.

3 Alternative Dispute Resolution (“ADR”)

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It is likely that a meeting held with the Case Officer will be a frustrating experience for a business involved in an HMRC extended verification exercise. The Case Officer may provide very little information on the progress of his/her enquiries, doing so in general terms alone and refusing to be drawn into discussing specific supply chains. In any event, the Case Officer will be required by a Senior Officer to submit his/her findings to the HMRC Policy Team before a decision is made to release any VAT refund, thereby generating further delay.

In 2011, HMRC launched a pilot to trial an approach termed Alternative Dispute Resolution (“ADR”) in the North-West of England, aimed at improving tax dispute resolution for Small and Medium Enterprises (“SME”). HMRC deemed the pilot exercise to have been successful and extended it to other parts of the country. ADR involves appointing one of a small team of trained HMRC “facilitators” in both indirect and direct tax matters where compliance checks have reached an impasse. Applying ADR has only been considered appropriate in circumstances where no appealable tax decision or assessment has been made. It is our view that businesses subject to HMRC extended verification exercises where no appealable decision or assessment apply are ideal candidates for ADR. Unfortunately, HMRC do not share this view. They believe that to apply ADR in these circumstances would comprise a departure from their established technical or policy view. We are aware that HMRC have rejected extended verification cases for ADR purposes.

4 Formal Complaint to HMRC

HMRC have a formal complaint process which applies where a business is dissatisfied with the manner in which its affairs have been dealt with, with the link <http://www.hmrc.gov.uk/complaints-appeals/> on the home page of their website. Businesses should however be aware that the HMRC complaint process will not generally provide a speedy resolution to their issues. The initial complaint has to be made to the Case Officer for consideration. The complaint is then forwarded to a HMRC Complaints Officer who will independently review the circumstances of the complaint prior to a further review conducted by the HMRC Complaints Manager, should the complaint be unresolved at this stage. Only after this further review has taken place can the matter be referred to the independent Adjudicator’s Office. The complaint process may well take up to a year to be finalised.

5 Complaint to Member of Parliament (“MP”)

It may be possible for a business to approach its local MP to step in to try to resolve the issue. Our experience in this area is that this can often lead to mixed results. Certainly, however, the involvement of an MP in a complaint will encourage HMRC to deal with the issue from the “top down” rather than the other way around.

6 Set-Off of Other Taxes

A business may be under pressure from HMRC to pay other taxes such as PAYE and Corporation Tax but may be unable to do so because of severe cash-flow problems directly caused by the delay to the payment of its VAT refunds. HMRC may be amenable to a “set-off” request. A tax demand from another HMRC department should therefore immediately be referred to the HMRC Case Officer dealing with the extended verification exercise.

7 Judicial Review

It may be possible for a business to bring Judicial Review action against HMRC where they are continuing to deny a refund of input tax. Furthermore, allegations that a HMRC Officer failed to properly address representations made or acted unfairly may also form valid grounds for Judicial Review.

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While it is difficult to outline the circumstances which may give rise to a strong Judicial Review application, businesses should bear in mind that Judicial Review is normally deployed with regard to decisions which involve discretion on the part of the decision-maker.

European Commission and Steps to Tackle the Fraud

The EU Commission is well aware of the threat to the tax system generated by MTIC fraud and has taken steps to tackle the problem. It has set out priority actions required to create a simpler, more efficient and more robust VAT system within the EU. One of the overriding objectives for the new VAT system is to tackle VAT fraud more effectively and a number of ideas have been laid out on how to achieve this:

- 1 The Commission has established a network of national officials to detect and combat new cases of cross-border VAT fraud. This network, Eurofisc, is now operational and is working to co-ordinate data exchange and establish an early warning mechanism against fraud;
- 2 the Commission intends to monitor the full implementation of the Anti-Fraud Strategy, ensuring that all instruments employed against fraud are functioning to full potential;
- 3 In 2014, the Commission will report on whether further action is needed to strengthen or complement these measures;
- 4 Further, the Commission will embark on a number of new anti-fraud projects. The Quick Reaction Mechanism (“QRM”), discussed below, is one such initiative; and
- 5 The Commission has also launched the idea of setting up an EU cross-border audit team composed of experts from national tax authorities to facilitate and improve multilateral controls.

As the success of any anti-fraud measure depends directly on the administrative capacity of the national tax authorities, the Commission will intensify its monitoring of the efficiency and effectiveness of the tax administrations of the Member States.

Quick Reaction Mechanism

QRM is a new tool to combat VAT fraud among EU states. It would enable countries to move more quickly to counteract VAT fraudsters. The mechanism would allow the implementation of a reverse charge, whereby the recipient of goods is liable for VAT rather than the supplier, which could be left in place for up to a year.

The effectiveness of this step is yet to be measured. In the UK, a reverse charge was introduced for VAT in June 2007 as part of the fight against carousel fraud. Despite this, HMRC's 2008/09 annual report revealed that up to £2bn was still being lost to carousel fraud each year. The reverse charge was subsequently introduced in relation to trading in carbon credits. We expect to see the application of reverse charge within other trade classifications in due course.

Conclusions: The Changing Face of MTIC VAT Fraud

The instalments of our article have hopefully demonstrated the changing face of MTIC VAT fraud, no longer confined to the EU or to any particular commodity but extending outside the EU and potentially involving any high-value commodity. Businesses need to be aware of the importance of due diligence conducted both upon suppliers and customers, intended to ensure their credibility.

Those intending to defraud the VAT system continually evolve and reinvent their approach. While both tax authorities across the EU and the EU Commission are attempting to keep pace with the fraudsters, nevertheless tax revenues continue to suffer at the hands of fraudsters and many innocent traders are unknowingly caught up in what seem to be legitimate supply chains.