

BULLETIN

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THE CAROUSEL EFFECT

UK Law dictates that a trader is entitled to offset input tax (purchases) against output tax (sales), and that where the input tax exceeds output tax, the difference can be reclaimed from the Revenue, something deemed to be a right of deduction.

However, certain traders exploit this system using Carousel or Missing Trader in Chain (MTIC) schemes to defraud other companies and HMRC from substantial revenues – estimates put the cost to the Revenue of between £3.5 and £4.74 billion each year.

Carousel or MTIC fraud is common through contrived chains involving highly intricate and plausible transactions. This often involves the supply of high value goods with a tax loss occurring when the VAT charged by the supplier is not paid to HMRC, but is claimed by the recipient.

"Amongst the many intricate and sophisticated methods employed by fraudsters in this area is the activity of bringing in tax-free goods from the EU," explains Challinors' Mark Kenkre. "These

goods are then sold on in the UK, applying VAT, but the sellers then go missing failing to pay the VAT due to the Revenue.

"In many cases, goods are imported and exported again and again, creating 'dirty chains' of traders in spurious 'contra-trading' and MTIC scams in an effort to avoid detection by the investigative authorities. This often proves to be the most profitable form of VAT evasion, but costs the UK economy dearly – up to £25 billion of UK trade is believed to be contaminated each year."

Extended verification

In 2006, HMRC developed a system called 'extended verification' which is applied to certain repayment claims. "Extended verification criteria work to deny payment of any VAT repayment claim if it exceeds a certain amount, if it was in a certain sector – such as mobile phones or computer chips – or the trader had a connection with an MTIC fraud or individual involved in Carousel fraud," explains Mark.

"However, HMRC has come under much criticism for the extended verification process. Traders feel that HMRC is simply operating a blanket approach, which is catching as many innocent traders as it is genuine fraudsters, and effectively wipes out many traders unable to sustain their business without the cash flow of VAT repayments."

Several traders have challenged HMRC and the extended verification procedure in the Courts, the most recent involving Livewire Telecoms Limited and in May, the trader in the Blue Sphere Global Limited case.

"These decisions could have huge significance to Carousel VAT fraud and extended verification," says Mark. "HMRC will now have to prove that the trader knew or ought to have known of the fraud rather than the onus being on the trader."

More information about Challinors Fraud & Asset Recovery Department is available at <http://fraud.challinors.co.uk>

SFO TO STEP-UP SURVEILLANCE

Business people suspected of fraud face dramatically increased surveillance such as e-mail monitoring and phone tapping.

Keith McCarthy, head of anti-corruption and proceeds of crime at the Serious Fraud Office (SFO), has said that the organisation is to use "all available tools" to improve its intelligence-gathering, in the latest effort to counter criticism that Britain is soft on financial crime.

He explained that the surveillance would be conducted via police forces under the 2000 Regulation of Investigatory Powers Act.

The law - which has been criticised by civil liberties campaigners for the wide discretion it allows public authorities - enables the use of techniques such as covert human surveillance, phone tapping and mail interception.

Challinors' Andrew Thomson comments: "This type of surveillance heralds the SFO taking a far more proactive approach to fraud than they have done previously. It remains to be seen if this type of covert activity will actually help in detecting and stopping frauds, particularly financial fraud in business, which is likely to continue to increase in the current economic downturn."



CHALLINORS TAKES UP FRAUD FORUM POST

Mark Kenkre, has been invited onto the Steering Committee of the Midlands Fraud Forum (MFF). The MFF is an industry-led initiative and aims to promote awareness of fraud issues and educate everyone on effective fraud prevention measures.

"Knowledge sharing is a key route to combating fraud, which costs UK businesses and individuals £billions p.a.," says Mark. "The MFF is proving to have an important role in this, and I am clearly delighted to have the opportunity to work with its steering committee members, that include other professional advisors and representatives from the Police authority, in pursuing and achieving its objectives."

www.midlandsfraudforum.co.uk

WHAT A SHAM!

Whilst the most high profile VAT fraud cases relate to Carousel or MTIC fraud, there are several other tactics fraudsters will use to defraud HMRC, and sham transactions are amongst the most common of these lesser-appreciated frauds, explains Arun Chauhan:

"A sham is an act or documents created which do not produce the legal rights they give the appearance of. For a sham to take effect, it does not always require everyone involved in the transaction to know it is a sham.

"This type of fraud is commonly used where a reclaim for input tax is sought, when a trader has purchased goods, paid input tax, and then sold the goods, probably aboard, and as such does not charge the output tax. The difference

is then reclaimed and, if suspicious, HMRC may investigate. However, this presents problems for innocent taxable parties, as 'uncommercial transactions' may be scrutinised and claims withheld on the basis of suspicion.

"A recent case centred on Plasma Trading Ltd, which reclaimed input tax on supposed purchases of platinum – Plasma had submitted a VAT return claiming a repayment of £58K. A subsequent return then claimed a repayment of more than £700K for purported purchases of platinum, which it claimed to have exported to China. Customs rejected the claim, believing the transactions to be a sham. Plasma appealed but was unsuccessful. One key factor Customs relied on in evidence of there being a sham was that the purchase invoices carried the VAT number of British Gas!"

THE NEVER ENDING CAROUSEL

Jonathan Lennon, a Barrister at 23 Essex Street Chambers in London, is widely experienced in fraud, civil recovery and all aspects of the Proceeds of Crime Act 2002. Here, he investigates HMRC's battle with the MTIC Fraudsters.

"HMRC's response to the MTIC problem was firstly to introduce joint and several liability for VAT that had gone unpaid – i.e. other traders could be held liable¹. This applied only to those goods associated with MTIC frauds, like mobile phones, CPUs etc. This gave the possibility of HMRC recovering the VAT left unpaid by the missing trader – i.e. the importer, by refusing input tax credit to the customer; the onus being on the customer to ensure that it was dealing with reputable traders.

"Next HMRC introduced 'extended verification', a procedure involving delaying repayment of input VAT whilst extensive checks were carried out on what were often complex trading chains. This could result in a trader being denied his input repayment for many months and cause hardship to innocent traders.

"The litigation challenges started in the European Court of Justice (ECJ). On 12 Jan 06

the ECJ delivered its judgment in the case of Optigen Ltd; Fulcrum Electronics; Bond House v Customs & Excise Commissioners [2006]. Customs policy had evolved so that HMRC was refusing to repay traders their input VAT on purchases – or allow them to offset against their quarterly output returns. HMRC's justification was that there had been a fraudulent evasion of VAT by the original importer and though the individual traders in the joined case were assumed to be innocent, the withholding of the VAT repayment was on the basis that the trade was not a genuine economic activity but part of a fraud. This argument was rejected by the ECJ who held that where the trader had no knowledge of the fraud, or no means of knowledge, then he was entitled to his input VAT repayment. This policy was underlined in the leading EU authority on this area; Kittel v Belgium; Belgium v Recoulta; ECJ 6/7/06.

"Now the domestic Courts have considered the

issues over the 3 years since Kittel. The leading case is now Commissioner for HMRC v Livewire Telecom Ltd; Olympia Technology Ltd [2009], 16/1/09. The Court considered when a trader could properly face liability for another trader's fraud. The emphasis is now on HMRC effectively having to prove a tacit conspiracy between the trader and the fraudster – i.e. in terms of at least having the means of knowing what was going on, if not actually knowing the identity of the fraudster. In reaching its conclusions, the Court held that the test included an element of the 'constructive knowledge' of the Director – i.e. what, objectively, a reasonable Director should have known – not necessarily what the actual Director did know.

"What is clear is that there are still plenty of cases to keep the new reformed Tribunal system considering these cases for quite some time – and, no doubt, more variations on the same scams will come to light."

IF YOU WOULD LIKE MORE INFORMATION ON OUR FRAUD AND ASSET RECOVERY SERVICES, PLEASE CONTACT:

Arun Chauhan

Joint Head of Fraud and Asset Recovery Department

T: 0121 204 2666

E: arun.chauhan@fraud.challinors.co.uk

Mark Kenkre

Joint Head of Fraud and Asset Recovery Department

T: 0121 204 2665

E: mark.kenkre@fraud.challinors.co.uk

CHALLINORS
SOLICITORS

Edmund House

12-22 Newhall Street, Birmingham B3 3EF

T: 0121 212 9393 F: 0121 212 3422

E: enquiries@fraud.challinors.co.uk

<http://fraud.challinors.co.uk>

¹ S77A of the Value Added Tax Act 1994, added by s18 of the Finance Act 2003, from 10/4/09.