VAT focus

Recent measures countering MTIC fraud

Speed read

Missing trader intra-Community (MTIC) fraud is said to cost revenue authorities around €60bn annually in tax losses. In addition to EU steps to combat MTIC fraud, the current UK Finance Bill imposes fixed penalties for entities entering into a transaction connected with the fraudulent evasion of VAT who knew or ought to have known of the connection.

Anthony Eskander
KPMG
Anthony Eskander is a barrister in KPMG's legal services team. He is a trial advocate and corporate crime specialist, who advises businesses and individuals on financial crime, tax evasion and the corporate criminal offences, AML and counter-terrorism financing and anti-bribery and corruption. Email: anthony.eskander@kpmg.co.uk; tel: 020 3078 3355.

MTIC fraud, VAT fraud and carousel fraud are terms used to describe when a person fraudulently takes advantage of the European single market rule, which provides for the sale of goods between EU member states VAT free. According to Europol, missing trader intra-Community (MTIC) fraud costs revenue authorities around €60bn annually in tax losses.

How MTIC and carousel fraud works

The following example shows how the fraud can be achieved.

- An innocent EU supplier sells an item for £100 to a missing trader, VAT free, in accordance with the EU single market rules.
- The missing trader sells the item on to an innocent customer for £90, charging £18 VAT on the item (£108 total).
- The missing trader does not account to HMRC for the VAT received from the customer.
- Although the missing trader sells at notional loss, he/she earns £8 per item due to the missing trader's deliberate failure to account for the VAT received.
- HMRC incurs a loss where the customer subsequently reclaims the full value of its input VAT, as it is seeking to recover funds that HMRC never received.

When HMRC identifies a fraudulent missing trader, in order to mitigate losses it will often enter the associated claim for input tax into extended verification or alternatively deny the claim. In the event of a denial, the taxpayer can appeal to the First-tier Tribunal (Tax).

Carousel fraud is a similar concept to MTIC fraud; however, it involves a chain of fraudulent transactions between companies in different member states. When all of the companies within the chain are operated as a group by the same person or persons, there is no net loss of money; rather, the price of the product and any VAT charged on it circulates between the companies. Every time the product is exported, HMRC pays the exporter the VAT as an input tax credit. The VAT therefore becomes the profit of the fraud.

MTIC fraud can also occur where the identity of an innocent company is stolen and false documents are created, leaving the innocent company unaware of the fraudulent transactions.

Often employees of companies collude with external fraudsters to create an MTIC framework. This can result in large losses and reputational damage for the company.

With this in mind, companies should ensure their policies and procedures are compliant with the Criminal Finances Act 2017 (CFA). The CFA, which came into force on 30 September 2017, introduces a strict liability offence of failure to prevent the facilitation of UK and foreign tax evasion by a person associated with the company (the corporate criminal offence). Where HMRC concludes that a company did not have reasonable procedures in place to prevent its agents from facilitating tax evasion, the company is at risk of being criminally prosecuted and if convicted receiving large fines.

UK measures

MTIC fraud has increased in size and complexity as the single market has grown. HMRC has attempted to combat the fraud in two ways:

- first, by withholding VAT repayments; and
- second, by requesting powers to impose fixed penalties for all entities entering into a transaction connected with the fraudulent evasion of VAT who knew or ought to have known of the connection.

In relation to the first category, HMRC has withheld VAT repayments from a significant number of traders, the most famous of which was the *Bond House* case (the three conjoined cases of *Optigen Ltd* (Case C-354/03), *Fulcrum Electronics Ltd* (Case C-355/03) and *Bond House Systems Ltd* (Case C-484/03)). In taking this course of action, HMRC has directly and indirectly penalised many innocent traders, in an effort to identify and prosecute the fraudulent traders.

In relation to the second category, proposed legislation is currently found within the Finance Bill 2017–2019 cl 68, which is now before the House of Lords on its second reading (and as a 'Money Bill' cannot be amended).

In terms of specifics, the Bill proposes new sections to be inserted into the VATA 1994. A proposed s 69C states that a taxpayer (T) is liable to pay a penalty where T has entered into a transaction, and that transaction satisfies three conditions:

- it is connected with the fraudulent evasion of VAT by another person;
- T knew or should have known that the transaction was connected with the fraudulent evasion of VAT by another person; and
- HMRC has issued a decision in relation to the supply which prevents T from exercising or relying on a VAT right in relation to the supply, is based on the facts which satisfy conditions A and B in relation to the transaction, and applies a relevant principle of EU case law.

'VAT right' includes the right to deduct input tax, the right to apply a zero rate to international supplies and any other right connected with VAT in relation to a supply.

The penalty payable under the draft legislation is 30% of the potential VAT lost.

Under the proposed s 69D, where a company is liable to a penalty pursuant s 69C, and the actions of the company which give rise to that liability were attributable to an officer of the company (whether an act or an omission), HMRC can specify that the officer is liable to pay up to 100% of that penalty.

Section 69E provides HMRC with the authority to publish the details of any person found liable to pay a penalty pursuant to s 69C where the penalty is based on potential lost VAT in excess of £50,000.

> [In certain circumstances,] HMRC can specify that the company officer is liable to pay up to 100% of the penalty

EU measures

The EU is also attempting to combat MTIC fraud. It is one of the European Union's nine priority crime areas (known as EMPACT priorities) under the 2014–2017 EU policy cycle. Associations such as Europol, in association with Eurojust, have tried to combat MTIC fraud by providing expert support to joint investigation teams (JITs) from member states. That said, Eurojust and Europol are hamstrung by the fact that they do not have the mandate to conduct criminal investigations.

This issue led to the European Commission, on 17 July 2013, proposing a European Council regulation on the establishment of a European Public Prosecutor's Office (EPPO), based on article 86 of the Treaty on the Functioning of the European Union, which, unlike Europol and Eurojust, would have the power to conduct criminal investigations. On 12 October 2017, the Justice and Home Affairs Council of the EU finally approved the regulation, having obtained the European Parliament's consent.

The EPPO will have the authority to investigate and prosecute crimes which affect the interests of the EU, with a focus on crimes such as VAT fraud. Eight member states, including the UK and Ireland, however, refused to participate in the initiative.

The EPPO, based in Luxembourg, will be headed by a public prosecutor and will include a team of investigators, or 'European delegated prosecutors' (EDPs), located in each member state. The Commission has stated that when the EDPs are acting for the EPPO, they will be fully independent from the national prosecution bodies.

The Commission has sought to ensure that safeguards are in place to avoid breaching the rights of individuals and to avoid conflicts between member states and the EPPO. Such safeguards include a requirement that the relevant national court pre-authorise any proposed breach of a fundamental right (such as telephone interception), and confirmation that EPPO investigations will be judicially reviewable by the relevant national courts.

The EPPO has been four years in the making, yet does not appear to be close to being operational. The Commission believes that the office will be up and running by 2020. ■

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- MTIC fraud: prevention is better than cure (Helen Thompson & Daniel Lyons, 8.5.14)