



House of Commons
Committee of Public Accounts

**Standard Report on the
Accounts of HM Revenue
and Customs: VAT Missing
Trader Fraud**

Forty-fifth Report of Session 2006–07

*Report, together with formal minutes, oral and
written evidence*

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Summary

VAT missing trader fraud is a large scale criminal attack on the EU VAT system. The most serious form—known as Carousel Fraud—involves a series of contrived transactions, within and beyond the EU to create large unpaid VAT liabilities and fraudulent claims.

The Department has been tackling missing trader fraud for over six years, yet has failed to stem the flow of tax losses: the fraud has continued to cost the exchequer at least £1 billion a year. In 2005–06, the level of fraud increased to its highest level yet, with the estimated cash loss to the exchequer of between £2 to £3 billion.

There are no reliable or comprehensive EU wide estimates of the cost of this fraud because most member states have not produced estimates. The EU Commissioner for Taxation has estimated the annual loss from VAT Fraud across the European Union at £40 billion (€60 billion).

The Department has introduced a range of legal and operational measures to tackle the fraud. The fraudsters are, however, resourceful and react quickly to such measures. In February 2006, the Government sought from the European Union authority to apply a special measure—the “reverse charge”—derogating from the Sixth VAT Directive for a wide-range of electronic goods, including those currently associated with the fraud, such as mobile phones and computer chips. In principle, once in force, this measure would prevent fraudsters from receiving VAT on the sale of mobile telephones and computer chips and would eliminate the opportunity for the fraud. The Council of the European Union approved the derogation on 16 April 2007, but the Council’s decision only allows the Department to apply the “reverse charge” to commerce in mobile phones and computer chips, rather than the wider range of products that the United Kingdom had originally requested. The Government now expects that this narrower measure, combined with other operational interventions, will protect revenue of £50 million in 2007–08.

The reverse charge can only be a provisional measure pending a more comprehensive EU-wide solution. The Commission is in favour of VAT being charged on all intra-community transactions in the country of purchase thereby eliminating VAT free operations and the opportunity for the present type of missing trader fraud. The United Kingdom and some other Member States are not in favour of this system. The Department considers that it would open the way for major new frauds.

Individual Member States cannot tackle VAT fraud on their own. The Department recognises that it has to work closely with the tax authorities of other member states and third countries, as well as with the accounting, tax and legal professionals to tackle the problem effectively. Ultimately the European Union will have to agree a new legislative framework for administering VAT, if missing trader fraud is to be eliminated in the long term.

Conclusions and recommendations

1. **VAT missing trader fraud has cost the Exchequer at least £1 billion each year since 1999–2000, peaking at estimated losses of between £2–3 billion in 2005–06.** It is a serious attack on the tax system by organised criminals, who are able to exploit the way in which European Union legislation provides for Member States to operate the VAT system. The Department has been dealing with missing trader fraud for over six years but has failed to stem the flow of tax losses. Progress on implementing the Committee’s previous recommendations for tackling VAT fraud has been limited.¹
2. **Other EU Member States experience VAT missing trader fraud, and the EU Commissioner for Taxation has estimated the annual loss from VAT fraud across the European Union at £40 billion (€60 billion).** The UK is one of the few that publish estimates of the losses, but the Commission intends to gather comparable data for all Member States. The Department should assist this process, for example by supporting the Commission’s initiative to establish reliable estimates for the European Union as a whole, and sharing methodologies with other Member States for calculating estimates at national level.
3. **Fraudsters may be able to avoid the Department’s “reverse charge” mechanism by switching the fraud from mobile phones and computer chips to other goods.** The Council of the European Union (EU) has authorised the United Kingdom to operate “a reverse charge” mechanism, but it can only be used by the Department for taxable supplies in mobile telephones and computer chips. There is a risk of criminals switching the fraud to other electronic equipment, which the Department originally sought to manage by seeking to operate the “reverse charge” across a range of electronic goods. The Department should be alert for any switch of the fraud to other goods and apply promptly for EU authorisation to wider the mechanism as necessary.
4. **The reverse charge is a provisional measure pending a more comprehensive EU-wide solution to tackle the fraud which would require legislation agreed by all the Member States.** The Commission considers that a VAT system based on the origin of the supply of goods with VAT charged on all transactions between Member States would remove the opportunity for the current type of missing trader fraud, though it could lead to new types of fraud and has little support among Member States. The Department should maintain and if possible expand the reverse charge mechanism unless and until an effective alternative can be agreed.
5. **The Department’s response rate to requests for assistance from other EU Member States to tackle missing trader fraud was only 53% in 2004–05 and 55% in 2005–06.** Each Member State is required under EU law to respond as quickly as possible to demands for mutual assistance and by law, should provide a substantive response no later than three months from the date of the request by another Member

1 Committee of Public Accounts, Thirty-sixth Report of Session 2003–04, *Tackling VAT Fraud*, HC 512

State. The Department should set a demanding target for bringing the response rate closer to 100%.

6. **There is, at present, no formal requirement for EU Member States to provide feedback to spontaneous information received from other Member States.** By February 2006, the Department had received 2,066 spontaneous exchanges of information but gave no feedback about the usefulness of the information. Feedback might, for example, have been useful for the Danish Tax Authority in investigating companies involved in trading chains where the loss is ultimately borne by the UK Exchequer. The Department should deal promptly and effectively with this type of co-operation from other Member States.
7. **The Department was unable to show that it had actively stepped up the reporting of accountants, tax advisers and lawyers to their professional bodies for instances of misconduct in response to the Committee's previous report.** We recommended that the Department should make greater use of sanctions available to professional bodies to investigate unethical conduct by their members. The Department is still considering whether its powers provide a sufficient framework to support referral of misconduct to professional bodies, but this work should not prevent the development of clear procedural steps to make professional bodies aware of unethical behaviour by their members on a timely basis.
8. **Criminals are only able to perpetrate VAT missing trader fraud because they have been able to obtain a valid VAT registration number.** The Department has applied tighter registration controls which have been effective in stopping fraudsters from obtaining a VAT number, and its risk based review and scrutiny of registrations resulted in 2,200 applications being refused out of 3,600 investigated in 2005–06. The Department should confirm that it has the management information to keep sight of the balance between preventing fraudulent VAT registrations, and impeding legitimate trade.
9. **The financial rewards from missing trader fraud have been high while the risk of fraudsters being caught and penalised has been low.** Since 2001–02, the Department has secured 157 convictions for total imprisonment amounting to some 603 years, or nearly four years per conviction. The Department, in liaison with the Revenue and Customs Prosecution Office, should work with the Ministry of Justice, the Sentencing Guidance Council and the Sentencing Advisory Panel to establish whether the Courts should have specific advice and sentencing guidelines to apply in missing trader fraud cases.

1 Extent of missing trader fraud in the United Kingdom

1. VAT is a general tax on the consumption of goods and services. It is collected by VAT registered businesses, but it is consumers who ultimately pay the tax. The European Union (EU) has a common VAT system for Member States governed by the EU Sixth VAT Directive. In 2005–06 the UK Exchequer collected £73 billion (net) of VAT receipts.

2. Organised criminal groups exploit the current VAT arrangements of the European Union that were established as part of the single market in 1993. The Department estimated VAT losses at some £12 billion in 2006–07; of which £2 billion–£3 billion was attributable to missing trader fraud.² In its simplest form, the fraud involves a business obtaining a VAT registration number in the UK for the purpose of purchasing goods, VAT free, from other Member States. The business then sells the goods at a VAT inclusive price in the UK and disappears without paying the VAT due to the Department. In its most abusive form—known as ‘carousel fraud’—fraudsters trade the same goods between Member States, through a series of contrived trade chains, and re-claim the VAT from the Department each time goods leave the United Kingdom. (**Figure 1**)

3. The goods most commonly-used in UK missing trader frauds are mobile phones and computer chips as they are readily portable, can be transported in bulk at low cost and are of high value.³ The Department is, however, concerned that fraudsters might switch their activity to other consumer products, such as MP3 players and are vigilant in monitoring potentially suspicious activity in such goods.⁴

4. In September 2000, HM Customs and Excise launched a national strategy to tackle missing trader fraud, which was aimed at detecting and disrupting fraudulent trade chains, prosecuting fraudsters and using civil powers to recover debts. The Department considers that this strategy, which continued to evolve in 2000–01 and 2001–02, reduced the levels of attempted fraud both in 2002–03 and 2003–04. But its estimate for 2004–05, between £1.12 billion and £1.90 billion, indicated that the fraud was rising again, as shown in **Figure 2**. The level of fraud continued to rise in 2005–06. The Chancellor’s Pre-Budget Report, published in December 2006,⁵ indicated that the cash losses from missing trader fraud now stood at between £2.00 billion and £3.00 billion.⁶

2 Q 2

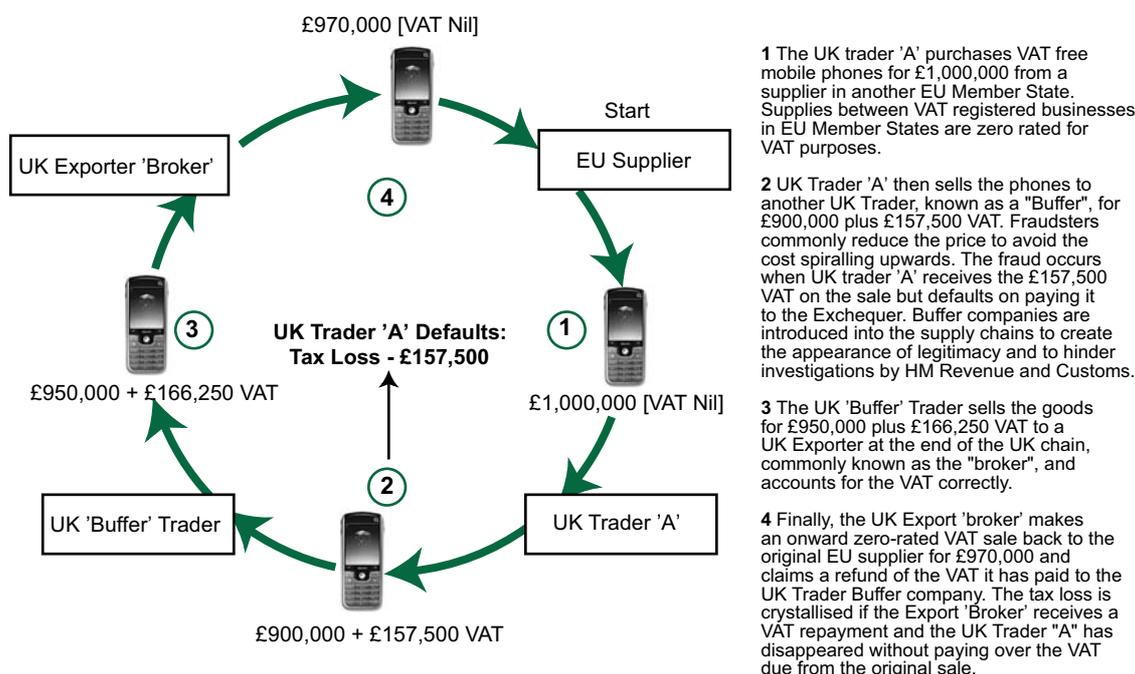
3 Qq 17, 32

4 Qq 17, 36

5 Pre-Budget Report, *Investing in Britain’s potential: Building our long term future*, HM Treasury, December 2006, CM6984, page 126

6 *Measuring Indirect Tax losses - 2006*, HM Revenue & Customs, December 2006, page 7; Q2

Figure 1: VAT missing trader 'carousel' fraud



Source: National Audit Office

Figure 2: Estimated tax loss of missing trader fraud

Financial Year	Lower Estimate (£bn)	Upper Estimate (£bn)
1999–00	1.17	2.29
2000–01	1.31	2.47
2001–02	1.72	2.53
2002–03	1.54	2.34
2003–04	1.06	1.73
2004–05	1.12	1.90
2005–06	2.00	3.00

Source: HM Revenue and Customs

5. A surge in the fraudulent activity towards the end of 2005–06 followed a ruling by the European Court of Justice that part of the Department's strategy, which entailed withholding VAT repayments from traders, was contrary to European law.⁷ The Department has therefore formulated a new strategy, which it believes is again reducing the level of fraud.⁸ It has also increased the resources to tackle the fraud, largely by deploying an additional 500 staff. The Department is continuing to look at new areas that need

⁷ Judgement made on 12 January 2006 in the case of *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems v Commissioners of Customs & Excise*.

strengthening, in particular in the way in which it conducts financial investigations. Despite these interventions, criminals are able to adapt the nature and complexity of the fraud in response to the Department's operational counter-measures,⁹ largely because the basic principles governing VAT are set in European legislation and have remained stable and unchanged for many years. Criminals have exploited this static legal framework, by mutating the fraud in ways that it is difficult for the Department to predict.

2 Co-operation between European Union Member States

The scale of missing trader fraud across the European Union

6. Missing Trader fraud is a European-wide problem and is recognised as a major threat by the European Commission and some EU Member States. The Commission recently published a paper on how the Member States can work together to tackle this growing fraud.¹⁰ In launching the debate on a European strategy to combat tax fraud, Mr Laszlo Kovacs, the EU Commissioner for Taxation and the Customs Union, estimated the annual loss from VAT fraud across the EU at £40 billion (€60 billion).¹¹

7. The United Kingdom publishes its estimates of the level of missing trader fraud, but few other Member States produce such figures. Germany, like the United Kingdom, is a target for the fraudsters and recognises that it is a significant problem; but it has no formal estimate of the cost of missing trader fraud. According to the Department, other countries also have serious problems, some greater than the United Kingdom.¹² Denmark estimated a loss of approximately £92 million (€134 million) between 1994 and 2005 and the Netherlands has estimated an annual loss of some £17 million (€25 million).¹³ The VAT loss in these two countries is comparatively low because fraudsters often sell goods as part of an apparently legitimate link in a larger chain and the tax is stolen in other Member States, such as the United Kingdom. The European Commission has recently initiated a study to estimate the scale of VAT fraud in each Member State, as it has scant information on the total value of VAT fraud across the European Union.¹⁴

8. The Netherlands has been successful in tackling the fraud; reducing losses from an estimated £173m (€250m) in the early 1990s to £17m (€25m) in 2005–06.¹⁵ The Department works closely with both the Netherlands and Germany and, to learn from good practice, has implemented similar measures to those adopted by the Netherlands.¹⁶ These include introducing, in the Finance Act 2003, the concept of a joint and several liability for a VAT debt.¹⁷ In 2005, the UK and the Netherlands carried out a joint operation which was successful in disrupting the finances of some of the fraudsters who operate in both countries.¹⁸

10 Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a coordinated strategy to fight against fiscal fraud, May 2006; a similar communication was issued in May 2004.

11 Press conference on the adoption of the Communication on fraud: Introductory remarks 31/05/2006 http://ec.europa.eu/commission_barroso/kovacs/speeches/introductory_speech_REV4.pdf

12 Q 19

13 C&AG's Report, page R38, para 4.5

14 Memo 60/221, Commission of European Communities, 31 May 2006

15 C&AG's Report, page R41, para 4.12

16 Q 26

17 Q 26

18 Q 6

Mutual assistance through administrative co-operation

9. The Council of the European Union and the European Commission recognise that mutual assistance between Member States is important in combating missing trader fraud. By its very nature, the fraud transcends the borders of Member States and they have to rely on their EU partners to provide cooperation and assistance to tackle it. Given the scale of the fraud in the UK, the Department relies more than most of its counterparts for effective and efficient exchange of information. A Council regulation provides the legal framework for the exchange of information between Member States.¹⁹ It set a mandatory deadline of three months for Member States to respond to a request for information, while including an expectation that a response will be given as “quickly as possible”. The three month time limit is important because a prompt response can be crucial to the satisfactory conclusion of an investigation or enquiry. During 2004 the Department received 854 requests, but responded to only 449 (53%) within the deadline. In September 2004, the Department set up a separate designated coordination team to deal exclusively with incoming requests on missing trader fraud. But for 2005, this resulted in only a slight improvement in the response rate; when the Department received 664 requests and responded to a mere 367 (55%) within the deadline.²⁰ The Department recognises that this performance is poor and that it needs to improve.²¹

10. The Council regulation allows Member States to provide information to each other ‘spontaneously’. There is no requirement, however, for the recipient Member State to inform the sending Member State of the benefit of the information supplied. By February 2006 the Department had received 2,066 exchanges of spontaneous information; of which 214 were from the Danish Tax Authority. The latter told the National Audit Office that it had not received any feedback from the Department in response to the information supplied. Such feedback could have allowed the Danish Tax Authorities to undertake further investigations of conduit Danish companies that participated in fraudulent chains, where the loss was borne by the UK Exchequer.²² There is also a risk that Tax Authorities may stop sending spontaneous information if they feel that the information submitted is not deemed useful by the UK.

Legislative measures: the ‘reverse charge’

11. In February 2006, the Government formally applied to the European Commission for authority to introduce a special measure—the “reverse charge”—derogating from the Sixth VAT Directive.²³ The Council has to approve unanimously any such derogation, on the basis of a proposal submitted to the Council by the Commission. Getting the support of the Commission for the special measure was therefore important. The Government’s intention was to allow the Department to introduce a “reverse charge” for mobile phones, computer

19 Council Regulation (EC) No. 1798/2003 on administrative cooperation in the field of Value Added Tax. The regulation entered into force on 1 January 2004

20 Q 59; C&AG’s Report, page R46, para 4.31

21 Qq 11, 61

22 C&AG’s Report, page R46, para 4.32

23 Article 21(1)(a) of the Sixth Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes—Common system of value added tax: uniform basis of assessment

parts and a wide-range of related electronic goods. Once applied, the measure would effectively remove the VAT from the distribution chain from wholesaler to retailer. Instead VAT would be invoiced at the end of the chain to the final customer, thereby eliminating the opportunity for missing trader fraud, as illustrated below.²⁴

An example of how the reverse charge mechanism should work

Under normal VAT rules, a British trader buys goods for £100 from a VAT registered operator in another Member State. Under the current VAT system, such trade does not attract VAT, because cross-border sales between VAT registered companies within the European Union are zero-rated. The UK trader sells the acquired goods for £200 plus £35 output VAT to a UK business customer. The UK trader pays £35 to the Department and the business customer is able to reclaim £35 input VAT from the Department. If dishonest, the UK trader could defraud the Department by withholding the £35 output VAT and disappearing, which is one facet of missing trader fraud.

Under the reverse charge system, the UK trader would not be able to receive the £35 VAT on the sale of goods at £200. Instead, the business customer would buy the goods for £200 and self account for both the input and output VAT of £35. There is then no VAT to reclaim from the Department; and the potential for the fraud to occur is removed.

The effect of the reverse charge mechanism is that VAT is removed from the business chain as cash and therefore cannot be stolen. A VAT registered trader at the end of the chain has to charge and collect VAT on sales to final consumers in the normal way.

Source: National Audit Office

12. In September 2006, the European Commission announced its support for the United Kingdom's application for a "reverse charge" special measure that would be effective from the date of the Council's approval until 31 December 2009.²⁵ The European Commission's draft decision also endorsed application of the "reverse charge" to the range of electronic goods included in the Government's request. In April 2007, the Council adopted a decision that permits the United Kingdom to apply the "reverse charge" special measure, but only to supplies of mobile telephones and integrated circuit devices (computer chips).²⁶ Based on its original application, the Government was confident that early implementation of the reverse charge would help eliminate the current type of missing trader fraud, and had expected that this special measure would contribute to protecting tax revenue of some £500 million in 2007/08; and £425 million in 2008/09.²⁷ The decision adopted by the Council came much later than the Department had originally expected, however, and is confined to the commodities that are currently identified with missing trader fraud, a narrower range of goods than the Government had envisaged. The Department now estimates that the additional Exchequer yield from its latest measures, including the reverse charge, will be £50 million in 2007–08, a significantly lower figure than it had originally projected. This

24 Qq 37, 87

25 Proposal for a Council Decision authorising the United Kingdom to introduce a special measure derogating from Article 21(1)(a) of Directive 77/388/EC. Commission document COM (2006) 555

26 Council Decision of 16 April 2007 authorising the United Kingdom to introduce a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax

27 The Financial Statement and Budget Report 2006

lower estimate takes account of the later implementation of the reverse charge, as well as the narrower focus to the products that it covers.

13. There is a real risk that fraudsters may attempt to switch to other electronic goods not covered by the decision,²⁸ including those that were on the United Kingdom's original application. The Department indicated that it will deploy existing operational tactics to deal with this risk if it materialises. In that event the Department would have to decide as to whether it can tackle the fraud on a sector by sector basis or seek a more comprehensive change in the system.²⁹ The European Commission and some other Member States would have concerns if the reverse charge was extended across the entire VAT system, because it would essentially turn VAT into a sales tax.³⁰

14. The Commission and Member States have discussed whether there should be a broader set of changes to the VAT rules.³¹ In the Commission's view, a VAT system based on the origin of the supply of goods would remove the opportunity for the current type of missing trader fraud. VAT would be charged on all transactions between Member States, and therefore traders would not acquire goods free of VAT. The Commission has found little support among Member States for the wholesale reform of the VAT system along these lines. They are concerned that such a system would demand a greater degree of tax harmonisation than currently exists, to avoid the new system being burdensome for traders.³²

15. Furthermore, there would have to be a system of VAT allocation from the country of origin to the country of destination. The Department's view is that an origin system would open up major new fraud opportunities, as all the documentation supporting VAT claims on the UK Exchequer would be held in other Member States, thus making it more difficult to verify.³³ The current arrangements, which were only meant to operate until 31 December 1996, have therefore continued in the absence of an agreement on a definitive system. Although there are a variety of ideas of how the VAT system can be improved, there are no other firm proposals other than the origin system proposed by the Commission.³⁴ Ultimately, it is EU Member States who must agree a legislative framework that will help to eliminate missing trader fraud against the VAT system.

28 Q 49

29 Q 50

30 Q 48

31 Q 39

32 C&AG's Report, page R40, para 4.6

33 Q 3

34 Q 45

3 Operational measures to tackle the fraud

The Department's approach to tackling missing trader fraud

16. The Department uses a range of operational measures to disrupt the fraudulent supply chains and to identify suspected traders for investigation. The Department has targeted its intervention measures in five ways:

- tightening up registration procedures;
- monitoring how fraudsters are evolving the nature of the fraud;
- developing new operational measures;
- extending the verification of repayment claims; and
- conducting concerted investigation and prosecution of suspected fraudsters.

Tightening up on registration procedures

17. An important part of the Department's strategy for tackling missing trader fraud is to deny fraudsters the VAT registration without which the fraud cannot be perpetrated. During 2005–06 the Department received 269,000 applications for VAT registrations, the majority from businesses that wish to trade lawfully.³⁵ The Department has performance targets for processing applications. But it must also protect VAT revenue, so it has tightened up its registration procedures.³⁶ Registration units seek to identify potential fraudsters through a combination of data-matching exercises and risk assessments. High risk cases are referred to intelligence teams for further checks. The Department's staff may also visit traders to verify that their activity is legitimate.

18. To target registration applications from fraudsters, the Department has placed experienced investigative staff at each of the registration units to provide risk advice. They have powers to refuse applications or to refer them for detailed checking. The deployment of these risk advisors has resulted in better targeted referrals for investigation: in 2002–03, 7,000 applications were referred for further checking which resulted in 900 applications being refused. In 2005–06 the registrations units refused 2,200 of the 3,600 referrals.³⁷ The appointment of risk advisors has also ensured that each of the registration units applies a consistent approach to risk analysis and referrals.³⁸ The Department intends to strengthen the registration procedures further through access to a much wider range of IT sources, which will enable registration units to carry out a broader range of checks.

35 Q 78; Ev 13

36 Q5; C&AG's Report, page R42, para 4.13

37 Q 24

38 Q 71

19. If a registration unit has concerns about an application but has insufficient evidence to refuse registration, the unit may request a trader, as a condition of registration, to provide a financial security to cover the estimated value of tax that may be at risk.³⁹ The trader must provide the security, usually in the form of a guarantee from a financial institution.⁴⁰ In addition to the security, the Department has new information powers in the Finance Act 2006 that allow it to monitor the activity of newly registered traders, for example in their first six months of operation.⁴¹ The use of the security has proved to be a successful disruption technique, both at registration and where it results from the Department's monitoring of a trader's activity. The Department requested security from 74 registered companies between April 2004 and February 2006 and 18 of these either ceased trading or were deregistered.⁴² The Department does not require all traders within the sector affected by missing trader fraud to provide a guarantee on registration, as it has to strike a balance between encouraging business and enterprise amongst legitimate traders and tackling fraud.⁴³

The evolving nature of the fraud

20. The Department monitors trader activity to help identify the ways fraudsters have developed the nature of missing trader fraud. In acquisition fraud, the simplest version of missing trader fraud, the hallmark was for the fraudsters simply to disappear. Instead of going missing, the Department found that fraudsters continued trading before eventually failing to make payment of the VAT that they owed. As soon as the Department identifies such traders it closes the VAT accounting period within a matter of days which forces the defaulting traders to declare their tax liability. The Department can then determine the liability and take appropriate action, by deregistering and/or invoking provisional liquidation. The principal purpose is to stop the fraudsters from continuing to accumulate further tax debts.⁴⁴

21. During 2005 the Department identified a further mutation of the fraud, with a change in the trading patterns of suspect traders. The Department noticed a substantial rise in UK exports of mobile phones to countries outside the European Union.⁴⁵ Fraudsters had become aware that the Department was monitoring their activities so they began re-directing their consignments, initially to Switzerland and then to Dubai.⁴⁶ The diversion of goods through a third country makes it more difficult for the Department to obtain evidence of the trail of goods and prove the contrived nature of the supply chain (**Figure 3**). This is because, to be able to work with the customs and tax authorities of countries outside the European Union, the Department has to collaborate with them through informal agreements rather than the legal framework of cooperation provided in EU law.

39 Q 83

40 Q 84

41 Q 84

42 C&AG's Report, page R42, para 4.17

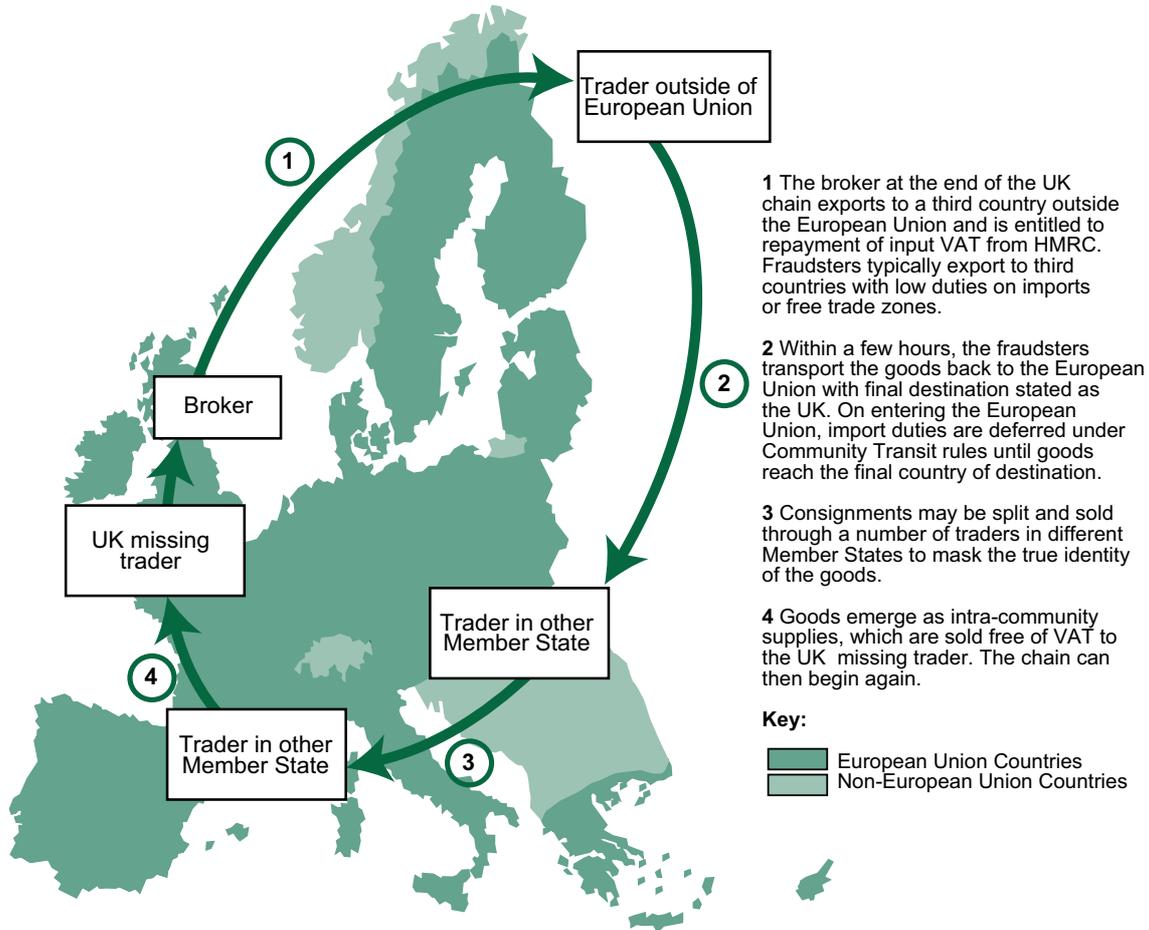
43 Q 92

44 Q 86

45 C&AG's Report, page R43, para 4.19

46 Q 27

Figure 3: An example of a missing trader chain through a third country outside the European Union



Source: National Audit Office

22. In response to this diversion of goods, the Department began to check exports of mobile phones to both Switzerland and Dubai. It carried out concurrent checks at different UK ports, reconciling export documents to the actual volume of goods. The Department also started to date-stamp packaging and to scan the unique identification numbers and barcodes on mobile phones. It then found that exports of mobile phones and computer chips to Switzerland and Dubai fell significantly. The Department attributed this to the deterrent effect of these exercises, conducted in cooperation with the Customs Authorities in Switzerland and Dubai. These counter-measures provided useful operational knowledge about the way the fraudsters operate, as well as an opportunity to pilot the scanning equipment. During one exercise the Department scanned 272,000 mobile phones, of which 36,000 (13%) had previously been stamped in the UK. This evidence helped to prove the circular sale of the goods.⁴⁷ The scanners have proved to be effective in tackling the fraud and providing a powerful disruption technique.⁴⁸

47 C&AG's Report, page R43, para 4.19

48 Q 27

23. As the Department has improved its VAT registration checks, fraudsters have tried to avoid detection by buying existing VAT registered companies; and then applying to the registration units to change their details.⁴⁹ The Department monitors trading patterns of registered traders to identify suspect activity which may indicate the occurrence of fraud. In 2005–06, the Department received some 50,000 formal notifications of a business undergoing a Transfer of a Going Concern (i.e. where a person acquires a business and its assets as a going concern). These notifications are subject to risk assessments in the same way as new applications for registration. Attempts by fraudsters to enter the VAT system can therefore be identified and prevented.⁵⁰ The Department has produced new guidance for registration teams to identify suspicious applications for variations in registration details.⁵¹

Extending verification of repayment claims

24. The Department's initial strategy to combat missing trader fraud included measures to control VAT repayments claimed by traders involved in carousel fraud chains.⁵² These measures included withholding repayments where the Department considered that they formed part of an overall chain to defraud, and that the circular sales of goods had no economic substance. In January 2006, the European Court of Justice upheld a challenge to this measure.⁵³ The Department has since adapted its approach to the scrutiny of repayments, to take account of the judgement.⁵⁴ The Department now considers that, provided it can establish that the trader knew or should have known about the fraud, it can refuse the repayment claim. The Department now has around 800 investigating repayment claims, though some traders have complained that delays associated with the extended verification of repayments adversely affect the cash-flow of their business.

Developing new operational measures

25. The Department is constantly reviewing the regulations and controls to ensure they are effective in tackling the fraud.⁵⁵ The Government introduced further legislation in the Finance Act 2006 to support the Department in intensifying its operational activities. This measure included making explicit the Department's power to evidence the inspection of goods (via marking) so that it can identify subsequent movements of goods and traders involved in fraudulent chains; and directing individual businesses to maintain relevant records, such as the unique identification numbers of mobile phones. The Department can now request information from traders in high risk sectors, which it has found helpful in regulating sectors prone to the fraudulent activity.⁵⁶

49 Q 75

50 Q 78; Ev 13

51 C&AG's Report, page R42, para 4.15

52 C&AG's Report, page R42, para 4.15

53 Judgement made on 12 January in case of *Optigen Ltd, Fulcrum Electronics Limited and Bond House System Ltd v Commissioners of HM Customs and Excise*.

54 European Court Judgment on 6 July in the *Kittel* case.

55 Q 21

56 Q 21

Conducting concerted investigation and prosecution of fraudsters

26. The Department is responsible for investigating criminal cases of revenue fraud and presenting the evidence collected to the Revenue and Customs Prosecutions Office (RCPO), the government department responsible for the prosecution of major drug-trafficking and tax fraud cases. The Department believes that a relatively small number of large scale organisers are primarily responsible for missing trader fraud.⁵⁷ There is also some evidence that they are involved in other serious criminal activity.

27. As at December 2005 the Department was investigating 70 missing trader fraud cases, of which 38 started before April 2003. The Department expects all of these to reach trial before 2008. During 2005–06 the Department began 16 new cases.⁵⁸ Missing trader investigations are, however, complex owing to the sophistication of the fraud.⁵⁹ The whole chain needs to be investigated which requires considerable resources because the Department may have to collect evidence from other EU Member States and third countries.⁶⁰ In addition, the Department has to assemble a large volume of material to meet its disclosure obligations and to gather sufficient evidence to enable RCPO to present each case to the courts. The Department's successful convictions have doubled since 2004 following legal advice on how to prosecute more complex cases.⁶¹

28. Since 2001–02, the Department had secured 157 convictions in missing trader fraud cases resulting in jail sentences of some 603 years and confiscation orders of around £97 million (**Figure 4**). Of that total, the Department and RCPO secured 45 convictions (28%) in 2006 alone, for sentences totalling some 194 years.⁶² The Department has expressed concern to the Attorney General over the adequacy of sentences that the courts have determined where the Department and RCPO have secured convictions in missing trader fraud cases.⁶³ The financial gains from perpetrating this fraud are considerable. But the penalties for conviction—an average sentence of 3.8 years per conviction—are relatively low. The Attorney General has responded to these concerns by taking one case to the Court of Appeal. The Department considers that the courts are now beginning to recognise the seriousness of the fraud, which has recently led to significant increases in sentencing.⁶⁴

29. It is not easy for the Department to recover debts owed by missing and defaulting traders. It can invoke provisional liquidation where significant levels of VAT are due and the company refuses or is unable to pay the debt. Provisional liquidation immediately stops the trader's activity and prevents further tax losses. If a company is unable to pay its debts the Department can petition the courts to wind it up. The courts may authorise the freezing of the company's assets and appoint a liquidator to use the assets to pay the debts.

57 Qq 70, 112

58 C&AG's Report, page R44, para 4.24

59 Q 66

60 Q 11

61 Q 66

62 Q 9

63 Q 7

64 Q 11

Freezing orders allow the Department to act earlier in the chain, deny the fraudsters access to their money and restrict their ability to fund further fraudulent activity.⁶⁵

Figure 4: Missing trader fraud: prosecutions, convictions, sentences, and confiscation orders

Year	Prosecutions (i)	Convictions	Sentences (Years Imprisoned)	Acquittals	Stayed (ii)	Confiscation Orders (iii)
01/02	10(7)	23	87	4	3(1)	13,613,600
02/03	15(12)	29	122	9	2(1)	28,146,500
03/04	14(11)	14	46	1	22(3)	10,572,400
04/05	10(9)	20	60	8	8(1)	12,820,900
05/06	17(10)	26	94	10	24(6)	2,759,700
06/07 (iv)	17(4)	45	194	10	6(2)	29,337,400 (v)
Total	83 (63)	157	603	42	65 (14)	97,250,500

Source: HM Revenue and Customs: Extract from Written Supplementary Report (Q67)

Notes:

(i) Total cases with successful prosecution figures in brackets.

(ii) Stayed cases include those where no evidence was offered. The figures include the numbers of individuals involved; and in brackets, the number of cases where the whole case was stayed.

(iii) Confiscation Orders obtained for successful cases in that year. It is likely that the orders were in part obtained in successive financial years as the process is lengthy and complex. Responsibility for realising the orders is with RCPO.

(iv) Figures only up to December 2006

(v) This total includes £28,722,377 against a defendant who absconded during trial.

30. The Department believes that most of the money obtained fraudulently is moved very quickly outside the United Kingdom.⁶⁶ It identified the First Curaçao International Bank as the preferred financial institution of missing traders. Fraudsters were using accounts with the First Curaçao International to launder the stolen value added tax, before transferring the proceeds in part to financial institutions in the United Arab Emirates, principally in the emirate of Dubai.⁶⁷ The Department is working with the authorities in the Netherlands who are investigating the First Curaçao International Bank. The Department is also working with the United Arab Emirates authorities, under mutual assistance arrangements, to trace stolen VAT.⁶⁸ The Department has used the powers available under the Proceeds of Crime Act 2000 to obtain freezing orders in supporting two large-scale operations that involved the movement of stolen VAT to institutions in the United Arab Emirates and in Curaçao.⁶⁹

65 Q 117

66 Q 116

67 Q 118; Ev 13

68 Q 116

69 Q 117

4 Co-operation with the accountancy and tax professions and manufacturers

31. The Department has worked with the tax and accountancy professions to raise awareness of missing trader fraud. In December 2005, Deloitte, PricewaterhouseCoopers, KPMG and Ernst & Young published a joint statement to assist the Department in tackling missing trader fraud.⁷⁰ They agreed to provide guidance to clients who may be at risk from dealing with traders in missing trader chains and remind their staff of the requirement, under the Proceeds of Crime Act 2002 and Money Laundering Regulations 2003, to report any suspicions of fraudulent activity.⁷¹

32. During 2006 several other accountancy firms have followed with similar statements. In addition, a number of professional bodies, including the Institute of Chartered Accountants in England and Wales and the Chartered Institute of Taxation, have expressed their willingness to cooperate with the Department to tackle missing trader fraud.

33. In March 2006, the Department held a workshop with members of the Joint VAT Consultative Committee to discuss further ways to tackle missing trader fraud, create a shared understanding of the key issues and discuss guidelines for legitimate businesses and tax practitioners.⁷² These guidelines cover areas such as hallmarks to identify suspect activity and how to report this to the Department.

34. In the last two years, the Department's investigations have led to the arrest of just 11 professionals, six of whom were convicted for missing trade fraud.⁷³ The Committee has previously recommended that the Department should act firmly in reporting accountants, solicitors and tax advisors to their professional bodies where it has discovered evidence of misconduct. The Department confirmed that when it obtains evidence to associate professionals with criminals it will also report them to their professional bodies.⁷⁴ The Department has indicated that it aims to take a more robust approach to tackling misconduct by agents and is considering whether its powers provide a sufficient framework to support reference to the disciplinary processes of professional bodies.⁷⁵

70 Q 106

71 C&AG's Report, page R46, para 4.35

72 The Joint VAT Consultative Committee is comprised of representatives from the Department, accountancy and tax professionals and representatives from industry and finance.

73 Q 104

74 Q 109

75 Treasury Minute on the 49th Report from the Committee of Public Accounts 2005–06 on Corporation Tax: companies managed by HM Revenue & Customs area offices, Cm 6908, October 2006.

Cooperation with Manufacturers

35. As mobile phones are manufactured all over the world, they could enter the European carousel from any destination.⁷⁶ The Department has worked closely with major manufacturers from the sectors currently affected by the fraud, i.e. mobile phones and computer chips, in identifying how to track the movement of goods. It notifies manufacturers of the characteristics of the fraudsters and what to look for when supplying goods to purchasers.⁷⁷ Intel, a major manufacturer of computer chips, has been helpful in providing training to the Department's teams to assist the detection of counterfeit chips. It has also loaned scanning equipment to help identify goods previously used in missing trader chains.⁷⁸

76 Q 34

77 Qq 36,113

78 C&AG's Report, page R47, para 4.36

Formal minutes

Monday 9 July 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon

Mr David Curry

Mr Ian Davidson

Mr Philip Dunne

Ian Lucas

Mr Austin Mitchell

Mr Don Touhig

Draft Report

Draft Report (Standard Report on the Accounts of HM Revenue and Customs: VAT Missing Trader Fraud), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 35 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Forty-fifth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Wednesday 10 October at 3.30 pm.]

Witnesses

Wednesday 17 January 2007

Mr Mike Eland CB, Director-General, Enforcement and Compliance, **Mr Euan Stewart OBE**, Deputy Director, Criminal Investigations, and **Mr Tony Walker**, Director, Missing Trader Intra-Community Fraud (MTIC) Compliance Operations, HM Revenue and Customs

Ev 1

List of written evidence

HM Revenue and Customs

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List of Reports from the Committee of Public Accounts 2006–07

First Report	Tsunami: Provision of support for humanitarian assistance	HC 25 (Cm 7018)
Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108 (Cm 7035)
Third Report	Collections Management in the National Museums and Galleries of Northern Ireland	HC 109 (Cm 7035)
Fourth Report	Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation	HC 110 (Cm 7019)
Fifth Report	Postcomm and the quality of mail services	HC 111 (Cm 7018)
Sixth Report	Gaining and retaining a job: the Department for Work and Pensions support for disabled people	HC 112 (Cm 7019)
Seventh Report	Department for Work and Pensions: Using leaflets to communicate with the public about services and entitlements	HC 133 (Cm 7020)
Eighth Report	Tackling Child Obesity—First Steps	HC 157 (Cm 7020)
Ninth Report	The Paddington Health Campus Scheme	HC 244 (Cm 7076)
Tenth Report	Fines Collection	HC 245 (Cm 7020)
Eleventh Report	Supporting Small Business	HC 262 (Cm 7076)
Twelfth Report	Excess Votes 2005–06	HC 346
Thirteenth Report	Smarter Food Procurement in the Public Sector	HC 357 (Cm 7077)
Fourteenth Report	Ministry of Defence: Delivering digital tactical communications through the Bowman CIP Programme	HC 358 (Cm 7077)
Fifteenth Report	The termination of the PFI contract for the National Physical Laboratory	HC 359 (Cm 7077)
Sixteenth Report	The Provision of Out-of-Hours Care in England	HC 360 (Cm 7077)
Seventeenth Report	Financial Management of the NHS	HC 361 (Cm 7077)
Eighteenth Report	DFID: Working with Non-Governmental and other Civil Society Organisations to promote development	HC 64 (Cm 7077)
Nineteenth Report	A Foot on the Ladder: Low Cost Home Ownership Assistance	HC 134 (Cm 7077)
Twentieth Report	Department of Health: The National Programme for IT in the NHS	HC 390
Twenty-first Report	Progress in Combat Identification	HC 486 (Cm 7151)
Twenty-second Report	Tax credits	HC 487 (Cm 7151)
Twenty-third Report	The office accommodation of the Department for Culture, Media and Sport and its sponsored bodies	HC 488
Twenty-fourth Report	Ofwat: Meeting the demand for water	HC 286 (Cm 7151)
Twenty-fifth Report	Update on PFI debt refinancing and the PFI equity market	HC 158
Twenty-sixth Report	Department for Work and Pensions: Progress in tackling pensioner poverty—encouraging take-up of entitlements	HC 169
Twenty-seventh Report	Delivering successful IT-enabled business change	HC 113
Twenty-eighth Report	ASPIRE—the re-competition of outsourced IT services	HC 179
Twenty-ninth Report	Department of Health: Improving the use of temporary nursing staff in NHS acute and foundation trusts	HC 142
Thirtieth Report	The Modernisation of the West Coast Main Line	HC 189
Thirty-first Report	Central government's use of consultants	HC 309
Thirty-second Report	The right of access to open countryside	HC 91
Thirty-third Report	Assessing the value for money of OGCBuying.solutions	HC 275
Thirty-fourth Report	Recruitment and Retention in the Armed Forces	HC 43
Thirty-fifth Report	BBC outsourcing: the contract between the BBC and Siemens Business Service	HC 118
Thirty-sixth Report	Reserve Forces	HC 729

Thirty-seventh Report	Child Support Agency: Implementation of the Child Support Reforms	HC 812
Thirty-eighth Report	Sure Start Children's Centres	HC 261
Thirty-ninth Report	Preparations for the London Olympic and Paralympic Games—risk assessment and management	HC 377
Fortieth Report	Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP	HC 368
Forty-first Report	Improving procurement in further education colleges in England	HC 477
Forty-second Report	The Shareholder Executive and Public Sector Businesses	HC 409
Forty-third Report	The Restructuring of British Energy	HC 892
Forty-fourth Report	Tackling Anti-Social Behaviour	HC 246
Forty-fifth Report	Standard Report on the Accounts of HM Revenue and Customs: VAT Missing Trader Fraud	HC 250

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 17 January 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr David Curry
Mr Ian Davidson

Mr Sadiq Khan
Mr Don Touhig
Mr Iain Wright

Mr Tim Burr, Deputy Comptroller and Auditor General, and Steven Ardron, Director National Audit Office, were in attendance.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

STANDARD REPORT ON THE ACCOUNTS

OF HM REVENUE AND CUSTOMS: VAT MISSING TRADER FRAUD

(HC 1159 2005-06)

Witnesses: **Mr Mike Eland CB**, Director-General, Enforcement and Compliance, **Mr Euan Stewart OBE**, Deputy Director, Criminal Investigations, and **Mr Tony Walker**, Director, Missing Trader Intra-Community Fraud (MTIC) Compliance Operations, HM Revenue and Customs, gave evidence.

Q1 Chairman: Good afternoon and welcome to the Committee of Public Accounts where today we are considering the Comptroller and Auditor-General's *Standard Report on the HM Revenue and Customs 2005-06 Accounts* which deals with recent developments in the Department's strategy to tackle VAT missing trader fraud. We welcome back Mike Eland, who is Director General of Enforcement and Compliance. Would you like to introduce your two colleagues?

Mr Eland: Tony Walker heads the task force tackling carousel fraud and Euan Stewart is the Deputy Director of Criminal Investigations who is dealing with that aspect of the fraud.

Q2 Chairman: Thank you very much. We also welcome members of the Namibian Committee of Public Accounts to our meeting. You are very welcome and thank you for coming. Perhaps we might look first of all, Mr Eland, at the scale of the problem and we can look at this in paragraph 4.2 of the Report in front of us. Here we see the Chancellor of the Exchequer giving a range of £1.1 to £1.9 billion for attempted missing trader fraud for 2004-05. We also see there that for 2005-06 his estimate was £3.5 to £4.7 billion, so has the fraud doubled in scale?

Mr Eland: No, it certainly has not. What happened was that in the course of 2005-06 there was a surge in the fraud towards the end of that year following a case in the European Court which ruled that part of our strategy was contrary to European law, so that led to a surge in the fraud. We regrouped, formulated a new strategy and we believe we are now succeeding in driving it down to new, much lower

levels. The estimate given in the Pre-Budget Report just before Christmas was that we felt that in the period 2005-06 fraud was in the range of £2 billion to £3 billion.

Q3 Chairman: Let us see how we could perhaps deal with this. There is one suggestion in paragraph 4.6 which comes from the European Commission that we should charge VAT in the country of origin. Why do we not do this?

Mr Eland: Perhaps if I could explain very briefly what that would involve. It would mean that the rate of VAT that was charged was charged in the country where a supplier purchased the goods so that if a UK business bought goods from, say, Denmark they would pay 25% VAT on those goods. They would then be able to reclaim that 25% from the UK Exchequer and every year there would be some sort of clearing house that would sort out the money between Member States. We would be concerned from a fraud point of view that essentially all the documentation and everything that supported that claim on the UK Exchequer for the repayment would be in Denmark and so would make it very much more difficult for us.

Q4 Chairman: So your opposition has got nothing to do with your worries about possible tax harmonisation?

Mr Eland: That is obviously one of the considerations that the Government would take into account and whether they felt that that was going to be one of the consequences. I was just looking at it particularly from our own point of view.

 HM Revenue and Customs

Q5 Chairman: If we have got this increase in the amount of fraud does that suggest that perhaps your registration procedures are not adequate for applying for VAT in the first place?

Mr Eland: That is obviously one of the important parts of our strategy to stop fraudulent traders getting into the system altogether. We have tightened up our procedures. We have been improving the risk assessment there. We have increased very significantly in the last few years the number of registrations we have refused because we believed them to be fraudulent—some figures I think are given in a table in this Report, table 22—so we believe we are making real progress there.

Q6 Chairman: Why has the Netherlands been so successful in dealing with all this?

Mr Eland: I think the Netherlands and we have done some very similar things in combating fraud. We work very closely with the Netherlands. We had a joint operation on the criminal side in the summer of last year which has been very successful in hitting the finances of some of the fraudsters who trouble both countries.

Q7 Chairman: Let us look at this. I did a back-of-the-envelope calculation myself on figure 24 which is a case study where in August 2005 four people were found guilty for their part in a carousel fraud worth an estimated £40 million. It is quite possible that these people might have walked away with £10 million each and ended up after parole with about four years' rest in an open prison. That is not bad going, is it?

Mr Eland: We have been concerned about the level of sentences that have been given when we have got convictions and we have made representations to the Attorney General who has actually taken a case to the Court of Appeal.

Q8 Chairman: The rewards are enormous and your chances of being successfully prosecuted are fairly low. Do you have any figures?

Mr Eland: It is difficult. I can give you figures on the numbers of convictions in 2006, which is about 40 convictions.

Q9 Chairman: 40?

Mr Eland: 40. Clearly what we are doing in terms of criminal—

Q10 Chairman: --- So this is 40 convictions in a fraud which is costing us how much at the moment do you reckon?

Mr Eland: We estimate for that year it was in the range of £2 billion to £3 billion.

Q11 Chairman: It is not a lot of successful convictions, is it?

Mr Eland: These are very major cases to bring. You have to carry out a major investigation into the whole carousel, so they are resource intensive, they often involve having to go overseas to get evidence there, and so they are difficult to bring. The good news is that the courts are beginning to recognise

how serious this is and we have had a recent significant increase in sentencing. We had a case just before Christmas where somebody got 15 years and obviously that is much more in line with the seriousness of the case.

Q12 Chairman: In paragraph 4.16 you say that in December 2005 HMRC transferred 230 non-criminal compliance officers, so why were they not transferred earlier if this was a problem which was building up?

Mr Eland: They were always there. We re-organised them into a single task force so that we could deploy them effectively against different aspects of the fraud, and we have since then significantly increased the resource and it is now about 800 in that area.

Q13 Chairman: Are you worried about your staff being transferred to the Serious Organised Crime Agency which we read about in paragraph 4.27?

Mr Eland: That was a division between those of our former Customs operation who dealt with serious drugs investigations. The people and the drugs work have moved to SOCA and we have retained the fiscal investigations work. It has had no direct impact on the resourcing level.

Q14 Chairman: Lastly, under co-operation with other Member States, paragraph 4.31, it seems that you are not really leading the way, are you, in producing timely responses?

Mr Eland: We do need to improve on that, and again we have looked to see if we can centralise that activity so that it is not competing with other priorities, which has been one of the problems. We are looking to get an improvement on that.

Q15 Chairman: The European Court of Justice has recently made some important findings. Has that hindered your work at all?

Mr Eland: The decision in January 2006 where the previous approach we were adopting was ruled contrary to European law, clearly did mean that we had to reformulate our strategy and there have been some cases since then that have clarified what is called the "knowledge test" and made it clear that if we wish to deny repayments it is not just that we have to prove knowledge but also if we can show that the person should have known, they have been reckless in other words in ignoring the signs.

Q16 Chairman: So that has helped your work?

Mr Eland: That is helpful.

Chairman: Thank you very much. Don Touhig?

Q17 Mr Touhig: What sort of goods are these fraudsters moving around?

Mr Eland: Predominantly mobile phones and also computer chips. Clearly we are worried that they might try to move into other areas so we are vigilant on that but overwhelmingly the evidence at the moment is that it is in those two sectors.

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Q18 Mr Touhig: Do we have a greater problem, say, between Northern Ireland and the Republic because of their land link?

Mr Eland: No. We did have some problems in relation to computer chips with Southern Ireland but it was not routing through the North.

Q19 Mr Touhig: Why does the UK attract more missing trader fraud than other EU partners?

Mr Eland: We are not totally sure that we do. We have followed a path of being very open about this and attempting to measure it and then publishing those figures. We do know that other countries do have very serious problems, some we believe greater than ours, but they do not follow through on that.

Q20 Mr Touhig: Are we considered a soft touch? Reference was made earlier to the sentencing. If you get caught the Chairman said you might end up in an open prison with £4 million in your bank.

Mr Eland: We have not picked up any evidence of people in other countries moving here to commit the frauds or anything. Most of the people who we have dealt with have been UK-based. They have moved their money overseas and there are some people who have located themselves overseas. I do not think there is anything we can point to which says this is a weakness that is unique to the UK and clearly if we did see that we would look to get it remedied.

Q21 Mr Touhig: Perish the thought we should have more regulation or control but do you need more regulation and control? Would that help in any way? Is there any particular measure you can point to and say, "If we had that power . . ."

Mr Eland: Yes, we do keep this under review and last year ministers did put proposals to Parliament which were carried in the Finance Bill that enabled us to ask for more information and so on from people working in high-risk sectors, and that has been useful in helping us regulate that sector.

Q22 Mr Touhig: This missing trading fraud is the European Union's number one tax problem?

Mr Eland: I think it certainly is seen as a really major problem across Europe and we are taking some initiative in this field. We are going to actually host a conference next month of European investigators to look and see what we can do to work together to combat it.

Q23 Mr Touhig: Why are there fewer checks made on VAT applicants? Is it a lack of staff?

Mr Eland: No, I think we would say that we are actually increasing the examination.

Q24 Mr Touhig: The figures we have got here suggest that the number of applications referred for detailed checks fell from 4,573 in 2004-05 to 3,629 in 2005-06.

Mr Eland: I think the important thing there is the bottom line, the numbers refused. We have put in each registration unit now experienced investigation staff who can directly refuse the registration so they do not need to refer it to anybody for further checking and the numbers that they actually refer for

more detailed checking are better targeted. For example, we referred 7,000 in that first year but we only succeeded in refusing 900 whereas in 2005-06 although we only referred 3,600 we were turning down 2,200 so it is a much better targeted operation.

Q25 Mr Touhig: Mention was made when the Chairman was questioning about the Dutch; are there lessons to be learned from other EU partners?

Mr Eland: We are always looking to see if somebody else has had a better idea or a better approach.

Q26 Mr Touhig: Is there anything in particular that we have adopted that our European partners have been doing that is beneficial?

Mr Walker: We work very closely with our Dutch and German colleagues and as a result of the Finance Act 2003 we introduced the concept of joint and several liability and that was based entirely on our work with our European partners.

Q27 Mr Touhig: And can you say that we have a problem mainly with these goods being trafficked through Holland, France or is it just generally right across the EU?

Mr Eland: They do actually alternate. We did see mainly European traffic up to about a year ago with a variety of different European countries being used. Then as people recognised we were monitoring that traffic they switched to initially Switzerland and then more recently they have used places like Dubai and so on. Each case we have been monitoring through our VAT return system and then that enables us to put in more investigators to that area, so it switches around quite a lot. Another thing we have done recently is we have used our Customs staff at the frontier to scan into a computer system the barcodes on consignments of mobile phones, so we are able to see where they are actually carouselled and physically moved round. That has been very helpful in tracking the fraud and also is a powerful disruption because the fraudsters once they realise we are doing this have to get more mobile phones, so it inhibits the actual exercise.

Q28 Mr Touhig: So that has been quite effective then?

Mr Eland: We are quite pleased with the way we have seen that work, yes.

Q29 Mr Touhig: If there is one thing that Parliament could do to help you tackle this problem what would it be? What do you think you could do with?

Mr Eland: I think ministers have been very receptive to ideas that we have put forward for different ways in which we can do things. I think it is very much around the powers we have to stop repayments while we verify. We are doing a lot of that activity at the moment and clearly there is then an agitation from the people involved to say we are holding up these repayments. We think we are entirely justified in doing that because it is paying out public money and we do need to carry out such checks. We feel we are properly resourced for that so that we can do it

HM Revenue and Customs

within a reasonable time. I think support for that approach and a recognition that it does have to be done is one of the things I am looking for.

Q30 Mr Touhig: Is most of the fraud that is perpetrated as a result of the repayments claimed?

Mr Eland: The way the fraud works essentially is that you have a chain where the commodity is circulated many times, and then one person disappears owing the VAT but everybody else in that chain is entitled to a repayment. What we are doing is looking at all of those repayments in the chain and saying were any of those people complicit in the fraud and should we be able to stop that payment. Clearly if we have strong evidence then we would mount a criminal investigation into them, but if we do not have that evidence of intent we now understand from the latest European Court decisions that provided we can prove that they should have known about the fraud then we can stop that repayment, and obviously that means they rather than the Exchequer bear the impact of the fraud.

Q31 Mr Touhig: Is that the most successful way you have got of stopping this fraud, stopping the repayment and investigating them?

Mr Eland: I think the really crucial thing is obviously criminal investigations and actually taking the masterminds out of the activity but, after that, ensuring that people who get involved in these chains bear some consequence of that I think is important, yes.

Mr Touhig: Thank you.

Q32 Mr Curry: What is it about mobile phones which lends them to this activity?

Mr Eland: It is that they are readily portable, they are of high value, and that is the sort of hallmark of MTIC fraud.

Q33 Mr Curry: There is a limited number of manufacturers of mobile phones, is there not?

Mr Eland: Yes.

Q34 Mr Curry: So you must be able to find where they are getting the mobile phones from? Where are they procuring these?

Mr Eland: We do work with the main manufacturers to try and get a handle on that. I do not know if one of my colleagues wants to give a few more details of that.

Mr Walker: Basically the phones could be sourced from anywhere in the world. Mobile phones are manufactured all over the world and they could enter the European carousel from any destination. I think the other point to make is that of course the same phones can be spun around the same carousel several times so for six different consignments, six different carousels you perhaps need only one consignment of telephones.

Q35 Mr Curry: Given that the market for mobile phones is, we are told, getting more and more saturated, are we about to have iPod fraud? Are we moving on to small, portable, high value, consumer lifestyle goods?

Mr Eland: It would be a natural place for it to progress. We are monitoring those goods very closely and we have seen no indication.

Q36 Mr Curry: In anticipation of that is there any way, because we are talking about far fewer manufacturers of iPods than phone manufacturers—and I am not massively up on this sector I have to say—that we can build bits of kit into them?

Mr Eland: Certainly the fact that all of the boxes are coded and there are unique numbers is very much part of the way we do track this and so that is very helpful. Also, as I said, we do talk to the manufacturers about whether we can track supplies. We inform them of the sort of characteristics of the fraudsters so they know to watch supplying to them.

Q37 Mr Curry: I seem to remember that about a month or so ago the Chancellor of the Exchequer announced he had solved this and Member States had agreed on this, since when we understand that there are more questions coming out and it has not been signed up. Can you give us *un peu de l'histoire* as far as this is concerned?

Mr Eland: Yes, one of the things we are looking to do which will make the fraud virtually impossible to do is to introduce for the sectors we are talking about what is called a “reverse charge”. I will not try and explain the technicalities of that. The effect of it is that instead of having a chain where there are payments between different companies which are then the subject of claim and reclaim from the Exchequer, there is no money that changes hands down the whole of the supply chain until the final point and at that point VAT is charged and accounted for to the Exchequer. That therefore eliminates the opportunity for this sort of fraud in all those levels above that. We believe, as the Chancellor announced before Christmas, that we have now concluded agreement on the main features of how that should operate. There are still some continuing issues that are being looked at at official level which we hope will be resolved very quickly and then we can proceed with it.

Q38 Mr Curry: They appeared to come up rather unexpectedly, did they not? Did we not think that this thing was a done deal?

Mr Eland: What this involves is the UK getting a derogation from the common set of rules so the UK is allowed to do something different from everybody else. It is normal in that sort of context for other countries to look at that to see whether there are any implications for them in allowing the UK to go down this route.

Q39 Mr Curry: You have said that other countries suffer the same problem and we know that it is difficult to quantify because we are more open than

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others about the degree of the problem. Is the remedy, which you are very confident as far as the UK is concerned, relevant to other countries as well?

Mr Eland: I think this conference next month will enable us to share good practice. I think in terms of the policy change we are looking there to make a unilateral change in the rules in that area. There are debates going on within the European Union about whether there should be a broader set of changes in the rules.

Q40 Mr Curry: Is there something particular about the United Kingdom which would make this formula work for us?

Mr Eland: No and we do know that it is possible that other countries will also ask if they can adopt this.

Q41 Mr Curry: So what is the hang-up then?

Mr Eland: The hang-up is just simply that a country that does not want to do this is checking whether it has any implications for them with some discussions.

Q42 Mr Curry: You are very confident this will do the trick. Why would another country have a different perception of this?

Mr Eland: It is difficult for me to speak for other countries. There is obviously a variety of factors that might make them decide on that. It might be that they see they have a different type of this fraud or they might have reasons why they do not like to make changes in the VAT system of that kind.

Q43 Mr Curry: So would it be fair to say that the problems in forming some common view are less an argument about instruments and more an argument about politics?

Mr Eland: I am not directly involved in these negotiations. I would imagine there is a political dimension to them.

Q44 Mr Curry: But we have agreed, have we not, that by the very nature of this fraud ultimately the framework for dealing with it has got to be an international framework not a national framework?

Mr Eland: I think that must be the ultimate goal yes, but obviously within the European Union that would mean getting agreement on a new fundamental system amongst 27 countries now. That is clearly going to take a while so this we see as an immediate measure we can take.

Q45 Mr Curry: Right so this would be a provisional measure pending a more comprehensive EU-wide measure?

Mr Eland: I think that there are bound to be future debates about how we improve the VAT system, yes, there is a variety of different ideas about that. However, there is no firm proposal for doing that.

Q46 Mr Curry: But it would need one would it not? If it is going to be a EU-wide system it can only be a Commission proposal that would lead to that?

Mr Eland: Yes, it would eventually need a Commission proposal.

Q47 Mr Curry: And where are we on the chicken and egg?

Mr Eland: The Treasury have now taken over tax policy so I am not directly involved in this, but my understanding is there is now beginning to be a debate about whether we do need to make these sorts of changes and how we can improve the system, but we are still some way off a formal proposal from the Commission.

Q48 Mr Curry: But you would again say that the hold-up from that point of view is technical rather than political? It is the opposite and the Commission is not having a problem about trying to formulate a response to this?

Mr Eland: Well, the Commission have been content for us to operate this derogation in this particular high-tech goods sector. I think they would have problems, as would other Member States, if this was done right across the entire VAT system because it would essentially be turning VAT into a sales tax and obviously that has a whole raft of economic and political implications, so I think there is that distinction.

Q49 Mr Curry: But this fraud is a product specific fraud. Again by the nature of it, it is only a limited number—and I do not wish to give people ideas—but is there a danger of this becoming more widespread?

Mr Eland: It is product specific at the moment. Our derogation is product specific. The risk obviously is that people attempt to move into other areas and it is that I think we have to be vigilant about.

Q50 Mr Curry: That might ultimately require some of international rule because you cannot keep multiplying individual national measures.

Mr Eland: You would have to decide whether you could continue to deal with it sector by sector or whether you needed a more comprehensive change in the system.

Mr Curry: Thank you.

Q51 Mr Khan: The C&AG's Report begins by saying that "missing trader fraud is one of the most serious attacks on the tax system ever seen." Do you agree with that bold first sentence?

Mr Eland: Yes, in terms of attacks by criminals.

Q52 Mr Khan: Figure 18 gives the figures for the estimated tax loss in the last six years. In the first year 1999-2000 the lower estimate was £1.17 billion and we see last year it was £1.12 billion. We have got an upper estimate as well which has also changed. Do you think that although the direction of travel is clearly going the correct way sufficient progress has been made in dealing with your estimated tax loss?

Mr Eland: I think in the last six months we have made real headway in driving fraud back down again.

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Q53 Mr Khan: This is the last six years.

Mr Eland: I know that is going into more recent territory than this Report but that is the latest position. I would not want to be complacent about this fraud, it does shift and change.

Q54 Mr Khan: I am surprised in answer to a question by Mr Touhig when he asked you what more could the Government do, you did not say, "We could do with 500 more investigators, 1,000 more case workers, three new pieces of European Directives," or whatever. You seemed to be taken by surprise and you did not really have a ready answer.

Mr Eland: I do not think I was taken by surprise. I think the question was what Parliament could do and I was trying to think of legislative changes that would respond to that. We have significantly increased the resource in this area to tackle the fraud and we are continuing to look at new areas that we ought to be strengthening. We are now strengthening the financial investigation side in particular because obviously we have had some big successes on the criminal side and we want to follow that through in terms of getting assets recovery and trying to get some of this back.

Q55 Mr Khan: How would you summarise your team's performance? How are they doing—good, average, very good?

Mr Eland: I think the contribution of the individual people is extremely good and I think we are beginning to get our act together in terms of putting all the measures together and driving it down, but I really do not want to sound as if I am complacent about this. This is a very serious attack. The fraudsters are very ingenious and as soon as we defeat them in one area they will come back in another.

Q56 Mr Khan: What sort of figure can we expect to see for financial year 2005-06 for the lower estimate of tax loss?

Mr Eland: I would hope that it is very substantially less than the £2 billion to £3 billion range that I have given you, but I would not want to put a figure on it, I think that would be foolish.

Q57 Mr Khan: One of the things the Report refers to is the EU Council Regulation of 2004. Are you familiar with the Regulation? This is the formal exchange of information between Member States. How mandatory is the requirement in the Regulation for there to be better co-operation between Member States?

Mr Eland: I think it is an enabling Regulation rather than a mandatory Regulation but—

Q58 Mr Khan: So none of our European partners are complaining about the fact that we only seem to respond to 55% of requests made?

Mr Eland: We have not had a complaint because everybody experiences difficulty in time on this. It is not just a matter of checking a name and an address sometimes. Sometimes it requires an actual visit to a company. It can be intensive.

Q59 Mr Khan: I thought you might say that, which is what surprised me because you have an EU Regulation made in 2004 requiring us to provide information requested by our European partners within 90 days. The number of requests which we responded to within 90 days was 53% last year and 55% this year. You say these take a long period of time and 90 days is probably a bit onerous. If that be the case why was 90 days fixed and not 120 days or 150 days?

Mr Eland: I am sorry, I do not know.

Q60 Mr Khan: Presumably the answer is because that is deemed to be a reasonable period of time for you to respond by?

Mr Eland: That was probably true at the time the Regulation was concluded. I was not involved in the discussions leading up to it.

Q61 Mr Khan: Are you concerned that 45% of requests are not dealt with within the deadline of 90 days?

Mr Eland: As I said earlier in response to a question from the Chairman, this is an area we think we do need to make improvements on. Obviously we are expecting other countries to respond to our requests—

Q62 Mr Khan: That was my next question. What sort of response do they give you when you make requests, as I am sure you must do for information? What is the response rate in different countries in broad terms?

Mr Eland: There are quite a few people in a similar position to us. We are not out of the pack here.

Q63 Mr Khan: Which countries do things well?

Mr Eland: I do not know if my colleagues can answer.

Mr Stewart: We get very good support from the Netherlands and I think it is important to consider when we get requests for information some are for mutual administrative assistance, which is covered by the Regulation, but others are for mutual legal assistance and that requires a quite different process and a very lengthy process. Part of the explanation as to why 90 days was appropriate in 2004 is that the frauds themselves were a great deal less complicated in 2004. Now the deal chains are extended through four, five or six different countries and it is quite difficult for us to give a full response.

Q64 Mr Khan: So have you explained this to the ministers and asked them to negotiate an extension of time of 90 days onwards so your response rates do not look as bad as they do?

Mr Eland: I agree this is an area that needs some further attention and I am happy to look at that as a possibility.

Q65 Mr Khan: You will have seen in the news in the last two or three weeks concern expressed about lack of harmonisation between us, lack of information being passed to us, and lack of a sophisticated system and areas of improvement that are required

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for us to deal with trans-national crimes being committed. We have here a statement from the C&AG saying we are talking about the most serious attack on the tax system ever seen and it seems to me that when we are responding to only 55% of requests within 90 days, when the Regulation stipulates we should be doing presumably all of them within 90 days, there seems to be a lack of concern from the Civil Service about this.

Mr Eland: There is not a lack of concern. As my colleague has explained, the sort of cases we are dealing with under this Regulation are now very complex ones and there is a recognition that that does sometimes mean it takes longer to resolve this, but how we can improve this is one of the issues that we are going to address during this conference of investigators that I talked about and to see how we can all improve—

Q66 Mr Khan: My time is about to run out. A couple more issues please and I am sorry for cutting you short but we have only ten minutes to ask questions. On the message to investigating fraudsters, we see in the Report that a number of investigations where we expect to have them concluding the trials by 2008 began in 2003. That must be very frustrating for you, a five-year period between start and finish. Is the reason for that the complexity you have talked about?

Mr Eland: Complexity is one of the reasons and the volume of material that is necessary to meet our disclosure obligations and to present the case to the court, but I will ask Mr Stewart to give a few more details about criminal investigations.

Mr Stewart: This year our delivery in successful cases has improved by almost 100%. I think that reflects the difficulties that we have had in taking prosecutions forward in 2004. We addressed that after receiving advice from five leading counsels on how best to prosecute the cases and the results that we have had in 2005-05 reflect a much improved performance.

Q67 Mr Khan: Mr Stewart, could you send us a memo setting out the number of prosecutions brought in the last five years, the convictions you have received and also the acquittals that there have been in each of those last five years, and in each of the last five years the amount of money you have managed to recover as a result of the excellent work of your team; is that possible?

Mr Eland: Yes, we can let you have that.¹

Q68 Mr Khan: My final question is to do with the point Mr Curry or Mr Touhig talked about, the fact that when applications are made for VAT registration being more robust in how you filter those through. I have two questions linked to that. Firstly, what happened to the 787 requests which were refused? Did you for example follow those up and investigate them to see if they were malevolent potential fraudsters? Part B of that question is how

do you make sure that you are not getting the balance wrong and putting too much burden and red tape on companies which wish to be VAT registered?

Mr Eland: On the first part, obviously if as a result of our enquiries into the registration we think we have got some leads into people organising things we will follow that through. On the second part, as you see, the total number of registrations is around 284,000 so we are only holding up a relatively small proportion of that. We try to do it in a targeted way. We are also trying to simplify some of the processes and everything without reducing security, so we are trying to get that balance. We recognise that it is one we have to strike.

Chairman: I will now call our new member Mr Iain Wright who I warn you is a Fellow of the Royal Institute of Chartered Accountants so he might know what he is talking about.

Q69 Mr Wright: Do not worry, I will let you down Chairman! Following on from that previous line of enquiry and what Don Touhig said about the UK being a soft touch, how easy is it for a trader to register in the UK, bearing in mind what has just been said about Britain trying to become regulation light, trying to promote enterprise and entrepreneurialism, how easy is it relative to EU partners?

Mr Eland: Everybody under the European VAT system has a right to be registered if they are carrying out a certain level of economic activity, and so that is the starting point. They have a right and we have got to have evidence to refuse them. I do not think our procedures are out of line dramatically with other countries. We have a much higher registration threshold than a lot of other countries, but I do not think that has a significant impact from this point of view. We did have complaints when we initially introduced these checks for fraud that we were holding up too many applications, we were being intensive and we were out of line. The sort of measures we have taken are putting risk advisers into the registration unit so they do not have to refer, they can actually do it on the spot, and this has helped speed things up. We think we have got the optimum balance between procedures which give us the right amount of information and that are not too onerous on companies and that the checking is done sufficiently quickly that it is not onerous on companies but is still sufficient to greatly improve the number of suspect people we are knocking out. However, this is a constant balancing act.

Q70 Mr Wright: Do you have any idea as to the nature and pattern of the missing trader fraud? What I mean is that do you think over the last few years there are fewer larger Mr Bigs, or do you think that more people are becoming aware of this type of fraud and want to get involved in it? Are you chasing the smaller, but numerically larger ones in terms of monetary value, or not?

Mr Eland: Our view is, and I do not want to go for obvious reasons into too much detail, that there is a relatively small number of large scale organisers, and we hope that in two huge operations we did last

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year we have hit two of those very hard. There is a bit of opportunistic getting-on-the-back-of-a-bandwagon, but I do not think we have a huge amount of evidence of that.

Mr Stewart: We obviously have tried to focus our investigations to determine the key principals in the organised crime groups that we believe are behind the attacks, and we are finding as we follow the money certain key individuals who are the beneficiaries of the proceeds of crime, and that is assisting in further enquiries.

Q71 Mr Wright: On risk assessment and the figures, there are fewer referrals for detailed check. With the audit that is carried out, are you happy that the risk assessment is robust and is consistently applied? I remember I used to work for a Big Four accountancy firm and did some work for Customs & Excise, as it was then, and Customs & Excise used the diamond system of recording at that time, and I remember one office being incredibly detailed in the amount of data it used to put on the diamond system and then another VAT registration office hardly putting anything on at all. In terms of the risk assessment approach, are you happy that it is consistent?

Mr Eland: Now that we have these risk specialists that are put into the registration centres we have got that consistency of approach because they work as a team, so I feel we have greatly improved the risk operation and I think we have results that demonstrate that. We are also looking to improve on it further through enhancing our ability to look at a much wider range of IT sources so that we can carry out quickly a broader range of check, so this is still an area where we want to see improvement.

Q72 Mr Wright: I do not want you to go into too much detail, for obvious reasons, but in terms of improvements to risk assessment you are content you have a programme in place to carry out the checks where the risks are taking place?

Mr Eland: Yes, we have a programme in place I think we have good staff in place who are expert in doing this; and we have a programme to improve that through IT which will give them a greater range of sources to draw on.

Q73 Mr Wright: How do you incentivise staff involved in this? Do you provide them with the greater amount of fraud that is picked up and carry it through into their remuneration package, for example?

Mr Eland: Only very indirectly. Obviously if they are performing extremely well they get higher marks in their annual appraisal, but we do not have any direct links into money bonuses.

Q74 Mr Wright: And there is no direct performance-related pay, and no plan to do so?

Mr Eland: We are gradually introducing it down the system but it will not encapture everybody at the moment.

Q75 Mr Wright: Finally from me, in terms of a scenario whereby a trader registers for VAT and is trading quite legitimately for 12/24 months with the deliberate intention of then trading fraudulently but trying to reduce the risk, what procedures have you got in place to detect that? As a prelude to that, do you think that goes on in quite a large amount of cases?

Mr Eland: If I could answer that last one first. As our registration checks get better we have seen people driven to buying companies that are already registered. As to whether there are the sort of sleeper-type arrangements like you have described, I think it is more people buying small businesses that are already registered than plotting that sort of penetration of the system over a period. We have to look, obviously, at trading patterns and we are always looking for unusual points across a pattern of trading that help us to identify this sort of thing.

Q76 Mr Bacon: May I continue with the line of questioning about businesses being purchased that are already VAT registered? It says on page R42 that it is an obvious way around the problem from a fraudster's point of view, and in paragraph 4.15 it talks about additional checks and registration procedures you have introduced to combat that but there are no figures. First, if a business is registered for VAT and it is bought and sold, in and of itself that is not something which you would become aware of, is it, the fact that the beneficial ownership of the business had changed—

Mr Eland: I do not think it is—

Q77 Mr Bacon: --- if the business carried on paying its VAT obligations. So it is only if it changes its activities, hence the description here “applying to HMRC to amend their details to reflect the new business activity”, that you become aware that it had changed hands?

Mr Eland: That is my understanding.

Q78 Mr Bacon: Are you aware—and I do not know the answer to this at all, it is not a trick question—what volume of businesses that are VAT registered are bought and sold each year?

Mr Eland: I do not have that data available; I will see if we do have it. Obviously we do check other people's databases, Companies House and so on, to look at material that could help us, but within the VAT system my understanding is the same as yours, that it is change of business that has to be notified to us, not change of ownership.

Mr Walker: Just to clarify, if a business is sold on then—

Q79 Mr Bacon: The directors would change.

Mr Walker: --- there is frequently a change which would need to be notified to our Department because, for example, the address might change or the bank account might change.

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Q80 Mr Bacon: Yes, so you use that as a trigger?

Mr Walker: Yes. There is probably a larger proportion of businesses that we do get to know about than those we do not, for those very practical reasons.

Q81 Mr Bacon: It would be very helpful if you sent us a note about the total volume and the volume you get to know about, irrespective of whether they are legitimate or not, just the sense of quantum, because what is striking about this paragraph is there is no number there at all². What sense do you have of how successful those additional checks and registration procedures you have introduced have been to identify fraudsters who try to bypass the initial registration by buying a VAT registered company? What sense do you have of the extent to which that monitoring has been successful?

Mr Walker: There are probably around about 30 a month which come to our attention where we need to take further action and some of those are deregistered and some are closely monitored.

Q82 Mr Bacon: On the bottom of that page on the other side, in paragraph 4.17, it says that HMRC may request traders to provide a financial security to cover the estimated value of tax that may be at risk, and that it has proved to be a successful disruption technique with 74 registered companies having security requested from them between April 2004 and February 2006, and 18 of these either ceased to trade or were deregistered. What happened to the other 56?

Mr Eland: We have security against—

Q83 Mr Bacon: But are they people whom you believe to be legitimate or about whom you still have concerns?

Mr Eland: It is only if we felt they were involved in fraud that we would not have registered them. Security enables us, in circumstances where we are not only happy about something, to try and protect the revenue without imputing fraud. We would then monitor that. It might well be that they actually turned out to be perfectly legitimate.

Q84 Mr Bacon: That was my point. You might be saying to perfectly legitimate businesses: “Please pay us security in advance”, and because they want to carry on trading and even though they do not like the idea they pay you.

Mr Eland: Security is usually in the form of a bank guarantee, it is not money up-front, so I do not think we are inhibiting trade there but we do need these sorts of measures which are not as draconian as refusing registration. I talked earlier about the new information powers that we were given last year by Parliament so if we are not certain about a company we can also say, “We would like you for the first six months to give us rather more information than we normally would.” It is that sort of halfway house.

Q85 Mr Bacon: In figure 22 it indicates that the total number of VAT registration applications went up from 2002-03 to 2005-06 from 257,000 to 284,000; the number of referrals halved and yet the number of suspect applications refused more than doubled from 900 to 2,200. Is that simply better targeting and better intelligence by your supervisors?

Mr Eland: It is a combination of better targeting and the fact that we put better risk advisers into the registration units so they do not need to refer matters out; they can actually use remote checking systems and do them on-the-spot, so we would see this as a sign of better performance and a better targeted approach.

Q86 Mr Bacon: I would like to ask you about paragraph 4.4 which talks about fraudsters who, instead of going missing, now continue to trade to generate greater tax losses before defaulting on payment of VAT. The word “default” there suggests, and I may be wrong, that by carrying on trading and generating tax losses they stop being liable for the VAT they had owed? This is the bottom of page 38, paragraph 4.4: “Fraudsters have changed their method in response to measures adopted by HMRC.” Am I right in thinking they would actually render themselves no longer liable? That they could by continuing to trade and generate tax losses obviate an earlier VAT debt they had had?

Mr Walker: Perhaps if I could just explain, as soon as we identify such a trader we bring the VAT accounting period to a close within a matter of days. This forces them to declare their liability, enables us to determine what that liability is, and then we take one of a number of forms of action. We may deregister; we may seek to invoke provisional liquidation and so on, but once identified we bring the accounting period to a close so that means that they do not continue to run up further tax losses.

Q87 Mr Bacon: Would the reverse charge mechanism essentially, if you were able to introduce it, eliminate this kind of trader fraud?

Mr Eland: In the sectors we impose it in, yes, because it effectively takes away the opportunity to collect tax and disappear in a carousel, because exports are zero-rated for VAT so if there is no VAT charged as it goes down the chain and then it is exported at the end of the chain there is no money, so that is why it would work.

Q88 Mr Bacon: Mr Khan referred to paragraph 4.42 earlier, which says missing trader fraud is one of the most serious attacks on the tax system ever seen, and given that according to the following paragraph, 4.43, tax practitioners recommended the introduction of a reverse charge mechanism in 2003, and in 2005 the Government then submitted an application to the European Commission to change the rule, and in September 2006 the European Commission announced its support for the UK’s application, and it was scheduled for discussion last November but apparently the discussions are not completed or concluded yet and the Council is due to Report back to the Commission by June 2007, we

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are talking about a period of four years from when somebody first had the bright idea to even a final consideration of whether the EU thinks it is to be backed or not. Is that timetable, given the urgency or lack of urgency reflected, adequate given the description of this as one of the most serious attacks on the tax system ever seen?

Mr Eland: I would just say that although the ideas were floating around in the accountancy profession and had been discussed in 2003, we did have a different strategy at that point. Our argument was that these carousel frauds did not have any economic activity in them and, therefore, people were not entitled to claim repayments. It was not until January 2006 that that approach was ruled outside European law. Before that it had been working, and very well, in terms of keeping fraud levels down, so I think I would say the clock started ticking, if you like, in January 2006 and it has taken a year to get to the point we have. Ministers announced in, I think, January or February last year they were going to seek this; there is then a process that has to be gone through whereby the Commission has to invite evidence from people and there has to be a set number of months for that; they have to see whether there is a burden on business—there is a whole lot of things that have to be gone through before they can even bring forward a proposal, and we cannot do anything until they have brought forward a proposal, so it is part of the European legislative process.

Q89 Mr Bacon: I will not ask any more questions because the Chairman tells me I am pretty much out of time, but just to be clear the brief we have says that the Council is due to Report back to the Commission in June 2007. I take it that is correct, and therefore the Commission subsequent to that has to come out with its proposals?

Mr Eland: No, I think that is not correct. My understanding is the Commission has produced a proposal and it is up to the Council to agree that proposal for a derogation. If they do then we will be able to implement it very soon after.

Q90 Mr Bacon: How quickly would it bite, assuming things went well?

Mr Eland: If we got a conclusion, either this month or next, we have obviously been talking to the industries affected on this and they need a period of notice to change their system, and I think we have been talking about eight weeks as a reasonable introductory period, and then it would come into operation.

Q91 Mr Bacon: So by the next time we see you it might already be up and running?

Mr Eland: I hope that is the case, yes.

Q92 Mr Davidson: I appreciate this is an immensely complex and difficult area. We have visitors here from Namibia and I think some of them are losing the will to live, but I want to pursue some of the points. In paragraph 4.17, where we are saying specifically that you can request traders to provide a

financial security to cover the estimated value of tax that may be at risk, why do you not do that virtually all the time, because at the moment the public sector bears all the risk of fraud. Why do not you transfer it to the private sector by saying “You have to provide some sort of guarantee and so on, so that we do not bear the risk.”

Mr Eland: We have got to strike a balance between encouraging small businesses and enterprise in the economy and trying to tackle fraud, so given we are investigating and refusing a whole lot of people, what we are trying to do—

Q93 Mr Davidson: So you are not investigating and refusing the whole lot; you are investigating and refusing a relatively small number, and there are a whole lot of people who are rascals and are robbing us blind.

Mr Eland: Registration is not the only thing and security is not the only thing. Now in these affected sectors when they put in a repayment claim we will be checking that as well, so it is something we follow the whole way through. The security is particularly designed against people who disappear, and in the carousel it might involve 20 companies --

Q94 Mr Davidson: But if you apply the security against people who have disappeared, by definition they have disappeared. The idea surely is you ought to be putting the security down before?

Mr Eland: No—

Q95 Mr Davidson: Why do you not work on the basis that by definition anyone who is dealing in mobile phones is trying to cheat the system and ought to be required to put down security until it is proven, by a period of trading, that that is not the position?

Mr Eland: We have not looked to take that blanket approach. We have taken a risk-based approach—

Q96 Mr Davidson: Why not?

Mr Eland: Because we are trying to strike a balance between encouraging business and treating legitimate businesses well.

Q97 Mr Davidson: What is the proportion of businesses involved in carousel mobile phones who disappear as compared to the percentage that actually trade honestly over the long period?

Mr Eland: I do not know if we have broad numbers on disappearance.

Mr Walker: In 2005-2006 we identified, and I think the figure is in the Report, just over 350 who had disappeared and who we deregistered as a result.

Q98 Mr Davidson: How many firms are there involved in such complicated dealings as mobile phones?

Mr Eland: 2,000 to 3,000.

Mr Davidson: 10%. So it is a fair assumption that here is an area of the economy where 10% are rascals. Now, that is even higher, Chairman, than

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the percentage of farmers that are involved in fraud of one sort or another, and in those circumstances I would have thought—

Mr Bacon: I thought you thought all farmers did it!

Q99 Mr Davidson: No; all farmers are tempted but not all undertake! But given such a high percentage of people are involved, surely different rules ought to apply and some of the risk ought to be transferred to the private sector?

Mr Eland: What we are doing differently in this sector is to look very hard at the repayment claims and those are subject to delays because we are carrying out verification checks, so we are focusing on that—

Q100 Mr Davidson: You have been stung over several years for—and I cannot add up that number right away but Mr Fratini recognised that across the EU it is £40 billion, is it not?

Mr Eland: Yes.

Q101 Mr Davidson: -- which I reckon is about the equivalent of 8p off income tax were it all applied to the UK, so we are talking substantial sums of money here and you seem to be remarkably laid back in terms of striking the balance.

Mr Eland: I do not want to give the appearance we are laid back at all. We have to have things that are targeted. The security is useful against a company that might disappear; it does not help in terms of the repayment claim side of things. What we are trying to do through all the 800 people we now have investigating those repayment claims, which have often led to quite significant delays before people can get their repayment claims, is to deny the fraudsters the money that they are trying to get out of the system.

Q102 Mr Davidson: How much has been saved as a result of these delays? You are indicating that the mechanism of investigation and delay—

Mr Eland: We have only been able to do that since we had these new European Court decision. We are still in the process of that exercise, and I cannot give you an answer.

Q103 Mr Davidson: Can I turn to another point about other examples of fraud that we have had? I am presuming that if we went downstairs and got a couple of ladies working in the cafeteria, they would not be able of themselves to start a mobile phone carousel fraud. They would require help from accountants and lawyers and so on. How many accountants and lawyers have been reported to their professional association for malpractice in all of this?

Mr Eland: We have not only reported some to professional organisations; we have actually prosecuted some.

Q104 Mr Davidson: How many?

Mr Stewart: In the last two years 11 professionals have been arrested and that has resulted in six convictions relating to MTIC fraud. In addition to that we have had three others convicted relating to straightforward VAT theft.

Q105 Mr Davidson: How many people have been reported to professional associations?

Mr Stewart: In addition to those, two solicitors were recently acquitted in a trial in July with a bench order that they be reported to the Law Society.

Q106 Mr Davidson: I think you can understand my feelings about the role, perhaps, that the accountancy and legal professions are failing to play in these matters, because clearly lots of these frauds could not operate without the expertise of accountants and lawyers who seem to be just sailing away with it scot free and are not applying due diligence. Is there much evidence that lawyers or accountants have been reporting to yourselves: “This looks like a scam”?

Mr Eland: We have had meetings with the Big Four and also accountancy rep bodies to describe the sort of characteristics of MTIC fraud—

Q107 Mr Davidson: That is right, but they should know that anyway really, should they not?

Mr Eland: Obviously it helps if you have some pointers, and we do know a number of people have been refusing clients as a result of that.

Q108 Mr Davidson: How many?

Mr Eland: I do not have those figures. I will see if we do and I will let you have them.³

Q109 Mr Davidson: That would be helpful, and if there was any evidence that the profession was self-policing that would be helpful.

Mr Eland: If we can get the evidence, either to associate them with the criminals, if they are helping them, or if we feel it is in a greyer area to report them then we will do that.

Q110 Mr Davidson: Can I clarify the position of the European Court of Justice? Would it be fair for me to say, from what you have said to us, that the European Court of Justice, given a choice between encouraging the single market and cutting down on fraud, have always come down on the side of encouraging the single market?

Mr Eland: I cannot say “always”. Obviously in this particular instance they are bound by the law so they have looked at the wording of the law and have decided that what we were doing was wrong, and yes, that has gone that side in this case rather than—

Q111 Mr Davidson: Have you ever won any cases with the European Court of Justice?

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Mr Eland: I think the most recent case we had is a case called *Kittel* which has laid down the test that if people should have known about the fraud then we can stop repayments, and that is a helpful one and that is what we are now doing.

Q112 Mr Davidson: So you have won some. You have mentioned here various organised crime groups. Who are these? Are these people who have been robbing the EU blind on agricultural subsidies for a few years and are now transferring into other things, or are they involved in drug smuggling, or are they home grown?

Mr Eland: I do not want to go into too much detail but they are largely UK-based, and there is some evidence that they are involved in other crimes as well. We have got two major criminal investigations under way now which are still *sub judice* so I have to be a bit careful, but these are real criminals and are not people—

Q113 Mr Davidson: These are real criminals probably known to the police for other crimes as well, and they are probably getting the same sort of help from accountants and lawyers as they are in their other areas of activities, but when we investigated tobacco smuggling it was quite clear that some of the tobacco companies either knew or ought to have known what was happening with their products. Does the same apply to mobile phone companies?

Mr Eland: No. Obviously we looked at that for precisely the same reason, whether there is a parallel with tobacco. It is a very different market and structure; it is an international trading activity in a different way from tobacco. We have gone to the main manufacturers to alert them to the risks of this and to ask them to look at their suppliers, and we have had very good co-operation from internal—

Q114 Mr Davidson: Better than from the tobacco companies?

Mr Eland: Yes. If you recall we did initially have some difficulties with the tobacco companies, and we have not experienced that sort of difficulty with the big companies in this area.

Q115 Mr Davidson: Clearly there are enormous sums of money sloshing about in all of this. In the past we have had discussions here and elsewhere about the leading role of the City of London in helping to money-launder Nigerian money and so on and so forth. Is there much evidence that the City of London is involved in the money-laundering associated with these frauds?

Mr Eland: No. I think most of it has moved very quickly offshore.

Mr Stewart: It is fairly consistent with the crime groups we are looking at that the money has moved very quickly out of the jurisdiction.

Q116 Mr Davidson: To where?

Mr Stewart: Across the world but great chunks of it to the United Arab Emirates and we are closely working jointly with the United Arab Emirates authorities to trace that money.

Q117 Mr Davidson: I think that is very helpful, Chairman. Finally, in terms of asset recovery, the asset recovery weapon has been a very valuable one in a whole number of clinical areas, but you do not seem to be particularly successful in getting much of the assets recovered here, and while I appreciate that in a way things going off to the UAE and elsewhere disappeared to some extent into a black hole, I had thought there was a greater degree of co-operation with these jurisdictions than before and that you ought, therefore, to be able to trace more of it?

Mr Eland: The Proceeds of Crime Act means we can act much more quickly than we used to be able to, so we can get freezing orders very early on in the process, and we are now with these two big operations we had last year getting freezing orders in both the United Arab Emirates and also in Curacao, which was another of these offshore areas. These are only freezing orders, and we still have a long way to go to get these through, but it does mean we can act earlier in the chain.

Q118 Mr Davidson: I think it would be helpful if you could give us an indication of the other jurisdictions about which you have concerns in order that Members can pursue that elsewhere⁴, and just for the reassurance of our visitors I take it Namibia is not one of those jurisdictions?

Mr Stewart: Not so far as I am aware.

Mr Davidson: So a clean bill of health for Namibia! Thank you very much.

Q119 Chairman: That concludes our hearing, Mr Eland. This is a poor Report and we are not overwhelmed by your response given that up to £4 billion worth of public money has now been lost. This is now the second time we have looked at this. I am looking at the Treasury Minute, Thirty-Sixth Report of 2003-04, and bearing in mind we work quite hard on this Committee and when we make recommendations we like there to be some effort made at a reasonable response, the PAC conclusion is: “Prompt exchange of accurate and up-to-date information on traders with other Member States is particularly important in tackling missing trader fraud”, and the Treasury Minute says: “The European Commission has announced a feasibility study with the aim of modernising the current EU-wide VAT Information Exchange System . . .”, and very little progress appears to have been made. The next PAC conclusion is: “The scale of VAT losses suggests that more investigations and prosecutions for all types of VAT fraud would be cost effective”, and the Treasury Minute says that Customs prosecutes only around 90 VAT fraud cases a year. The next PAC conclusion is: “To achieve the maximum effect from prosecutions for VAT fraud,

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court time should be made available promptly so that cases are brought to trial more quickly”, and the Treasury Minute says that it can take “up to a year for court time and lawyers to become available to try a complex VAT fraud case”. Not good enough. The next PAC conclusion, and very little progress has been made on this either, says: “Despite the thousands of under-declarations of VAT discovered each year Customs has only reported the accountant or other professionals involved to their professional

body on four occasions”, and the Treasury Minute says: “Only 24 VAT investigations have been in cases where professionals such as accountants, lawyers and tax advisers were involved”, so on that recommendation very little progress seems to have been made. If we come back to this again in two years’ time, Mr Eland, we expect more progress to have been made given the large amounts of public money lost and, if not, someone should consider their position. Thank you very much.

Mr Eland: Thank you.

Supplementary memorandum submitted by HM Revenue and Customs

Question 67 (Mr Sadiq Khan): *Number of prosecutions brought in the last five years, the convictions you have received and also the acquittals that there have been in each of those last five years, and in each of the last five years the amount of money you have managed to recover.*

Having carried out a complete audit of MTIC fraud prosecution files for the last five years, HMRC has concluded that some data in respect of criminal prosecutions previously published by HM Customs and Excise was incomplete. The correct figures are in the table below:

<i>Year</i>	<i>Prosecutions</i> ¹	Convictions	Sentences (Years Imprisonment)	Acquittals	Stayed/NEO ²	Confiscation Orders ³
2006–07 (to 12/06)	17(14)	45	194.25	10	6(2)	29,337,431 ⁴
2005–06	17(10)	26	93.67	10	24(6)	2,759,739
2004–05	10(9)	20	60.08	8	8(1)	12,820,946
2003–04	14(11)	14	46.25	1	22(3)	10,572,438
2002–03	15(12)	29	121.91	9	2(1)	28,146,459
2001–02	10(7)	23	87.33	4	3(1)	13,613,550

Due to the complexity and scale of most MTIC prosecutions and the judicial process, cases can take up to five years from start to determination at trial. Currently, HMRC have 69 MTIC cases at varying stages within the judicial process. With aim of achieving maximum impact, our investigations have targeted those principals that control and orchestrate the frauds. By the nature of their involvement, these principals have often remained in the background with no obvious link to the control of those companies participating in the contrived carousel transactions. Whilst this has led to an increase in the complexity and length of the investigations, the successes that have been achieved against them has had a greater impact than solely prosecuting minor players such as missing traders, which has a very limited effect on the capabilities of the organised crime groups.

In 2006 record individual prison sentences of 11 years and 15 years were imposed by the courts. This reflects the growing recognition by the Judiciary of the seriousness of this fraud and the impact and harm it has on our communities.

Question 78 (Mr Richard Bacon): *What volume of businesses that are VAT registered are bought and sold each year.*

HMRC do not collect specific data on “businesses bought and sold” and such data is not routinely produced by either the Office for National Statistics or the Small Business Service. However the following HMRC data may be indicative:

To set the context, in the year 2005-06, HMRC received:

- Over 269 000 new applications for new VAT registrations.
- Almost 158 000 applications for deregistration from the VAT system.

¹ Total cases with successful prosecution figures in brackets.

² Stayed/No Evidence Offered numbers of individuals with the number of cases where the whole case was stayed/NEO in brackets.

³ Orders obtained for successful cases in that year. It is likely that the orders were in part obtained in successive financial years as the process is lengthy and complex. Responsibility for realising the orders is with RCPO.

⁴ Includes £28,722,377 against a defendant who absconded during trial.

In the same period, there were in excess of 1.8 million businesses on the VAT register.

In the year 2005–06, HMRC received:

- Almost 428 000 request to vary particulars relating to specific businesses: ranging across change of address/phone number, change of bank details, change of trade class, change of ownership and others.
- Around 50,000 formal notifications of a business undergoing a Transfer of a Going Concern (where a person acquires a business and its assets as a going concern).

Requests to vary particulars and notifications of a TOCG are subject to risk assessment in the same way as new applications for registration in order to identify attempts by MTIC traders to enter the VAT system by purchase of companies that are already registered.

Questions 106-108 (Mr Ian Davidson): *Number of people (accountants/lawyers) refusing clients and any evidence that the profession is self-policing.*

Working with accountancy and other tax professional bodies is an important part of HMRC's strategy to tackle the fraud. The primary, but not exclusive, focus of that work is to inform them of the indicators of fraud and secure their support and commitment to tackling the fraud.

HMRC would not normally be made aware of instances where professional advisers refuse to act for businesses they suspect are acting recklessly or turning a blind eye to obviously suspect trading. However, through our discussions with individual firms and representative bodies we have been informed that they have refused to take on businesses as clients, but we have no numerical data. We have also been informed by a number of firms that they have revised internal governance procedures or taken disciplinary action because of their increased understanding of the indicators of MTIC fraud. Individual firms may retain this information.

HMRC's work with tax professional firms and representative bodies led to the Big 4 accountancy firms publishing a statement condemning MTIC fraud in December 2005. This has been followed by smaller accountancy firms making their own statements condemning the fraud and those who perpetrate it. The Standard Report refers to some of those organisations.

HMRC held a workshop on tackling MTIC fraud for Joint VAT Consultative Committee (JVCC) members and MTIC fraud is a standing item on the agenda for the JVCC meetings. External membership of the JVCC comprises representatives of professional and trade bodies. We worked with JVCC members to produce guidance for new and existing businesses to alert them to the indicators of MTIC fraud and the potential consequences of involvement. The leaflet can be accessed through this link to our Internet site.

<http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?—nfpb = true&—pageLabel = pageVAT—ShowContent&propertyType = document&id = HMCE—PROD1—025808>

JVCC members have also written supportive articles for their professional magazines, such as Tax Journal, alerting professionals to the fraud indicators and the reputational risks of representing fraudsters.

Question 118 (Mr Ian Davidson): *An indication of the other jurisdictions about which you have concerns.*

The Organised Crime Groups behind MTIC fraud have the flexibility to change their tactics in response to HMRC's strategies to tackle the fraud. This is demonstrated by their ability to design complex and contrived transaction chains, both within and outside the EU, to frustrate our ability to track and trace the stolen VAT.

As our knowledge of the complex MTIC money flows has developed, we have identified countries being targeted/used by the fraudsters and have worked closely with the appropriate authorities to combat the money laundering.

- HMRC identified that the First Curacao International Bank (FCIB) was the preferred bank for the majority of MTIC traders. We are working with the Dutch authorities who are investigating FCIB.
- It has been identified that the stolen VAT, having been laundered through the FCIB accounts, was then transferred out in part to financial institutions in the UAE, principally Dubai. To address this HMRC has worked with the authorities and put in place Memoranda of Understanding governing the exchange of information about imports and exports between Dubai and the UK. The UK has also recently concluded a Mutual Legal Assistance Treaty (MLAT) with the UAE, which provides for the exchange of information and evidence in support of criminal investigations to tackle various forms of fraud including MTIC fraud. This has facilitated closer working and co-operation between HMRC and the UAE.
- In 2006 a high level HMRC delegation visited Singapore to give a presentation on MTIC fraud and the resultant money laundering in order to alert the authorities to the potential for their financial systems and institutions being used for the purposes of laundering the proceeds of MTIC fraud.

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- HMRC have stationed 2 officers in Hong Kong who have engaged with the authorities to raise awareness of MTIC fraud and have enlisted their support in attacking money laundering associated with the fraud.

THE EFFECTIVENESS OF THE UK'S STRATEGY FOR TACKLING MTIC FRAUD

In his evidence to the PAC, Mike Eland explained that estimates of MTIC fraud for 2006–07 would be published alongside the Pre-Budget Report in line with current practice.

However, to update the Committee on the effectiveness of our strengthened strategy, we include data from the Office for National Statistics (ONS). The ONS, using overseas trade data supplied by HMRC, publishes monthly estimates of the value of UK trade that is missing or under-reported as a result of MTIC carousel fraud. That data, contained in the table below, provides an indicator of the level of MTIC-related trading activity, and demonstrates the scale of the attack by fraudsters and how HMRC's operational strategy has impacted on the fraud over recent months.

Table 1

Estimates of missing trade associated with MTIC fraud in the UK

<i>Quarter ending</i>	<i>Value of MTIC-related trade (£bn)</i>
September 2004	0.6
December 2004	0.7
March 2005	1.0
June 2005	2.3
September 2005	3.5
December 2005	4.4
March 2006	11.6
June 2006	14.3
September 2006	2.2
December 2006	0.6

⁵ Note that export trading typically results in a VAT repayment claim being submitted to HMRC between one and four months later.