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Stopping the Carousel: Missing Trader Fraud in the EU

Report with Evidence

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(Q) refers to a question in oral evidence

(p) refers to a page of written evidence

FOREWORD—What this report is about

Cross-border transactions within the EU have, since 1992, been zero-rated for Value Added Tax (VAT). Importers of goods are thus able to receive goods without paying VAT, but charge VAT on their resale. If the VAT they receive is not then remitted to the revenue authority, they are committing a crime: this is Missing Trader Fraud. Should the goods be repeatedly exported and re-imported then this criminal practice can be repeated, giving the activity its more common name, Carousel Fraud.

This is not a fraud against the institutions of the European Union, nor does it occur because of any mismanagement by them. Instead it is the fiscal authorities of the Member States that are being defrauded, due to the rules that they have chosen to implement for the taxation of intra-Community trade. The report examines whether Missing Trader Fraud can ever be prevented under the current system and considers some alternative mechanisms for the taxation of intra-Community trade.

Attempts to undertake this fraud have risen considerably in the past decade, largely due to the proliferation of high value & low weight goods, such as mobile phones, and substantial losses—up to £4.75 billion for 2005/06—are estimated to have occurred in the UK alone. This report examines the measures that have been taken in the UK both to recoup income already obtained fraudulently by those undertaking this activity, and also to prevent the fraud from being able to occur. We look ahead to the limited reverse charge accounting system which is to be introduced to the sectors most commonly used by the criminals exploiting the loophole in the tax system.

In addition to considering the effectiveness of measures taken to date, we have also examined whether the Government's policies to date have imposed an unreasonable burden upon legitimate businesses within the affected sectors.

We conclude that existing measures to tackle Missing Trader Fraud do not prevent its occurrence and are unsustainable. Furthermore, the Government needs to take real and substantive steps to ensure that their actions do not damage innocent traders. We accept that the reverse charge will eradicate Missing Trader Fraud from the sectors currently affected but we expect that the fraud will mutate to other sectors. We call on the Government to work with other Member States to implement a system for taxation of intra-Community transactions which will be more enduring and less vulnerable to major fraud.

Stopping the Carousel: Missing Trader Fraud in the EU

CHAPTER 1: THE DEVELOPMENT OF MISSING TRADER INTRA-COMMUNITY FRAUD¹

Introduction

1. Missing Trader Intra-Community (MTIC) Fraud is an exceptional crime. It is exceptional in its scope: HM Revenue & Customs (HMRC) believe approximately £3 billion was retained by fraudsters in the 2005/06 financial year. It is exceptional in its execution: a deliberate criminal act undertaken by criminal gangs whose activities have led to a distortion of the UK's trade figures. It is also exceptional in its design: because of the nature of the VAT system companies are able to collect tax on behalf of the government and simply fail to remit it to HMRC. It is a high profile, lucrative and systemic fraud, but one which requires a solution which will neither propel the problem into other Member States nor place an over-onerous burden on legitimate business.
2. Our concern about MTIC fraud is heightened by the fact that it occurs because of a fundamental flaw in the design of the VAT system. This is not the plain evasion and fraud—such as under-reporting or mis-reporting of sales, or failing to register with the tax authority—that is also seen in other tax regimes. There is no evidence that the VAT evasion rate is higher than that for other forms of taxation²: approximately 12% of the hypothetical VAT revenue is being lost each year, but a third of this loss is attributable to MTIC fraud.

VAT

3. Value Added Tax (VAT) has a key strength: the government effectively collects a proportion of the tax at each stage in the sales chain, rather than concentrating the potential revenue, and the risk of evasion, in the final seller. This “fractionated” nature is also VAT's principal weakness: many more transactions have to be logged and reported by traders, raising both the regulatory burden and the difficulty of monitoring compliance. In addition, the seller of an item is collecting the tax on behalf of the revenue authority, rather than the revenue authority collecting it directly from the taxpayer. This extra link in the chain increases the opportunity for fraud. A tax authority considering claims for VAT repayment has to maintain a balance between not being so restrictive that legitimate claims are denied and the tax

¹ Missing Trader Intra-Community Fraud is popularly known as “Carousel Fraud”: this term represents the practice on continual import and export of the same goods in a chain of transactions. See paragraphs 7 & 8.

² Other forms of VAT evasion include non-registration and non-compliance by registered firms. Losses under other types of tax are also suggested to be between 10–15%. *VAT fraud and evasion: what do we know and what can be done?* Keen & Smith, National Tax Journal Vol LIX, No 4 December 2006

effectively becomes a tax on production inputs, and not being so lax that fraud continues unchecked.

4. In the past forty years, VAT has been introduced in around 130 countries, including all OECD members other than the United States. Several European nations, including Denmark, France, Germany, the Netherlands and Sweden introduced the tax in the 1960s; the UK introduced VAT in 1973. The Council of Ministers adopted its First and Second VAT Directives³ in 1967, which introduced a common VAT system across Europe. The Sixth VAT Directive⁴, adopted in 1977, standardised the basis of the application of VAT on goods and services within the EU. The Sixth Directive has been amended and was replaced in 2006 by a recast text (the “Principal Directive”).⁵ Member States continue to operate derogations to allow them to apply a reduced rate or exempt classes of goods from VAT.
5. The abolition of barriers to internal trade in 1992 required further changes to the system of VAT applied to intra-Community trade. The Commission proposed a clearing house which would ensure that tax collected in the supplying Member State and deducted in the importing Member State would be passed to the latter Member State’s revenue authority. This proposal was rejected by the Council of Ministers, who expressed concerns that the clearing house would not be practicable, not least because Member States would have no incentive to investigate their purchasers in order to collect tax which would be passed on to another Member State.
6. Instead, Member States adopted a system under which intra-Community transactions were zero-rated. An exporter would not charge VAT, but would be able to claim a refund of input VAT; a purchaser would not pay VAT, but would have to charge it on subsequent sales and remit the VAT income to its fiscal authority. Thus consumption is taxed in the importing country. Any changes to this system, and other fiscal matters, require unanimity. This, along with a lack of political will to make a major change, has led to the current system continuing largely unchanged, despite suggestions on its introduction that it would only operate until 1997.

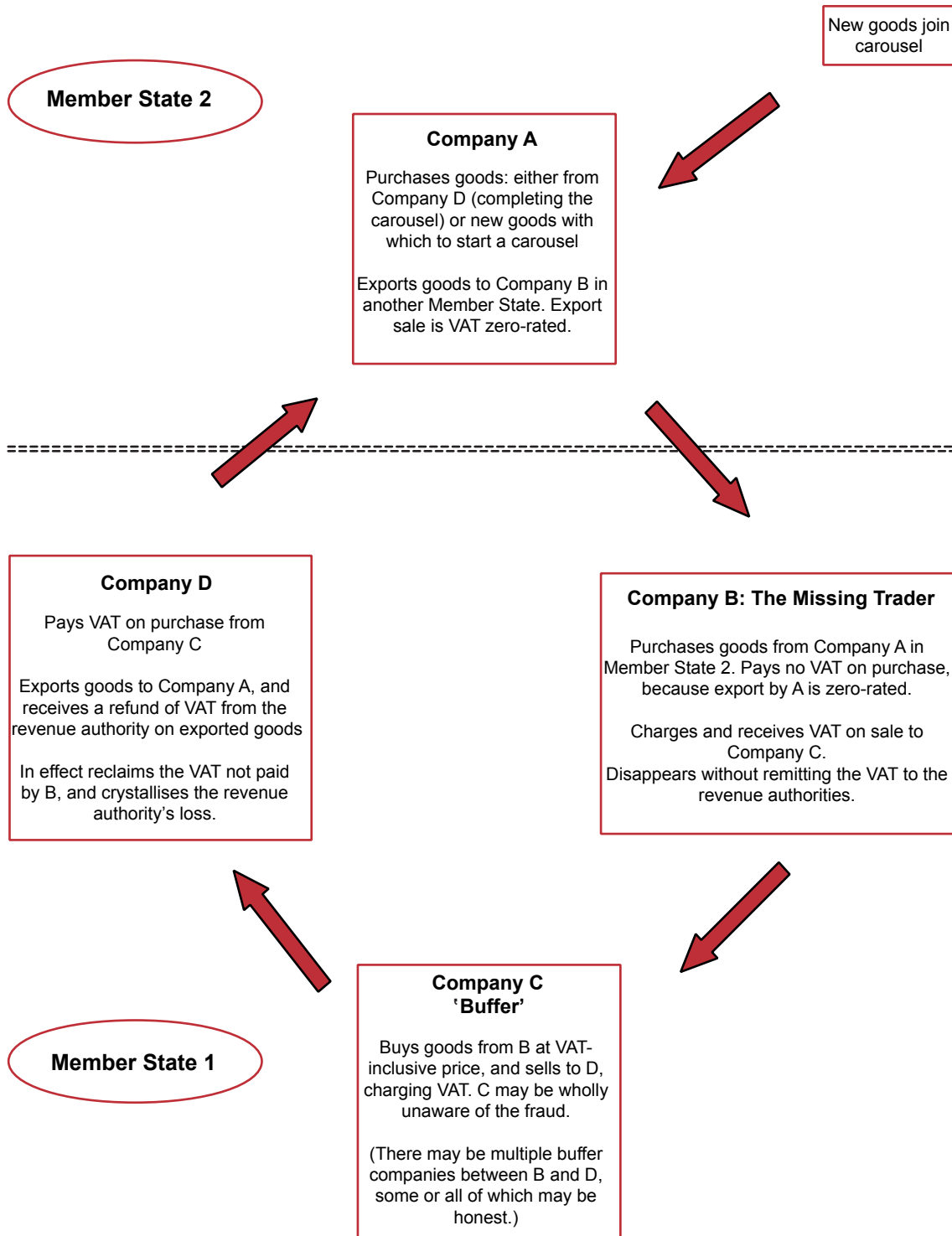
³ 67/227/EEC and 67/228/EEC

⁴ 77/388/EEC

⁵ 2006/112/EC

MTIC Fraud

FIGURE 1
A Basic MTIC Fraud⁶



⁶ Adapted from VAT fraud and evasion: what do we know and what can be done? Keen & Smith, National Tax Journal Vol LIX, No 4 December 2006

7. In MTIC fraud's most simple form, a trader collects tax on sales and then fails to remit it to the government, for example by engineering bankruptcy. In the past decade a more damaging form of this fraud has arisen in the European Union. It is not a fraud against the Community itself, and does not come about because of mismanagement by European institutions, but instead is an attack upon the measures Member States have introduced to promote cross-border trade in the Community. Growth in the fraud is driven by four factors:
 - (a) The increase in high value/low weight goods which make it easy and inexpensive to transport valuable consignments.
 - (b) The zero rate of taxation on intra-Community cross-border trade, which allows purchasers of goods from other EU countries not to pay VAT on purchase, although they then charge VAT on sales as normal.
 - (c) At the same time, exporters of goods are still able to reclaim VAT they have paid to other traders, thus crystallising the loss as the revenue authority refunds a payment for which it had not received a remittance earlier in the transaction chain.
 - (d) The abolition of frontier formalities within the European Community which prevents Member States from operating procedures which could impede the free flow of goods within the Union. This means that the verification of the zero-rated goods imported could only be based on an audit of the traders' transaction records—a process which at present is normally only undertaken when VAT receipts are remitted, some time after the transactions.
8. In MTIC fraud's more virulent form, the first and fourth factors above are abused to trade repeatedly the same consignment of goods between companies set up for this specific purpose. It is this repeated cycling of goods which gives this version of the fraud its common name of Carousel Fraud.
9. Once the shell companies have been created, MTIC fraud is a relatively simple crime to commit, with the cycling of goods allowing continuing profit from one initial outlay⁷. While it is more lucrative on zero-rated intra-Community trade, it can also occur on trade from countries outside of the EU. In these cases, illustrated in figure two, goods enter the EU in one Member State with a final destination in a different Member State, and under the Community Transit rules they travel duty-free within the Union. Before reaching their supposed final destination, goods are diverted to smaller consignments and their true source masked. The Common Customs Tariff remains unpaid on these items.

⁷ It is also suggested that in many cases of the fraud, the goods do not exist, or are only traded on paper (p 30).

10. We were told that cargo planes are chartered each week to carry electronic goods out of the EU as part of the extended carousel fraud outlined in Figure 2 (Q 277). This type of fraud is able to occur because of poor management and oversight of the Community Transit system by Member States.
11. The European Court of Auditors recently reported on the Community Transit system and found:
- “Commission services have not yet carried out analyses of transit fraud patterns nor developed transit-specific risk analysis tools. Systematic risk management for transit is rudimentary or non-existent in many Member States and only a few of them have risk profiles integrated into NCTS [New Computerised Transit System]. The number of physical checks on transit consignments is very low in some Member States, and in some they are non-existent.”⁹
12. The Court of Auditors’ Report makes several recommendations for improvement and the Commission is considering these.¹⁰ The Paymaster General has told us that the Government will support these improvements when they are brought forward¹¹, and **we recommend that Government works with other Member States to ensure that these changes are prioritised in order to attack the supply chain for this variant of MTIC Fraud.**

Losses to MTIC Fraud

13. MTIC fraud occurs across the EU. Very few Member States publish estimates of the size of the problem but the European Commission believes that in some countries it has reached levels of up to 10% of VAT receipts.¹² Germany has recognised that the fraud is a significant problem; it estimated a reduction in revenues due to MTIC frauds of €4.5 billion in 2002.¹³ The National Audit Office reported that Denmark and the Netherlands were often used by fraudsters as the location for apparently legitimate transactions in a larger chain in which the tax is being stolen in other Member States, such as the UK.¹⁴
14. In the UK, levels of MTIC fraud have risen since it was first identified and measured in the late 1990s. However, like any criminal activity its nature makes it difficult to measure, and we have been presented with a variety of different estimates of the size of the activity. HMRC’s estimates of the size of MTIC fraud are contained in Table 1:

⁹ European Court of Auditors Special Report No 11/2006 on the Community transit system OJ C44 (27 February 2007) p 1

¹⁰ The improvements include: improving the management and operation of the NCTS within Member States; taking steps to encourage closer work between Member States using the NCTS; proposing sanctions against traders who block enquiries; requiring Member States to take prompter action to recover unpaid duties; improving the levels of risk management within Member States Customs’ authorities, and requiring the Member States to carry out more physical checks on consignments.

¹¹ Government Explanatory Memorandum 7073/07, 15 March 2007

¹² Speech given by Commissioner Kovacs, 29 March 2007
ec.europa.eu/commission_barroso/kovacs/speeches/VATFraud_20070329.pdf

¹³ European Commission paper, 29 March 2007
ec.europa.eu/taxation_customs/resources/documents/taxation/vat/conferences/tacklingfraud2007/workshop_en.pdf

¹⁴ HM Revenue & Customs 2005–06 accounts—The Comptroller and Auditor General’s Standard Report NAO, July 2006

TABLE 1
MTIC Fraud estimates¹⁵

Year	Estimated size of MTIC fraud—HMRC
1999/2000	£1.5–£2.4bn
2000/1	£1.3–£2.5bn
2001/2	£1.7–£2.5bn
2002/3	£1.5–£2.3bn
2003/4	£1.1–£1.7bn
2004/5	£1.1–£1.9bn
2005/6 ¹⁶	£3.5–£4.75bn

15. HMRC produced two figures for 2005/6. One used the existing methodology and produced an estimate of the size of the fraud of £1.4–£2.4 billion, but this figure was not supported by operational indicators. Operational evidence instead suggests that the scale of attempted fraud in 2005/06 is £3.5–£4.75 billion. It is possible that the scale of the fraud in earlier years may also have been higher than estimated. The Paymaster General told us that she is confident that the size of the fraud recorded in 2006/07 will be lower than in previous years (Q 237).
16. Separate figures produced by the “Eurocanet” project¹⁷ have been widely quoted in media coverage of MTIC fraud and were referred to by some witnesses. Their report¹⁸ suggests that the UK lost £8.4 billion to the fraud in the year to June 2006. We do not agree with their analysis, which was based on inadequate information and did not justify the conclusions drawn. We believe HMRC’s calculations are more realistic.
17. The majority of the frauds in recent years have centred on the mobile phone and computer chip sectors, although the subject of the fraud is beginning to diversify. Witnesses told us that cosmetics, “precious” metals and computer software were products that criminals were now targeting (Q 273, pp 70–1) and the Paymaster General also outlined a range of goods that were potential vehicles for fraud (p 66). The industries used by the criminals generally involve high value/low weight goods, or service industries, usually with few barriers to entry. Industries with a significant grey market are common targets.

¹⁵ Source for 2000/1–2005/6: HMRC supplementary evidence Annex D 27 February (p 63). The figure for 1999/2000 is a measurement of the estimated loss to HMRC due to the fraud, rather than the level of the fraud itself. Source: *Measuring Indirect Tax Losses November 2002* HM Customs and Excise

¹⁶ HMRC introduced a new methodology for calculating the loss to the fraud in 2005/6. Source for this row: *Measuring Indirect Tax Losses December 2006* HM Revenue & Customs

¹⁷ A programme of mutual assistance between Member States’ Fiscal and Law Enforcement authorities. Led by the Belgian VAT carousel support unit, it aimed to identify Missing Traders by compiling information on fraudulent transactions (Q 53). However, the information it was able to use was restricted by some Member States, who raised concerns about sharing information relating to criminal investigations.

¹⁸ An English translation of extracts from their report, *Tentative d’évaluation de la Fraude à la TVA transfrontalière*, is reproduced in the evidence (pp 126–132)

BOX 1**Grey Market**

A “grey market” normally refers to the flow of new goods through distribution channels other than those usually authorised or intended by the manufacturer. Goods are imported outside of the manufacturer’s normal distribution channels, often in order to take advantage of different pricing policies in different jurisdictions, and normally sold on at a price below the manufacturer’s recommended level. Some grey markets include goods traded entirely legitimately, for example when a manufacturer is looking to dispose of excess stock.

18. It is clear from the evidence we have received that a number of participants—often small businesses operating in the grey market—in the mobile telephone and computer chip sectors have been adversely affected by the Government’s attempts to eradicate the fraud in their industry. Big businesses do not appear to have been affected, primarily because they trade directly with manufacturers and end users (Q 286).
19. **Missing Trader Intra-Community Fraud is occurring on a substantial scale across the European Union. We agree with HMRC that this is an outright attack on the tax system (Q 224), and note that it precipitates other crimes, such as theft of consignments (p 68). We accept the evidence that the majority of the fraud is being undertaken by a small number of sophisticated criminal gangs (QQ 275–276, 341–344).**

A need for further action?

20. In this report we consider the actions already taken by the Government to tackle MTIC fraud, including the planned introduction of a “reverse charge” mechanism for VAT in the mobile telephone and computer chip sectors from June 2007. We also examine whether further action will be necessary, either in the form of changes to administrative practice in the UK, or via a major change to the European VAT system which would require unanimous agreement of EU Member States. For each possible change, we will consider two tests: whether it would stop the fraud; and whether it appears that it would create insurmountable compliance costs for legitimate business.
21. We make this report for debate.

CHAPTER 2: TACKLING MTIC FRAUD: ACTIONS TO DATE

Extended Verification and Joint & Several Liability

22. The Paymaster General outlined HMRC's strategy to date for interrupting MTIC fraud in her written evidence (pp 47–8) and oral evidence (QQ 229, 232–236). Over 1500 HMRC staff are now employed on the MTIC strategy, at a cost of £95 million per year (p 66). The strategy dates back to September 2000 but has evolved over time. It started by using risk-based controls to identify, prevent and disrupt potentially bogus businesses and transactions. HMRC initially argued that purchases and sales in the supply chain were not part of any economic activity for VAT purposes and thus fell outside the scope of VAT. This meant that VAT purportedly paid to suppliers was not VAT which could be reclaimed. HMRC attempted to recoup the VAT charged, but never paid over by the missing trader, by refusing to repay the VAT reclaimed later in the supply chain, typically by the exporter of the goods. This approach was challenged by those denied refunds in the UK courts and ultimately the European Court of Justice (ECJ), in *Bond House*¹⁹: the Court ruled against HMRC's approach.
23. The ECJ held that the transactions in question were supplies of goods or services for the purposes of the then Sixth Directive: as long as a transaction itself was not vitiated by VAT fraud, the right to deduct VAT paid could not be affected by the fact that there was a fraud elsewhere in the supply chain. However, the right to reclaim VAT was taken away where the trader knew or had any means of knowing that there was fraud within the supply chain. This judgment was released in January 2006 and, according to HMRC, is the reason for the very significant rise in carousel fraud in the early part of 2006, presumably because the fraudsters felt encouraged that VAT recovery could not be denied on "non-economic activity" grounds.
24. HMRC's position was clarified in July 2006, with the judgment of the ECJ in *Axel Kittel*²⁰. Following the decision in *Bond House*, the ECJ held that where it is ascertained, having regard to objective factors, that the trader knew or should have known that, by his purchase, he was participating in a transaction connected with VAT fraud, he can be refused his entitlement to the right to deduct VAT. However, the Court said that traders would not risk losing the right to deduct VAT paid where they "take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud."²¹
25. As a result of these cases, HMRC's approach in the past year has focused on a "means of knowledge" test involving extended verification; HMRC staff conduct lengthy and far-reaching enquiries into every constituent part of each transaction chain, examining whether frauds have occurred and whether other participants in the trail could have known of it. As HMRC explained, this is an extensive task as some chains involve over 600 companies (Q 321).

¹⁹ Cases C-354/03, C-355/03 and C-484/03. *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise* [2006] ECR I-483.

²⁰ Cases C-439/04 and C-440/04. *Axel Kittel v Belgian State and Belgian State v Recolta Recycling SPRL* [2006] ECR I-6161.

²¹ *Ibid.* Paragraph 51

26. But firms who are confident that they have never traded directly with fraudulent participants claim to have had VAT repayments withheld (pp 76, 108–9, 135–6, QQ 289–290). The Federation of Technological Industries and others told us that every participant in the grey markets for mobile phones and computer chips has had their VAT repayments withheld since spring 2006, and that the due diligence required by firms under the “means of knowledge” test appears to be imposing an increasing burden on legitimate businesses (QQ 288–289). HMRC disputed this claim, although they did indicate that up to 1500 firms are currently subject to extended verification and that some of these firms may not have been a complicit party to the fraud (Q 336). HMRC also said that traders facing bankruptcy can receive repayments while verification is ongoing, if security for the repayment is given, and that they take steps regularly to inform firms subject to extended verification of progress (QQ 322–323).
27. HMRC’s interpretation of the scope of the “means of knowledge” test has been considered by the UK courts²² but its application is yet to be considered by the VAT and Duties Tribunal against the facts of a particular case. The Federation of Technological Industries told us that they planned to challenge the legality of HMRC’s approach in a judicial review (Q 308).
28. **As things stand, HMRC has no option but to continue with extended verification; however they need to take real and substantive steps to ensure that their actions do not damage the innocent and are proportionate to the scale of the fraud. We note that, according to the Paymaster General, this approach has led to a “massive drop” in attempted MTIC fraud in 2006/07 (Q 231). This appears to justify their approach, however, the system of extended verification is an inefficient and unsustainable use of HMRC’s resources, and does impose a significant burden on smaller firms.**
29. Under UK law, section 77A of the VAT Act 1994 entitles HMRC to issue a notice that persons in a supply chain may be joint and severally liable for VAT unpaid if HMRC has reasonable grounds to suspect that the VAT would go unpaid elsewhere in the supply chain. The provision only applies to certain goods²³ and only when the addressee knew or had reasonable grounds to suspect that VAT would go unpaid on the supply to which it is a party or earlier in the supply chain.²⁴ Although the sectors in which most of the MTIC fraud has occurred are already covered by the scope of section 77A, the powers have not been widely imposed by HMRC. Section 77A has been referred to, however, in warning letters issued by HMRC designed to deter companies from trading in a way which HMRC believes puts them at risk of becoming liable for unpaid VAT elsewhere in their transaction chains (Q 325).

²² HMRC’s interpretation of the scope and application of the “means of knowledge” test has been considered in *Dragon Futures Limited* (Decision of the VAT & Duties Tribunal dated 10 October 2006) and *Just Fabulous (UK) Ltd, Evolution Export Trading Ltd and Greystone Trading Ltd; Brayfal Ltd* (Judgment of Mr Justice Burton dated 15 March 2007). The VAT and Duties Tribunal’s first hearing to consider the facts of a particular case (*CallTel Telecom Ltd and Opto Telelinks (Europe) Ltd*) was held in early May 2007.

²³ Originally section 77A was limited to telephones, computers and their parts and accessories. The range of goods was extended by a Treasury Order of 21 March 2007 to include “certain sorts of electronic equipment, of a kind ordinarily owned by individuals and used by them for the purposes of leisure, amusement or entertainment”, and to clarify the inclusion of satellite navigation systems.

²⁴ The 2007 Finance Bill includes provisions to extend the circumstances in which HMRC may presume the business had reasonable grounds to suspect fraudulent activity in the supply chain.

30. While the range of section 77A is limited to certain products, the ECJ rulings and the “means of knowledge” test can be applied to all exported goods. In practice the Government has already sought to extend the “joint and several liability” provisions to allow HMRC to apply these powers alongside the “means of knowledge” test.

Disruption of criminal activity

31. HMRC has also taken steps to disrupt the activities of fraudulent traders. HMRC believe that a relatively small number—in “the low end of the hundreds”—of sophisticated criminal gangs are behind the fraud, and it is likely that most of these gangs are also involved in other criminal activity including money-laundering and smuggling (QQ 342–344). The Paymaster General told us that “thousands of accounts” at an offshore bank had been frozen following HMRC’s investigations, and that accounts at other banks were being investigated (QQ 241–244)²⁵. The Minister also stated that HMRC is working with the Serious and Organised Crime Agency and other police forces and were continuing to work towards prosecutions (Q 345). The Paymaster General has also visited Dubai to hold talks on fraud and recouping money from fraudsters’ accounts in the United Arab Emirates (Q 224)²⁶.
32. The Metropolitan Police Service coordinates Operation Grafton, a multi-agency initiative tackling organised crime in the Heathrow area, where many freight forwarders are based. It is possible that some freight forwarders may be facilitating MTIC fraud if they act as a conduit for goods which are being repeatedly imported and exported. We were told that Customs have the power to log the contents of consignments of mobile telephones in order to trace goods moving into and out of the country; this works for these products, currently used in the fraud, but may not be a useful measure as the fraud mutates into products without serial numbers.²⁷
33. HMRC is content that they have the right range of powers to tackle the criminal groups undertaking the fraudulent activity. We welcome work between Customs and other law enforcement agencies to target the criminals behind the frauds, although in so doing we note that this close cooperation is only needed because the crime is so easy to accomplish.

Cross-border co-operation

34. While this work continues, HMRC’s strategy has broadened to include co-operation with other EU Member States. The European Commission operates the VAT Information Exchange System, which can be used by exporters to verify that their customer in another Member State is registered for VAT and thus entitled to a zero-rated purchase. We were told by Commissioner Kovacs that the system is significantly under-used. In 2005,

²⁵ In a joint operation with the authorities in the Netherlands, accounts at the First Curacao International Bank in the Dutch Antilles were frozen.

²⁶ During 2005/06, there were six successful prosecutions resulting in 18 convictions with sentences totalling 72 years imprisonment. HMRC also took action against 29 companies involved in MTIC fraud resulting in £9.4 million being recovered or frozen (*HMRC Annual Report 2005–06*). Ongoing prosecutions involve some £2.5 billion of VAT (HL Written Answer 27 March 2007 col 266).

²⁷ Mobile telephones have unique IMEI identification numbers which are relatively difficult to change. We were told that other goods have no identifying marks and can be repackaged (Q 273, p 70)

- there were only 26,000 information exchanges, despite there being 35 million traders involved in intra-Community trade (Q 115). The Paymaster General told us that the November 2006 ECOFIN agreed there is a need for more rapid exchange of information and the UK is part of a working group looking at ways to improve the efficiency of the VAT Information Exchange System (p 64). Commissioner Kovacs also noted that the Commission has taken the first step towards developing proposals to clarify and strengthen the legal framework for operational assistance between countries (Q 115).²⁸
35. There is an absolute need for revenue bodies to work with law enforcement agencies within each Member States, and across borders. HMRC have taken a lead on this work by hosting a conference for European law enforcement agencies and tax authorities in February 2007 (QQ 225–226), and we would welcome increased coordination of links between customs authorities and law enforcement agencies, rather than a series of bilateral links.²⁹ This work must continue: the scale of this fraud demands cross-border co-operation between revenue authorities and law enforcement agencies. Concern about protection of data shared during joint work (Q 222) must be resolved.³⁰
 36. As outlined in Figure 3, the reverse charge allows a VAT-registered firm selling goods to another VAT-registered firm not to charge VAT. The tax is only collected by a firm which is selling on the product to a final consumer or a non-VAT registered firm. Critics of the reverse charge have noted that this still creates the opportunity for a firm to become a missing trader, and suggest that the problem may be magnified: as tax has not been collected in stages along the consumption chain, all of the tax due on the product is concentrated in the last trader (pp 79, 108). On the other hand, there are fewer traders collecting the tax for the revenue authority to monitor. In addition, as VAT is not collected by any one trader in the chain depicted in Figure 1, there is no opportunity for trade carousels to develop.
 37. While all of the measures described thus far create, in the Paymaster General's words, "a severe downward pressure on the potential loss" (Q 248), they can only be a palliative and will not prevent the fraud from happening. In 2006 an application was made by the Government for a derogation to enable the introduction in the UK of a reverse charge accounting procedure for the goods most commonly used in MTIC frauds. Changes to the VAT system require the unanimous approval of the Council; after some negotiation with other Member States, who may have been concerned that the derogation would move fraud from the UK to their territories, the derogation was granted and the measure will come into force on 1 June 2007.³¹ The Paymaster General explained the reasons for the delay were of a technical nature, with other Member States seeking reassurance that the proposal would truly be limited (Q 257).
 38. The limited reverse charge is not unprecedented. A "Special Accounting Scheme for Gold" was introduced in the UK in April 1993, and since January 2000, "investment" gold has not been subject to the standard VAT rules anywhere in the European Union. These measures were introduced to

²⁸ COM(2006) 254

²⁹ HMRC have also participated in cross-border operations with colleagues overseas (Q 340).

³⁰ This is an issue we have addressed in other reports, most recently in European Union Committee, 18th Report (2006–07): *Prüm: an effective weapon against terrorism and crime?* (HL 90)

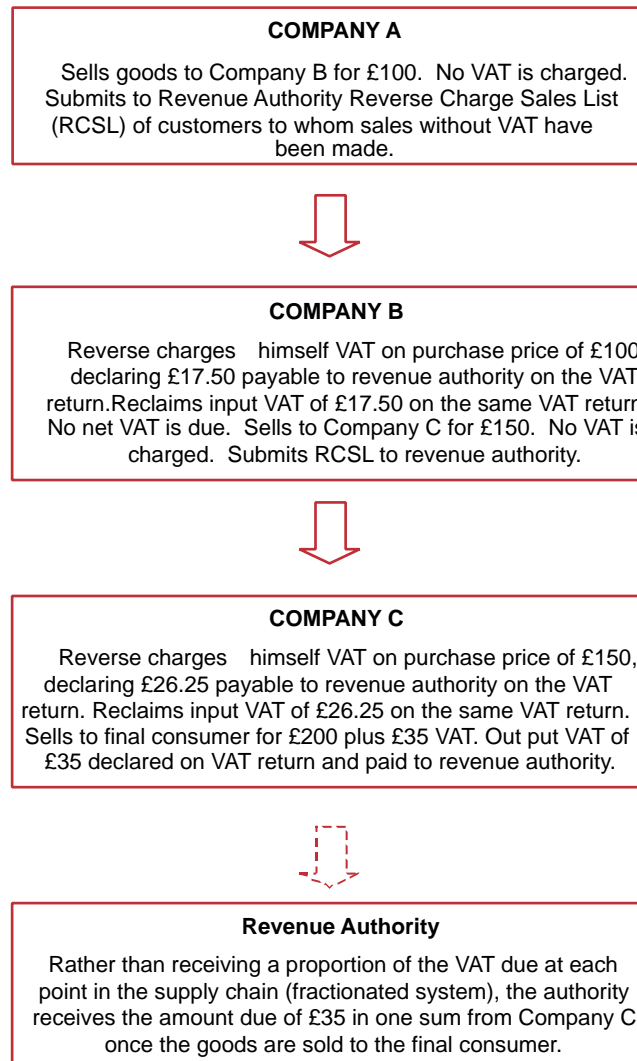
³¹ OJ L109 (26 April 2007) p 42

combat VAT fraud being undertaken using investment gold, and also to protect the City of London's requirements as a major trading centre of gold. The measures are now accepted and understood by participants in the gold markets.

Reverse Charge

FIGURE 3

A Reverse Charge accounting system



39. For this change to the VAT system, HMRC have worked with the mobile telephone and computer chip industries to design the reverse charge in a way which minimises administrative costs (Q 311). HMRC are also educating industry about the changes to the accounting methods through a dedicated team of several hundred staff who work to educate the public of changes to the tax system (Q 315). We support their decision to apply a light touch to compliance activity in the first year of the charge, particularly as some witnesses have suggested that the transition time is not long enough (Q 311, pp 124, 238). We also support the decision to raise the *de minimis* level to £5000, as we received evidence noting the difficulties the proposed £1000 *de minimis* level would create for retailers and the charity sector (p 103).

40. HMRC states that they now have the monitoring capability to detect the growth of fraud in other sectors before it gets out of control (Q 334), but recording fraud via monitoring is not the same as preventing it from occurring. **It is generally accepted that the broad phenomenon of MTIC fraud is out of control; we expect it to continue to mutate into other sectors.** The reverse charge is only a temporary solution.

CHAPTER 3: FURTHER ADMINISTRATIVE ACTIONS

41. As well as the measures taken to date considered in chapter two, the evidence we received suggested further administrative solutions. In this chapter we address these.

Scrutiny of new VAT registrations

42. The Paymaster General told us that enhanced measures are in place to monitor applicants for a VAT registration, and that these are processed within a reasonable time period despite these checks (QQ 232–233). Representatives from trade suggested that this work could be extended, with newly registered firms closely supervised—including on-site visits and examination of business plans—until they have demonstrated that they are trading legitimately (Q 288). Security for VAT due could be requested from newly registered businesses in sectors where risk of fraud was considered to be high (Q 306).

Real-time logging of trades and verification of counterparties

43. Some witnesses suggested that HMRC should concentrate its resources on monitoring transactions in real-time (or near real-time), hopefully uncovering non-economic transactions as they occur (p 121, Q 192, 303–304). HMRC have calculated the cost of such monitoring at £1.3 billion (p 64)—an amount which they might recoup in less than a year at current levels of fraud. It is likely that there would be significant transition costs for business, although a reporting threshold could be introduced to ensure small businesses and charities are not over-burdened.
44. HMRC indicated that it is already using technology to perform a more sophisticated analysis of VAT returns to identify rising levels of fraud in different sectors (Q 334). But this analysis is made only on the basis of returns submitted. A considerable lag can occur between the initial charge of VAT by a trader, who then disappears, and the recognition of fraud when traders later in the transaction chain request reimbursement of VAT paid.
45. Any new online system for reporting trade must be “hacker proof”, but it is clear from the credit card industry and from intra-bank payment systems that reliable technology exists to handle and transmit high volumes of transaction data in a secure environment. The collection of data (including the VAT registration numbers of the supplier and purchaser, the sales price, and the nature of the goods traded) at the time of transaction, as proposed by some witnesses (Q 304), combined with HMRC’s analytical capability, could act as first line of defence against an expansion of MTIC and other frauds. Alternatively, it could act as means by which legitimate business could gain “clearance to trade” and immunity from verification. **We suggest that HMRC should undertake further work to examine the viability of real-time data capture of transactions by VAT-registered companies.**
46. The Construction Industry Scheme³², which sets out the rules for how payments to subcontractors must be handled by contractors in the construction industry, allows contractors to check the taxable status of

³² An HMRC scheme setting out the rules for how payments to sub-contractors for construction work must be handled by contractors in the construction industry and certain other businesses.

subcontractors online. There appears to be no reason why this scheme cannot be extended to industry sectors where Missing Trader Fraud is common to enable legitimate companies to verify the status of their trading partners.

Collection of VAT in real-time

47. An extension of a real-time VAT monitoring scheme might see HMRC collect the VAT due as the transactions are made. Traders would be required to open a separate bank account, monitored by HMRC, into which they would transfer an amount equal to the VAT charged to their customers. This might happen automatically as part of the logging process, or the database could generate invoices for firms to pay within a short period. HMRC would pass a trader's VAT claim for payment once HMRC were satisfied that the claimant's supplier had deposited the VAT income—a strong incentive for purchasers to ensure they were trading with a reputable organisation.
48. Aside from the administrative cost, such a scheme might also create a shortage of working capital, as businesses would no longer be able to hold VAT income until their quarterly return to HMRC.³³ This would particularly harm small businesses.

Containment or Prevention?

49. The proposals we have considered in this chapter could prevent MTIC fraud to some degree, but none will stop this crime. Furthermore, these proposals, like HMRC's existing strategy, impose ongoing costs on business—either directly from increased administrative costs, or indirectly from cash-flow constraints caused by delayed verification of repayments. The Institute of Chartered Accountants in England and Wales likened extended verification to preventing a series of thefts at a windowless jewellery shop by controlling those who could walk past it, rather than putting glass in place (Q 173).
50. HMRC agree. They told us that “from an operational perspective ... it is always the best solution to change the rules so that things cannot happen in the first place. Any enforcement activity is always going to be following on after the event or in response to a failure ... of those rules, so getting the rules right ... is obviously what we want to do. That is often easier said than done.” (Q 348)
51. **HMRC's current strategy has succeeded in containing MTIC fraud, but will not eliminate it; the Government sought the reverse charge derogation because HMRC's current strategy is unsustainable. The reverse charge will stop MTIC fraud where it has been most prevalent, but we expect the fraud to migrate and mutate. Consequently we anticipate that when the UK's derogation is reviewed in two years time there will be requests for the reverse charge scheme to be expanded, either to other Member States or other products, or both.**

³³ This problem might be overcome if a system of “trusted third parties” is introduced to act as a guarantor for firms' VAT payments; however it is likely that these would place some cost on business. Similar systems are already used to collect Sales Taxes in some American states. *Carousel Fraud in the EU: A Digital VAT Solution* Richard T Ainsworth, Tax Notes International 1 May 2006.

52. **The current mechanism for intra-Community VAT transactions is not sustainable. While the amount of money being lost in the United Kingdom may have fallen in 2006/07, mutation into other industry sectors will bring a subsequent rise in fraud levels. We believe that prevention is better than cure. A wide-ranging change to the VAT system is required and the Government should start discussions with the European Commission and other Member States on the form this should take.** The next chapter examines some of the options for change.

CHAPTER 4: OPTIONS FOR CHANGE

53. The adoption of any of the measures in this chapter would require unanimous approval from the 27 Member States. The majority of our witnesses agree that some change is required, but there is no consensus on the form this change should take. We consider in turn five options that have attracted some support in the evidence we have received and which we consider to be viable proposals for change. These options are:

1. Generalised “reverse charge” or Sales Tax

54. We discussed the reverse charge accounting mechanism in Chapter 2 (see Figure 4). A generalised reverse charge would pass the liability for VAT on all transactions between businesses onto the buyer, rather than the seller. VAT would not change hands, and the buyer would be expected to account for the tax to HMRC, and apply it as a credit against tax on sales made. The final buyer in a chain before the final consumer would become responsible for remitting all the VAT on that item. This would in effect replace VAT with a Sales Tax.
55. As already noted, the UK has secured a derogation to operate a reverse charge accounting mechanism in the mobile telephone and computer chip industries, and a Community-wide reverse charge operates for investment gold. A proposal whereby countries could choose to adopt a reverse charge mechanism on all products was put forward by the German Government, but it has not met with any support from the Commission and it does not appear that it will be pursued during the last weeks of the German Presidency.³⁴
56. If, as we expect, MTIC fraud mutates or migrates to other Member States, it is likely that there will be further requests for derogations to apply a reverse charge to more products in other Member States. The European Commission would not be opposed to these if they were targeted and proportional (Q 135–137). Cross-border trade is likely to continue to grow as the Union expands and the internet facilitates international purchasing. Unless and until all high value/low weight goods, and service industries, are subject to a reverse charge fraud will continue to move into new sectors. A series of limited reverse charges would inevitably merge in time to a generalised reverse charge or Sales Tax.
57. The change from Value Added Tax to an “end user” or Sales Tax system would come at a considerable cost to both revenue authorities and individual businesses. It is also possible to raise more tax under a VAT system than under a Sales Tax. In a Sales Tax system, the whole of the revenue is collected from the final link in the commercial chain, when the retailer sells to the final consumer; this is commonly disproportionately made up of small businesses for whom tax collection is a considerable burden.³⁵ Furthermore, studies have shown that a Sales Tax is efficient at relatively low rates but is increasingly difficult to administer as rates rise.³⁶ Cross-border trade would

³⁴ Austria supports the proposal. Other Member States and the UK are opposed to it (QQ 248–251).

³⁵ The Government also noted that the advantage of having the remittance of the VAT liability spread amongst numerous traders in the supply chain would be lost (Q 366).

³⁶ *Value added Tax: International Practice and Problems* Alan Tait IMF 1988

become more expensive as firms would now pay the Sales Tax rate of the country of purchase. With increasing use of the internet for the purchase of goods, this would lead to firms being undercut by those based in the Member States with the lowest Sales Tax rates. Unless harmonised this would in turn lead to pressure from market forces for tax rates to be cut, and reduce the revenue raising potential of the tax.³⁷

2. Destination System

58. Under this system the exporter charges VAT according to the rate applicable in the country of consumption or “destination”.

FIGURE 4

The Destination System³⁸

Member State 1			Member State 2	
	Firm A	Firm B	Firm C	
	Sells	Buys	Buy	Sells
PRICE	100	100	200	300
VAT (10%)	+10	-10	-20	+30
NET VAT	+10	Overall: +10 In Member State 1: -10 In Member State 2: +20		+10
TAX REVENUE	0 (+10 from Firm A, -10 from Firm B)		+30 (+20 From Firm B, +10 from Firm C)	

59. This system would require the exporter to register for VAT in each country to which he supplies goods. The European Commission told us that it is currently investigating this system as an add-on to the “one-stop-shop” proposal, currently under consultation, whereby a trader registers for VAT in his home country in respect of all VAT liabilities throughout the EU (Q 142). The taxpayer would file the VAT return electronically and either pay the VAT due directly to the revenue authorities in the destination country, or make one payment to his national bank, who will allocate it between the appropriate countries. There would be no need for a clearing house in this system.
60. This proposal would eliminate the opportunity for MTIC fraud. However, witnesses have warned us that there will be high additional compliance costs for business: exporters would need to be conversant with VAT rates (both standard and lower rates) and the rules governing deductible VAT in

³⁷ High Sales Tax rates encourage evasion techniques such as using or creating a business to buy goods tax-free when they are intended for personal use rather than resale. It would be likely that there would be more off-book “cash” transactions, which is already a common fraud in other sectors (Q 41).

³⁸ Adapted from *Combating Vat Fraud in the EU: The Way Forward*, International VAT Association, March 2007

27 Member States in order to calculate the correct amount of VAT due (Q 192, 195). Similarly, there would be costs for revenue authorities who would have to provide information in most, if not all, of the official languages to the EU. Furthermore, it relies on the “one-stop-shop” proposal being adapted to cater for business to business transactions, and adopted by Member States, if the costs associated with separate registration in other countries are to be avoided.

61. For most companies, the compliance costs of a Destination System would be unacceptable and would act as a barrier to intra-Community trade, thus fundamentally frustrating the Single Market.

3.1 Origin System

62. The fundamental principles behind the introduction of VAT across the European Community, in respect of intra-community trade, included the eventual abandonment of the taxation of products in the country of destination in favour of taxation of products in the country of origin (the exporting country). This was accordingly proposed by the European Commission when addressing the removal of tax barriers in attaining the Single Market in 1993, but rejected by the Member States.

FIGURE 5
The Origin System³⁹

Member State 1			Member State 2	
	Firm A	Firm B	Firm C	
	Sells	Buys	Buy	Sells
PRICE	100	100	200	300
VAT (10%)	+10	-10	-20	+30
NET VAT	+10	+10	+10	
TAX REVENUE		+20	+10	
TAX REVENUE IF CLEARING HOUSE USED			+30	

63. Under this scheme, VAT would be charged at the rate of the exporting country and the purchaser would be able to request a refund of the tax paid from the revenue authority in its own country. This would mirror the position of a business selling to another business in the same Member State and would be logically consistent with the creation of the Single Market.

³⁹ Adapted from *Combating Vat Fraud in the EU: The Way Forward*, International VAT Association, March 2007

However because of the wide disparity in VAT rates throughout the Community, it was recognised that there would need to be a transfer of the VAT collected by the supplying country to the purchasing country so as to restore the importing country's VAT revenues. This in turn requires the creation of a clearing house to facilitate transfers of VAT between revenue authorities.

64. The key attribute of the Origin System is its simplicity for traders: purchasers simply pay the appropriate VAT rate for the territory from which they are buying the product. The vendor only needs to know the appropriate tax rates in its own country. Charging VAT on intra-Community trades would eliminate the possibility of Missing Trader fraud as no participant in a trading chain would receive goods VAT free. However, VAT is designed to be a consumption tax and so this system is contrary to its underlying concept, i.e. that products should be taxed at the point of consumption.
65. A problem arises when the purchaser requests the refund of the tax paid from the revenue authority in its own country. Because the tax has been remitted in the origin country, the purchaser's revenue authority is paying out money it will not receive unless and until it gets a refund from the revenue authority in the exporting country. This system of transfers between revenue authorities would be facilitated by the creation of a clearing house. The Commission's original proposal for a clearing house suggested that the flows through it might be determined by broad macro-economic data, rather than relating information to actual trades. However, modern technology means that HM Treasury can envisage the latter option (Q 348) and it is reasonable to assume that this could be linked to a EU-wide real-time trade logging system should one be introduced.
66. Member States, however, continue to oppose the Origin System, as they did in 1992. HMRC have told us that some businesses support this approach but that zero-rating of transactions facilitates trade and is of great benefit to business and consumers (p 64, Q 258). HM Treasury expressed concerns that there could be difficulties for Member States in ensuring that they received the tax they were due through the clearing house, and noted that around £40 billion of VAT is associated with goods traded between the United Kingdom and the other Member States (Q 348). They believed there would be "considerable risks" associated with the system (Q 349).
67. The combination of an Origin System with a clearing house has considerable merit. The clearing house would be logistically feasible and greater sums are reliably and securely handled by the various clearing houses and payment systems operating in European financial markets. The interwoven nature of the European economy means that all countries would have an interest in ensuring that cross-border transactions are accurately recorded and verified, because all countries export to some degree. The risk inherent in having to trust other Member States' revenue authorities, and the associated costs, should be lower than the risk posed by MTIC fraud and the associated losses.
68. We do not accept that the Origin System would automatically lead to a harmonisation of VAT rates in the Community although we accept that there is likely to be an adjustment in levels of cross-border trade as some purchasers switched to alternative suppliers in lower tax territories. The majority of VAT rates in Member States are already within a small range except for those products which are currently zero-rated in selected Member

States, where a large difference between applicable VAT rates would become apparent. The problem this creates would be circumvented by introducing a “Flat Rate” Origin System.

3.2 Flat Rate Origin System

69. Instead of the supplier charging VAT at the rate of the supplying country, the lowest rate of VAT allowed by the Principal Directive, currently 15%, would be charged.⁴⁰ The purchaser would request a refund of VAT paid from revenue authorities in his country on his normal VAT return, who in turn would request a refund from the revenue authorities of the supplying country. The purchaser would need to account for the difference between the higher VAT rate in the country of destination and 15% by way of a reverse charge to ensure that VAT at the full rate of the importing country is paid by businesses who cannot recover their VAT in full.⁴¹ A clearing house would still be necessary but this proposal would meet the principal objection to the original Origin system in that it would avoid large transfers between the revenue authorities to account for differences in VAT rates. The transfer would need only to reflect the net position of trade flows between member states.
70. The Flat Rate Origin System removes several of the disadvantages of the standard Origin System. As VAT is charged at a single rate, the clearing house would only need to reflect the balance of trade between member states, and not different VAT rates. This would reduce the cost and complexity of the clearing system. Businesses would face no higher compliance costs than at present: vendors would change from charging a flat rate of 0% to a flat rate of 15% (or whatever flat rate level is set out by the Council of Ministers). Furthermore, there should be no political pressure to harmonise VAT rates, or remove derogations for zero-rated products.
71. There is still an opportunity for Missing Trader Fraud to be perpetrated under this system. However, by minimising the disparity of tax rates between imported goods and those traded within a Member State, the profitability of the fraud and thus its inherent attraction to criminal gangs would be significantly reduced.

3.3 Origin System or Flat Rate Origin System without Clearing House

72. This proposal would operate an Origin System or Flat Rate Origin System as described above but without the transfer of VAT revenues between member states through the clearing house. The VAT charged by the exporter would be collected and retained in the country of the supplier; the VAT would in turn be refunded to the purchaser in the country of destination. Net exporting countries would benefit from increased revenue flows at the expense of net importing countries, although this imbalance would be reduced if a Flat Rate Origin System were in place, because the rate of VAT refunded would never be more than the rate of VAT in the importing country. Furthermore, this system retains the “fractionated” nature of VAT,

⁴⁰ Only two member states, Cyprus and Luxembourg, currently apply this rate; however many Member States have derogations which allow them to zero rate some classes of products.

⁴¹ Partly exempt businesses which cannot recover all of their VAT would be the only purchasers affected by this measure, although as a control mechanism, all businesses would be required to make entries on their VAT returns.

whereby its collection is split between the member states in which value is added.

73. Without a Clearing House, VAT would change in nature from a pure consumption tax, but the cost associated with the clearing house and the risk associated with relying on other Member States to collect and remit tax revenue would be removed. There would be winners and losers from the change and HM Treasury did not appear to favour it (QQ 351–354). VAT would become payable on goods imported from another Member State even when those goods are normally zero-rated in the domestic market, increasing the cost of some goods in some markets. Countries running a trade deficit with EU partners would lose revenue; those with a trade surplus would receive more.⁴²
74. In their evidence, HM Treasury gave three criteria for any new taxation system: that the right tax ends up in the right place; that the potential for fraud and non-compliance is minimised; and that business is not unreasonably burdened (Q 348). HM Treasury believe an origin system without a clearing house would fail on the first criterion. **We believe however that this proposal merits further serious study.**

A need for change?

75. **Harmonisation of VAT rates would remove the opportunity of MTIC fraud. The UK is not alone in opposing this harmonisation.** There appear to be three options for tackling MTIC Fraud: do nothing and accept it; take steps to make the existing system more robust and sophisticated; or accept that MTIC fraud is inherent in the system and accordingly reform the system. **Doing nothing is not an option. A continued ratcheting up of the complexity and compliance requirements related to the existing system will impose increasing costs on legitimate business. A solution to MTIC Fraud will benefit every Member State: countries need to recognise this and agree to act together. It is now time for the Government and other Member States to look more sympathetically at a radical change to the VAT system. The flat rate origin system proposal, either with or without a clearing house, merits further serious study of the potential impact on businesses, levels of trade, and Member State revenues.**
76. **We invite the Government, when responding to this Report, to assess the relative merits of all the options for reform which it describes.**

⁴² The United Kingdom's deficit for trade in goods with the EU in 2006 was £37.6 billion. If all traded goods were subject to VAT at the full rate (a generous assumption) this would have led to a potential loss of revenue of £6.6 billion for the UK. However, if a flat rate of 15% is applied to all imports and exports, this loss of revenue would be £5.6 billion: this is of the same magnitude as estimates of losses to MTIC fraud. There would also be considerable savings in administrative and compliance costs, and the system would be simpler for business.

CHAPTER 5: SUMMARY OF CONCLUSIONS

77. We recommend that Government works with other Member States to ensure that the Court of Auditors' proposed changes to the Community Transit system are prioritised in order to attack the supply chain for this variant of MTIC Fraud. (Paragraph 12)
78. Missing Trader Intra-Community Fraud is occurring on a substantial scale across the European Union. We agree with HMRC that this is an outright attack on the tax system, and note that it precipitates other crimes, such as theft of consignments. We accept the evidence that the majority of the fraud is being undertaken by a small number of sophisticated criminal gangs. (Paragraph 19)
79. As things stand, HMRC has no option but to continue with extended verification; however they need to take real and substantive steps to ensure that their actions do not damage the innocent and are proportionate to the scale of the fraud. We note that, according to the Paymaster General, this approach has led to a "massive drop" in attempted MTIC fraud in 2006/07. This appears to justify their approach; however, the system of extended verification is an inefficient and unsustainable use of HMRC's resources, and does impose a significant burden on smaller firms. (Paragraph 28)
80. It is generally accepted that the broad phenomenon of MTIC fraud is out of control; we expect it to continue to mutate into other sectors. (Paragraph 40)
81. We suggest that HMRC should undertake further work to examine the viability of real-time data capture of transactions by VAT-registered companies. (Paragraph 45)
82. HMRC's current strategy has succeeded in containing MTIC fraud, but will not eliminate it; the Government sought the reverse charge derogation because HMRC's current strategy is unsustainable. The reverse charge will stop MTIC fraud where it has been most prevalent, but we expect the fraud to migrate and mutate. Consequently we anticipate that when the UK's derogation is reviewed in two years time there will be requests for the reverse charge scheme to be expanded, either to other Member States or other products, or both. (Paragraph 51)
83. The current mechanism for intra-Community VAT transactions is not sustainable. While the amount of money being lost in the United Kingdom may have fallen in 2006/07, mutation into other industry sectors will bring a subsequent rise in fraud levels. We believe that prevention is better than cure. A wide-ranging change to the VAT system is required and the Government should start discussions with the European Commission and other Member States on the form this should take. (Paragraph 52)
84. We believe however that an Origin System or Flat Rate Origin System without a Clearing House merits further serious study. (Paragraph 74)
85. Harmonisation of VAT rates would remove the opportunity of MTIC fraud. The UK is not alone in opposing this harmonisation. Doing nothing is not an option. A continued ratcheting up of the complexity and compliance requirements related to the existing system will impose increasing costs on legitimate business. A solution to MTIC Fraud will benefit every Member State: countries need to recognise this and agree to act together. It is now time for the Government and other Member States to look more

sympathetically at a radical change to the VAT system. The flat rate origin system proposal, either with or without a clearing house, merits further serious study of the potential impact on businesses, levels of trade, and Member State revenues. (Paragraph 75)

86. We invite the Government, when responding to this Report, to assess the relative merits of all the options for reform which it describes. (Paragraph 76)

APPENDIX 1: SUB-COMMITTEE A (ECONOMIC AND FINANCIAL AFFAIRS, AND INTERNATIONAL TRADE)

Sub-Committee A

The members of the Sub-Committee which conducted this inquiry were:

Lord Blackwell
Lord Cobbold
Baroness Cohen of Pimlico (Chairman)
Lord Giddens
Lord Inglewood
Lord Jordan
Lord Kerr of Kinlochard
Lord MacLennan of Rogart
Lord Steinberg
Lord Trimble (from 27 March 2007)
Lord Watson of Richmond

Declaration of Interests

A full list of Members' interest can be found in the Register of Lords Interests:

<http://www.publications.parliament.uk/pa/ld/ldreg.htm>

APPENDIX 2: LIST OF WITNESSES

The following witnesses gave evidence. Those marked ** gave both oral and written evidence; those marked * gave oral evidence only; those without an asterisk gave written evidence only.

- ** Association of Chartered Certified Accountants
- * Belgian Finance Ministry
- * Mrs Sharon Bowles MEP
- Charities' Tax Reform Group
- Chartered Institute of Taxation
- ** Dr Michael Cheetham
- Earthshine Ltd
- ** Commissioner Kovacs, European Commission
- ** Federation of Technological Industries
- ** Mr Royston Ford
- Hassan Khan & Co Solicitors
- ** HM Treasury
- ** Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- Institute of Indirect Taxation
- The Law Society
- OCS SPF Finances Belgique
- OLAF
- Olympia Technology Ltd
- PricewaterhouseCoopers
- * Vodafone

Additional written information was received from:

- Mr Geoffrey Lee

It has not been printed but is available for inspection at the Parliamentary Archives (020 7219 5316).

Supplementary evidence was also received from the following and is also available for inspection at the Parliamentary Archives:

- HM Treasury
- Institute of Chartered Accountants in England and Wales
- Olympia Technology Ltd

We would like to take the opportunity to thank all our witnesses for their submissions to our inquiry.

APPENDIX 3: CALL FOR EVIDENCE

The Sub-Committee, under the Chairmanship of Baroness Cohen of Pimlico, in the light of the Government's request to the Commission to apply for a derogation from the directive on turnover taxes to introduce a "reverse charge" system for certain products, has decided to broaden its continuing inquiry in the issues surrounding VAT Missing Trader fraud. The inquiry will seek to address the following key questions:

- What impact does this fraud have on the internal market?
- What are the measures currently applied in the UK and other Member States to combat this fraud and what are their weaknesses?
- The Commission has suggested measures including increased cross-border liaison by tax and law enforcement authorities and Governments, improved risk management, and mutual assistance by Member States wishing to recover unpaid taxes. Are these mechanisms adequate?
- Are Member States, within the context of the internal market and the globalised economy, capable of fighting individually against this fraud or is it right for the Commission to bring forward proposals on their behalf?
- Is it necessary to simplify or restructure the VAT system to prevent this type of fraud? If so, how might this be done?
- Does the adoption of measures to fight VAT fraud at the Community level undermine Member States' control over the functioning of national fiscal systems?
- What would be the benefits and costs of moving from the current destination system to an origin system?

The Sub-Committee would welcome written comments on these issues. Witnesses who have already submitted material following our earlier call for evidence, are not required to repeat earlier submissions but are invited to submit additional evidence.

GUIDANCE TO THOSE SUBMITTING WRITTEN EVIDENCE

Written evidence is invited in response to the questions above, **to arrive by no later than Wednesday 17 January 2007.**

The questions above cover a broad range of topics and there is no need for individual submissions to deal with all the issues. Evidence should be kept as short as possible: submissions of not more than six sides of A4 paper of free-standing text, excluding any supporting annexes, are preferred. Submissions longer than this should include an executive summary. Paragraphs should be numbered.

Evidence should be sent in hard copy and electronically to the addresses below.

Evidence should be attributed and dated, with a note of the author's name and position. Please state whether evidence is submitted on an individual or corporate basis.

Submissions will be acknowledged. Evidence becomes the property of the Committee, and may be printed or circulated by the Committee at any stage. Once you have received acknowledgement that evidence has been received, you may publicise or publish your evidence yourself, but in doing so you must indicate that it was prepared for the Committee.

Any enquiries should be addressed to: Simon Blackburn, Clerk of Sub-Committee A, Committee Office, House of Lords, London SW1A 0PW; telephone 020 7219 3616; fax 020 7219 6715; e-mail blackburns@parliament.uk.

This is a public call for evidence. You are encouraged to bring it to the attention of other groups and individuals who may not have received a copy directly.

APPENDIX 4: GLOSSARY

EC	European Communities
ECJ	European Court of Justice
EP	European Parliament
EU	European Union
FTI	Federation of Technological Industries
GDP	Gross Domestic Product
GNI	Gross National Income
HMRC	HM Revenue & Customs
HMT	HM Treasury
ICAEW	Institute of Chartered Accountants in England and Wales
IMF	International Monetary Fund
MTIC	Missing Trader Intra-Community
NCTS	New Computerised Transit System
OLAF	European Anti-Fraud Office
SOCA	Serious Organised Crime Agency
VAT	Value Added Tax

APPENDIX 5: REPORTS

Recent Reports from the Select Committee

Prüm: an effective weapon against terrorism and crime? (18th Report session 2006–07, HL Paper 90)

Annual Report 2006 (46th Report session 2005–06, HL Paper 261)

Scrutinising EU Legislation—Public Awareness of the Role of the House of Lords (32nd Report session 2005–06, HL Paper 179)

Annual Report 2005 (25th Report session 2005–06, HL Paper 123)

The Further Enlargement of the EU: threat or opportunity? (53rd Report session 2005–06, HL Paper 273)

Session 2006–2007 Reports prepared by Sub-Committee A

Funding the European Union (12th Report, HL Paper 64)

Other Relevant Reports prepared by Sub-Committee A

Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals (50th Report session 2005–2006, HL Paper 270)

The 2007 EC Budget (39th Report session 2005–2006, HL Paper 218)

A European Strategy for Jobs and Growth (28th Report session 2005–2006, HL Paper 137)

Future Financing of the European Union (6th Report session 2004–05, HL Paper 62)

Evidence from the Financial Secretary on the proposed reforms of the Stability and Growth Pact (7th Report session 2004–05, HL Paper 74)

Evidence from the Financial Secretary on the Stability and Growth Pact and the European Central Bank (14th Report session 2003–04, HL Paper 88)