

**Opinion Statement of the CFE
on the consequences of involvement in missing trader fraud**

Submitted to the European Institutions in February 2011

This is an Opinion Statement prepared by the CFE Fiscal Committee. The CFE is the leading European association of the tax profession with 33 national tax advisory organisations representing over 180,000 tax advisers.

The CFE notes that the principle of legal certainty and the protection of individuals requires, in areas covered by Community law, that the Member States' legal rules be worded unequivocally so as to give the persons concerned a clear and precise understanding of their rights and obligations, and to enable national courts to ensure that those rights and obligations are observed (case 257/86 *Commission v Italy* [1988] ECR 3249).

In the Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and Others*, para. 52, the ECJ ruled that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct input VAT.

In the Case C-439/04, *Axel Kittel*, the ECJ ruled that where it is ascertained, having regard to objective factors, ***that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct.*** In practice, it is not easy for business to know if a supplier or a purchaser is a fraudster or not. It is also easy for tax authorities to use hindsight to suggest that a trader could have detected a fraud, even though the trader has acted reasonably and had no knowledge of the fraud.

The CFE acknowledges that missing trader fraud has, from the very beginning of the VAT system, been a major challenge and tax authorities should therefore have the legal tools that they need to penalise criminal organisations. A major flaw of the current system is that it encourages fraud, because a criminal organisation does not have to pay VAT to its suppliers in another state, because no VAT is charged by a supplier on cross-border supplies, but the criminal organisation can charge VAT to its customers in the same state. Other factors that may encourage fraud are the fact that tax authorities do not obtain information about defaults or possible defaults more quickly.

The CFE observes that missing trader fraud has been made easier by the incapacity of the Member States to adopt a common VAT system that would make it less profitable for criminal organisations to commit the fraud, for example by requiring suppliers to charge VAT on all their operations within the European Union. However, it is accepted that any changes in the treatment of supplies between Member States will have no impact on the possibility of similar frauds being conducted in relation to supplies from third countries, so that other measures that extend to trade with third countries are more likely to be an effective solution to the problem.

The CFE observes that the principle contained in the Case *Kittel* punishes honest businesses which are directly or indirectly connected to the chains of supply where a criminal organisation has defaulted and who become liable for the revenue losses without having themselves been accused of any criminal activity. This is particularly unfair in cases where the tax authorities, with the far greater resources available to them, have suspicions about the fraudulent nature of the criminal organisation but have given no warnings to the trader who they know is about to enter into transactions with the organisation and has no actual knowledge of the fraud. Another issue of concern with the principle is that it encourages legitimate traders to only deal with other established traders, because of concerns that they may otherwise lose their right to recover input tax. This can make it impossible or very difficult for other legitimate traders to enter a market.

In UK, the application of the *Kittel* test was considered by the UK Court of Appeal in *Mobilx v HMRC* [2010] EWCA Civ 517. In that case the UK Court of Appeal considered that the *Kittel* test applied even though the UK had no legislation that sought to restrict the right to deduct input tax when a transaction was connected with fraud. The Court also considered that the principle could apply in a case where there

was no loss of tax in the chain of transactions that the trader was directly involved in. The Court considered that it was sufficient that the loss of tax should arise in another chain of transactions with a connected party, so that the loss could be transferred from one chain of transactions to another chain of transactions by an exporter in a chain where there has been a fraud seeking to recover input tax on his importation of goods in the clean chain. The UK Court of Appeal, it is suggested wrongly, also considered that the trader lost all his rights to recover any input tax even though the input tax he was seeking to recover exceeded the tax lost as a result of the fraud, because of profits made in the chain of transactions where there had been no fraud. On the issue of extent of knowledge, the Court of Appeal considered that the principle only applied in cases where the trader should have known that there was a fraud. It was not sufficient that he should have appreciated that there was a risk of fraud. The Court considered that the “ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected with the fraudulent evasion of VAT”. The Court, arguably harshly, considered that this could be inferred from the fact that a trader continued to trade despite evidence that an increasing proportion of its earlier transactions were tainted with fraud.

In France, a low price or increase of turnover are considered an indicator of fraud somewhere in the chain of production.

In Belgium, the Court of Appeal of Mons decided on 23 April 2010 in the Case *ANG Computime* (Case C-439/04, *Kittel* before the ECJ) that the taxpayer knew or should have known that he was a party to a missing trader fraud because his turnover has been multiplied by 100 in 6 months without new investment, new personnel or an advertising campaign. The taxpayer was dealing directly with suppliers whose seat of activity was fictitious and who did not dispose of any stock. The suppliers had no particular knowledge about computers (although they were active in trading in computer chips). About 23 % of the goods had previously been purchased by it, so that it was selling the same goods more than once. Therefore the Court of Appeal of Mons considers the VAT charged by the suppliers was not deductible.

It has been observed that some businesses in some sensitive sectors are requiring new clients to fill in questionnaires. When they have concerns, they may engage the services of investigators so that they can find out more information about the business. However, even such measures may not be sufficient in cases where established businesses are taken over by other organisations or are facing acute financial problems and such measures are expensive.

The CFE welcomes the efforts of some Member States to publicise fraudulent practices in order to alert bona fide business of issues that might suggest that a transaction is tainted by fraud.

The CFE invites the Members States to clarify the situations in which the *Kittel* principles will be applied. Such clarification should be made at the level of the VAT Committee in order to be available to businesses of all Member States. The CFE considers that it would be desirable if any guidelines applied to transactions above a certain amount. The CFE has significant concerns about guidelines that seek to rely on the price at which goods are sold as an indicator of fraud. This is because it is not uncommon for goods to be sold at different prices in a genuine market, so the fact that goods are being sold at a relatively cheap price is not necessarily an indication of fraud. Such an approach therefore interferes with the legitimate workings of the open market.

The CFE welcomes the efforts that are being made to use information collected by the national tax authorities in a more effective manner to detect suspicious transactions. A specific example is the central collection of data obtained from VAT returns, recapitulative statements and payments.

The CFE considers that other helpful steps might be to apply the reverse charge mechanism that is applied by at least one member state to some products on an EU wide basis to transactions above a specified value in specified products.