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KITTEL, “*R*” AND MARC**

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A PERFECT STORM IN THE EU VAT:
KITTEL, "R" AND MARC

Richard T. Ainsworth

EU VAT authorities are close to turning the tables on missing traders. For many years organized fraudsters have been stealing huge amounts of VAT on the domestic resale of exempt cross-border supplies.¹ Losses have been enormous whether the transactions are in goods (notably cell phones and computer chips)² or in tradable services (CO2 permits and VoIP).³ No market has been safe from the fraudsters.⁴

Answers are developing, but these answers may look more like Armageddon than measured enforcement. Solutions are so draconian, and so all-encompassing that very few intra-community traders will feel safe from the gathering storm.⁵ The situation is not optimal, but it appears to be where we are headed.

¹ Pricewaterhouse Coopers, *Study of the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or intermediaries* 129 (Final Report – September 20, 2010) TAXUD/2009/AO-05 (estimating MTIC fraud contributes between 17% to 26% of the 118.8 billion euro VAT gap in the 27 Member States of the EU which is roughly 19.8 billion to 30.8 billion euro in 2009). Missing trader frauds do not need to involve intra-community transactions. They can be carried out domestically, or with third parties, but the most common is intra-community based.

² On missing trader fraud in cell phones and computer chips see: Richard T. Ainsworth, *Tackling VAT Fraud: 13 Ways Forward*, 45 TAX NOTES INT'L 1205 (Mar. 26, 2007) (assessing the MTIC problem at the time when mostly cell phones and computer chips appeared to be the medium of the fraud);

³ On missing trader fraud in CO2 certificates see: Richard T. Ainsworth, *CO2 MTIC Fraud – Technologically Exploiting the EU VAT (Again)*, 57 TAX NOTES INT'L 357 (Jan. 25, 2009), and on missing trader fraud in VoIP see: Richard T. Ainsworth, *VAT Fraud: The Tradable Service Problem*, 61 TAX NOTES INT'L 217 (January 17, 2011) (discussing the morphing of MTIC fraud into MTEC fraud). and introducing the expression).

⁴ HMRC Letter to UK traders (Abu Bokor, Specialist Investigations Officer, HMRC), Euston Towers, London (13 September 2010) at page 1, para. 1 (on file with author, emphasis added):

Further to our discussion on 25 August 2010 you are aware that the trade sector in which you are trading could be at risk from Missing Trader Intra-Community (MTIC) Fraud. Although the commodities regularly involved in this type of fraud are computer chips and mobile phones and other high value electrical goods, other goods have also been used such as clothes, handbags and soft drinks. *In essence almost all wholesale commodities could be at risk to being involved in Missing Trader Intra-Community Fraud.*

⁵ There are many descriptions of missing trader intra-community fraud (MTIC). Some times the fraud is a simple linear fraud (acquisition fraud), while at other times the supply (goods or service) circles round-and-round (carousel fraud), and at other times a highly complex pattern of contra-trading is used to disguise trading patterns. David Demack, Tribunal Judge for the UK's First-Tier Tribunal (Tax Chamber) recently provided the following description in a contra-trading case:

The basic structure of MTIC fraud takes the following form. A "missing trader", i.e. a UK VAT registered trader, or one who uses another's VAT registration, purchases goods from abroad and imports them into the UK. The importation bears no VAT. The trader sells the goods intra UK, charging VAT at the standard rate on the sale to an intermediary known as a "buffer". The goods then pass along a chain of purchase and sale transactions intra UK through a series of other buffers. Each buffer properly charges and reclaims VAT. The final buffer in the chain then sells the goods to a "broker" – in the present case the appellant traders were the brokers in most of the chains concerned – who, as the last link in the chain, sells the goods abroad in a zero-rated transaction and proceeds to reclaim the input tax he paid to the final buffer. Consistently with his name,

This will be a perfect storm. Aided by new mutual assistance rules, challenges will come from multiple directions. Some traders will face the prospect of paying VAT twice on the same transaction – without a deduction. The damage to some will be severe.

This paper examines the confluence of three legal imperatives – two decisions of the European Court of Justice (ECJ), and a new Council Directive and suggests that a serious EU-wide fraud enforcement action is imminent. The contours of the coming storm will surely challenge cross-border EU traders.

In particular, this paper discusses the alignment of (1) the joined cases of *Axel Kittel v. Belgium* and *Belgium v. Recolta Recycling SPRL*;⁶ (2) the *Criminal Proceedings against R*;⁷ and (3) the Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties, and other measures.⁸

A concluding section presents a series of six hypothetical fact patterns that apply these imperatives. Later papers will present (a) a better solution, and (b) real examples from the early waves of this enforcement action. The overall intent is chart the intensity and direction of this storm system.

(1) *Axel Kittel v. Belgium* and *Belgium v. Recolta Recycling SPRL*

The joined cases of *Axel Kittel* and *Recolta Recycling* [hereinafter *Kittel* or *Recolta*] stand for the proposition that a trader who participates in a fraudulent scheme knowing or having the means to know that he is participating in the fraud, forfeits the right to deduct input tax incurred on purchases used as vehicles of the fraud.

Facts. In *Recolta* (Case C-440/04) Mr. Ailliaud sold to Recolta Recycling sixteen luxury cars. VAT was charged. Mr. Ailliaud had previously purchased the cars from Auto Mall.

the missing trader then disappears having failed to account for the VAT he charged the first buffer.

In the more complex form of MTIC trading known as contra-trading, the broker in the chain of transactions described in the last preceding paragraph himself purchases goods from abroad of equal value to the goods he sells, and sells them along a second chain of transactions before a second broker sells the goods abroad. The first broker has a net liability to VAT of nil, and so declares in his VAT return. (The claim for input tax in the first chain is cancelled out by the output tax in the second chain). The second broker – again in this case the appellant traders were the brokers in the chains other than those at [12] above - who has no apparent connection with the fraudulent VAT loss in the first chain, then proceeds to claim repayment of the input tax on his purchase.

(Joined appeal) *Haroon Younas t/a Micromedia v. Commissioner and Triton Communications Co. UK Ltd. v. Commissioners*, [2012] UKFTT (TC) at ¶¶ 13 & 14 (23 January 2012).

⁶ ECJ judgment of 6 July 2006, Joined Cases C-439/04 and C-440/04 [2006] ECR I-6161.

⁷ ECJ judgment of 7 December 2010, Case C-285/09 [hereinafter “R”].

⁸ O.J. (L 84) 1 (2010) [hereinafter MARC].

Immediately after the purchase Recolta sold the cars back to Auto Mall. Because the cars were to be distributed to other Member States, this transaction was zero-rated (according to the previous Article 43 of the Belgian *Code de la TVA*). The cars in fact never left Belgium.

Mr. Ailliaud (the missing trader) did not remit the VAT that was paid over to him by Recolta to the Belgian Treasury. The court notes:

The documents in the file show that, according to an investigation by the Special Inspectorate of Taxes, Mr. Ailliaud and Auto-Mall had set up a scheme for “carousel” tax fraud, of which the transaction with Recolta formed a part. ... [but it also found that] there was nothing to suggest that Recolta and its directors knew or had any suspicion that they were involved in a major fraud scheme ...⁹

Nevertheless, the Belgian tax administration argued that Recolta should be denied the right to deduct input VAT. The invoices upon which Recolta’s deduction was based were void under domestic law. Because the main purpose of Mr. Ailliaud’s contract with Recolta was to perpetrate a fraud on the Belgian State the contract was void under Article 1131 of the Belgian Civil Code. Recolta therefore, could not meet the requirements for deduction under the VAT Act, according to the Belgian tax authorities.

In *Kittel* (Case C-439/40) Mr. Kittel was the receiver in bankruptcy for Ang Computime Belgium (Computime). Computime bought and resold computer components as a wholesaler in the Belgian market, and exported them to other Member States (notably Luxembourg). The recipients in Luxembourg regularly sold and re-sold the components in that market, and eventually exported them (again) to Belgium where they were purchased in a zero-rated intra-community acquisition by the enterprise that regularly supplied Computime.

This supplier invoiced Computime with VAT, but never remitted the VAT it collected to the Belgian Treasury. Computime however, deducted the VAT it paid, and was aware of the fraud of its suppliers.

Decision. The ECJ does not follow the suggested decision of Ruiz-Jarabo Colomer, the advocate general. The difference in outlook is substantial.

The facts of *Ricolta* and *Kittel* present basic missing trader carousels. In both cases the litigant is the “broker” (the entity that pays VAT to the missing trader, claims a deduction, and then makes a zero-rated intra-community supply). In both cases the Belgian tax authority seeks to deny the input tax deduction to the broker.

The critical difference between *Kittel* and *Recolta* is that in one instance the broker has actual knowledge of the fraud (*Kittel*) where in the other the broker has no knowledge (*Ricolta*). There is no evidence whether or not Ricolta or its directors *should have known* of the fraud.

⁹ ECJ judgment of 6 July 2006, Joined Cases C-439/04 and C-440/04 [2006] ECR I-6161 at ¶¶15 & 17.

Ricolta's facts present the easy case. Both the advocate general and the ECJ agree that *Ricolta* should not be denied the right of deduction. Both base this result on the *Joined Cases Optigen Ltd., Fulcrum Electronics, Ltd and Bond House Systems Ltd. v. HMRC*.¹⁰ Ruiz-Jarabo Colomer indicates:

It may be inferred from this precedent [*Optigen*] that the common system of VAT does not permit that a person who, in good faith, buys goods without knowledge of the scheme operated by the seller should be denied that advantage on the ground that, under the Belgian Civil Code, the agreement is incurably void.¹¹

The ECJ agrees with the advocate general, also references *Optigen*, but states the outcome more broadly. The ECJ presents its decision in two paragraphs: the first paragraph references fraud in *prior or subsequent transactions* (even though in both *Ricolta* and *Kittel* the fraud was only in the immediately prior transaction) and ties this principle to *Optigen*. Then, in a second paragraph the ECJ applies this general rule to fraud that is committed by the *immediately prior seller* (which is the *Ricolta* and *Kittel* fact pattern).

The Court observes that the right to deduct input VAT of a taxable person who carries out such transactions likewise cannot be affected by the fact that, in the chain of supply of which those transactions form a part, another *prior or subsequent* transaction is vitiated by VAT fraud, without the taxable person knowing or having any means of knowing (*Optigen*, paragraph 52).

The same conclusion applies where such transactions, without that taxable person knowing or having any means of knowing, are carried out in connection with fraud committed by the *seller*.¹²

Kittel's facts present the hard case. In *Kittel* there is actual knowledge of fraud carried out by others. The question is about the broker's participation in it. Both the advocate general and the ECJ make distinctions to arrive at a finding of *participation in the fraud*. Ruiz-Jarabo Colomer associates "participation in the fraud" with receiving *actual (financial) benefits* from the fraud; the ECJ however, *presumes* "participation in the fraud" if a taxpayer *knows or should have known* of the fraud. The advocate general's suggestion is as follows:

... where the taxable person is unaware that he is immersed in a broader scheme, intended to avoid the tax liability, or where he is aware of it, but keeps out of the unlawful agreement, his right to deduct is unaffected. ... [Thus, when a person is fully unaware of the fraud] the answer is the same

¹⁰ ECJ judgment of 12 January 2006, *Joined Cases C-354/03, C-355/03 and C-484/03* [2006] ECR I-6161

¹¹ Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 14 March 2006, *Joined Cases C-439/04 and C-440/04* at ¶39.

¹² ECJ judgment of 6 July 2006, *Joined Cases C-439/04 and C-440/04* [2006] ECR I-6161 at ¶¶45 & 46.

where the taxable person is aware of the fraud, but neither participates in it, nor derives a financial advantage from it.¹³

The ECJ's approach is entirely different. It focuses on what a trader *should have known*, not whether a trader *actually benefited* from the fraud. The ECJ ties together two nodes of knowledge: (1) knowledge of the fraud and (2) knowledge of the transaction.

It postulates, if the taxpayer knows or should know of the fraud, and if he knows that his contemplated transaction is connected to this fraud, then there is a presumption that he is participating in the fraud if he proceeds with the transaction. The ECJ states:

... it is apparent that traders who take *every precaution* which could reasonably be required of them to ensure that their transactions are not connected with fraud, ... must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT
...

... [However,] a taxable person who *knew or should have known* that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a *participant* in that fraud, irrespective of whether or not he profited by the resale of the goods.

That is because in such a situation the taxable person *aids the perpetrators* of the fraud and becomes their *accomplice*. ...

Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person *knew or should have known* that, by his purchase, he was *participating in a transaction connected with fraudulent evasion of VAT*,
...¹⁴

One final note. In *Kittel* the ECJ closely follows its earlier *Optigen* decision.¹⁵ *Optigen* provides principles. *Kittel* is a specific application of them. Thus, when *Kittel* discusses a "... taxable person who *knew or should have known* that, by his **purchase**, he was taking part in a transaction connected with fraudulent evasion of VAT ..." (emphasis added) it needs to be remembered that the same *Optigen* principles would apply if the context involved a taxpayer's **sales** that are connected to the fraudulent evasion of VAT. The discussion of purchases in *Kittel* is simply a reflection of the *Kittel* and *Ricolta* fact patterns, both of which involve the deductibility of input VAT on purchases.

¹³ Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 14 March 2006, Joined Cases C-439/04 and C-440/04 at ¶¶60 & 63.

¹⁴ ECJ judgment of 6 July 2006, Joined Cases C-439/04 and C-440/04 [2006] ECR I-6161 at ¶¶ 51 & 56-57.

¹⁵ The *Optigen* decision is reference eight times in *Kittel*, far more than any other case at ¶¶ 39-41, 43-45 and 49.

(2) *Criminal Proceedings against R (“R”)*¹⁶

“R” extends *Kittel*. Where *Kittel* established criteria for denying the right to deduct input credits, “R” establishes criteria for denying the exemption on intra-Community supplies. Where *Kittel* is factually domestic (but without jurisdictional limitation) “R” is factually international (between Member States within the Community). *Kittel* requires courts to:

... refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT ...”¹⁷

Similarly, “R” indicates that Member States are:

... required to refuse to grant the [intra-community] exemption to the supplier of goods and to require that supplier to pay the tax subsequently ... [if there] are genuine reasons to assume that the intra-Community acquisition corresponding to the supply at issue might escape payment of VAT in the destination Member State.¹⁸

Facts. Mr. R, a Portuguese national, was the manager of a German company that traded in luxury cars. Established in 2001, this company sold more than 500 vehicles per year. Most of Mr. R’s buyers were automobile distributors in Portugal. One of the reasons for Mr. R’s business success seems to have been the scheme he developed to help his Portuguese buyers evade Portuguese VAT.

In 2002 Mr. R began manipulating the accounting records to conceal the true identity of his purchasers. This deception enabled his true buyers to evade detection. For German VAT purposes Mr. R declared that his sales were exempt intra-Community supplies. Mr. R recorded these supplies as VAT-free transactions on annual VAT returns. To support the figures on the German return Mr. R prepared false invoices. The invoices were drafted in the name of real businesses, with correct addresses and VAT ID numbers, but these businesses were not the true purchasers.

- Each invoice listed the following:
 - Name of the false buyer and the true seller,
 - Address of both parties
 - VAT ID numbers of both parties,
 - An accurate description of the vehicle,
 - The actual purchase price, and
 - A notation indicating “tax-free intra-Community supply under ¶6a of the UStG.”

¹⁶ ECJ judgment of 7 December 2010, Case C-285/09. See also: Michelle Goulet Phillips, *Lessons on VAT: The R Case in the ECJ*, 66 TAX NOTES INT’L. 443 (April 30, 2012) (considering “R” in the context of both EU and US policies, and suggesting solutions to missing trader fraud that engage technology).

¹⁷ *Kittel*, at ¶ 59.

¹⁸ “R,” at 52 [Note: to make the construction of this passage from “R” parallel with that in the *Kittel* passage above the clauses were flipped, and placed in reverse order, without altering the meaning.]

- False shipping documents were also prepared indicating that shipment was made to the false buyer.

For German purposes it would appear that these transactions were VAT-exempt, taxable in Portugal. If the German tax administration opened an audit, the auditors would have a difficult time tracing the real commercial chain. Paper records would be decoys. A check for valid names, address and VAT ID numbers would have to be supplemented with a physically tracing of specific auto sales (manufacturer to final consumer).

For Portuguese purposes a different set of invoices were prepared. In this instance the sales were represented as used car sales, taxable under the margin scheme. The false paperwork would make it appear (to a Portuguese auditor) that these transactions were already taxed in Germany. If a final consumer was known before delivery, Mr. R produced:

- Vehicle registration documents in the name and address of the final consumer indicating that this was a sale of a used vehicle, and
- A (false) notation was inscribed on the invoice: “taxation of profit margin pursuant to ¶25a of the UStG.”

This scheme allowed Mr. R to sell automobiles at very favorable prices. Benefits were measured by sales volume and profits. In 2002 Mr. R sold €7,720,391 in cars, and avoided €1 million in VAT. In 2003 he sold €1,169,460 in cars and avoided €1.5 million in VAT.

Criminal courts. After a thorough audit, the German tax authorities denied Mr. R the right to zero-rate his sales. Criminal fraud penalties were imposed, and the *Landgericht Mannheim* (Mannheim regional criminal court of first instance) upheld the tax administration’s determination. Mr. R was sentenced to a three-year prison term for tax fraud.¹⁹ The *Landgericht Mannheim* determined that the falsified sales to Portugal were not intra-Community supplies within the meaning of the Sixth Directive. In reaching its decision the *Landgericht* followed a 2008 case of the *Bundesgerichtshof* (Federal Supreme Court).²⁰

Civil courts. This was not the way that the *Finanzgericht* (tax court of first instance) and the *Bundesfinanzhof* (Federal Supreme Court for Tax Matters) saw the matter.²¹ According to the civil courts the zero-rate on Mr. R’s intra-Community supply could not be refused. The cars were sold, they were dispatched to Portugal, and thus the requirements for an intra-Community supply were met.

¹⁹ “R,” at ¶22.

²⁰ Judgment of the First Criminal Chamber of the *Bundesgerichtshof* of 20 November 2008, No. BGH 1 StR 354/08 (in German, translation on file with author).

²¹ Judgment of the *Bundesgerichtshof* of 29 July 2009, No. BFH, XI B 24/09 (in German, translation on file with author); “R,” at ¶23.

As a result, the civil courts reasoned, the objective conditions set down in *Albert Collée v. Finanzamt Limburg an der Lahn*,²² had been met. Under these conditions, a zero-rate could only be refused if there was a risk of loss of tax revenue, or if the levying of VAT was in jeopardy. The civil courts reasoned, any risk of VAT loss arose in Portugal, not Germany. It was Portugal's obligation (not Germany's) to enforce the rules.

In light of the *Bundesfinanzhof's* opinion, the *Bundesgerichtshof* decided to refer the following question to the ECJ for a preliminary ruling:²³

Must Article 28c(A)(a) of the Sixth Directive [VAT Directive 138(1)] be interpreted as meaning that a supply of goods within the meaning of that provision is to be refused exemption from value added tax if the supply has actually been effected, but it is established on the basis of objective factors that the vendor, a taxable person,

- (a) knew that, by his supply, he was participating in a transaction aimed at evading VAT, or
- (b) took actions aimed at concealing the true identity of the person to whom the goods were supplied in order to enable the latter person or a third person to evade VAT?

ECJ decision. As with *Kittel*, the ECJ in “R” rejects the advocate general's opinion and crafts new law. In “R” the court holds that where deliberately fraudulent invoices, declarations, and substantial manipulation of evidence is used in support of an intra-Community supply, a Member State is *required* to refuse the application of a zero-rate.

Thus, the ECJ agrees with the German criminal courts. The proper way to look at this case is not German-centric (how should the German tax authority respond to Mr. R's fraud in their duty to protect the German fisc). The correct perspective is Euro-centric (how should any Member State respond to Mr. R's fraud to protect the “proper functioning of the [Community's] common system of VAT.”²⁴)

Framed in this way the logic of the ECJ is inescapable. First, the prevention of tax evasion, avoidance and abuse is an overriding concern of the Sixth Directive [VAT Directive].²⁵ Secondly, the paired intra-Community supply/ intra-Community acquisition

²² *Albert Collée as full legal successor to Collée KG v. Finanzamt Limburg an der Lahn*, Case C-146/05 [2007] ECR I-7861 (27 September 2007).

²³ Judgment of the First Criminal Chamber of the *Bundesgerichtshof* of 7 July 2009, in criminal proceedings against R, No. BGH 1 StR 41/09 (in German, translation on file with author).

²⁴ “R,” at ¶48. Emblematic of this shift in focus is apparent in the citations. Where the *Bundesgerichtshof* specifically asks about Art. 28c(A)(a) [VAT Directive 138(1)] the ECJ directs most of its attention to the heading, Art.28c(A) [VAT Directive 131].

²⁵ “R,” at ¶36. See: Joined cases of *Gemeente Leusden and Holin Groep BV v. Staatssecretaris van Financiën*, Cases C-487/01 and C-7/02 [2004] ECR I-5337 at ¶76; *Halifax and Others v. HMRC*, Case C-255/02 [2006] ECR I-1609 at ¶71.

rules are an objective “mechanism” designed by the Directive to delimit Member State’s authority to tax.²⁶ Departing goods are exempt, *because they are taxed* at destination.

Third, this “mechanism” is so important to the proper functioning of the common system of VAT that the Directive places three express conditions on the exemption, and further requests that Member States supplement them with additional conditions “... for the purpose of ensuring the correct and straightforward application of the exemptions subsequently provided for and preventing any evasion, avoidance or abuse.”²⁷ The exemption is not a unilateral grant. It is specially designed to toggle back and forth (alternately granting or withholding a zero-rate) based upon the satisfaction of the articulated conditions.

Fourth, because in this case Germany has not put forward additional conditions, the ECJ will rest its decision on the three conditions in the Directive:

- Is the right to dispose of the goods as owner transferred to the purchaser?
- Has the supplier established that the goods have been dispatched?
- As a result of the dispatch or transport, have the goods physically left the territory of the Member State of supply?²⁸

Fifth, the ECJ notes that each of these conditions is evidentiary-based.²⁹ Satisfying them depends on the quality of the taxable person’s proof. How to assess this evidence is left to the Member States. The ECJ states:

... it is principally on the basis of *evidence* provided by taxable persons and their statements that the national tax authorities are to carry out the necessary checks. However, ... none of the provisions of the Sixth Directive specifically lays down the *evidence* required to be furnished by taxable persons in order for them to be eligible for the exemption ... Moreover, ... in order to be eligible for the exemption under the first subparagraph of Article 28c(A)(a) of the Sixth Directive [VAT Directive 138(1)] it is for the supplier of the goods to *furnish the proof* [of the three conditions for exemption as well as any additional conditions set out by the supplier’s Member State] ...³⁰

The outcome is now a foregone conclusion, but the ECJ carefully crafts its response. It does so in three stages: (a) Mr. R’s fraudulent proof is a serious affront to the Community’s common system of VAT, (b) the Sixth Directive does not bar a Member State from weighing a taxable person’s proof when they seek to qualify for an exemption, and if they find the proof wanting then they may disallow the zero-rate, but (c) in the

²⁶ “R,” at ¶¶38-39. See: *EMAG Handel Eder OHG v. Finanzlandesdirektion für Kärnten*, Case C-245/04, [2006] ECR I-3227 at ¶¶30 & 40; *Joined Cases Optigen and Others v. HMRC*, Cases C354/03, C-355/03 and C-484/03 [2006] ECR I-483 ¶44; *Kittel*, at ¶41; and *Teleos and Others v. HMRC*, Case C-409/04 [2007] ECR I-7797 at ¶38.

²⁷ “R,” at ¶40; Sixth Directive, Art. 28c(A); VAT Directive Art. 131.

²⁸ “R,” at ¶41. See: *Teleos*, at ¶42; *Twoh International v. Staatssecretaris van Financiën*, Case C-184/05 [2007] ECR I-7897, at ¶23.

²⁹ “R,” at ¶42. See: *Teleos*, at ¶44; *Twoh*, at ¶24.

³⁰ “R,” at ¶¶42-43 & 46.

specific facts of this case settled Community law goes further and *requires* the Member State of origin to deny the zero-rate, and *requires* the supplier to pay the tax. These points are set out below:

(a) The ECJ's assessment of Mr. R's scheme [producing fraudulent German documentation to facilitate tax evasion in Portugal] is an open affront to the common system of VAT. The ECJ says this is a serious concern.

... the invoices and returns which [Mr. R] produced for the tax authorities as evidence of intra-Community transactions were deliberately substantively inaccurate. ... The presentation of false invoices or false declarations and any other manipulation of evidence is liable to prevent the correct collection of the tax and, therefore, to compromise the proper functioning of the common system of VAT. Such actions are all the more serious when committed in the context of the transitional arrangements for the taxation of intra-community transactions, which, ... operate on the basis of the evidence provided by the taxable person.³¹

(b) The ECJ instructs the German civil courts (the *Finanzgericht* and the *Bundesfinanzhof*) that they are *not* prohibited by Community law or prior ECJ decisions from *denying* the zero-rate to any supplier seeking to make an intra-Community supply, if the national court determines either [1] that granting the zero-rate would facilitate tax evasion, or if [2] the local court determines that the taxpayer has not complied with a pre-condition for exemption imposed by national law.

EU law does not prevent member States from treating the issuing of irregular invoices as amounting to tax evasion and from refusing to grant the exemption in such cases ... The refusal of exemption in the case of non-compliance with an obligation provided for by national law – in this instance, the obligation to identify the person acquiring the goods and receiving the intra-Community supply – has a deterrent effect which is intended to ensure compliance with that obligation and to prevent any tax evasion or avoidance ...³²

(c) In this particular case, the ECJ finds the fraud to be so egregious that Community law indicates that Germany is *required* to deny the zero-rate, and that Mr. R is *required* to pay the tax. This is true even if the tax is collected subsequent to completion of the transaction upon which the tax it is based.

However, with regard to particular cases in which there are genuine reasons to assume that the intra-Community acquisition corresponding to the supply at issue might escape payment of VAT in the destination Member State, notwithstanding the mutual assistance of and administrative cooperation between the tax authorities of the member States concerned, the member State of departure is, in principle, *required*

³¹ “R,” at ¶¶47-48.

³² “R,” at ¶¶49-50. See: *Schmeink & Cofreth and Strobel v. Finanzamt Borken* and *Manfred Strobel v. Finanzamt Esslingen*, Case 454/98 [2000] ECR I-6973 ¶62; *Transport Service*, Case C-395/02 [2004] ECR I-1991, at ¶30.

to refuse to grant the exemption to the supplier of the goods and to *require* that supplier to pay the tax subsequently in order to ensure that the transaction in question does not escape taxation altogether.³³

“*R*’s” extension of *Kittel*. “*R*” is an extension of *Kittel* because “*R*” applies the same reasoning to deny zero-rates on intra-Community supplies that *Kittel* applies to deny input tax deductions. There are differences however, in both operating principles and the ambit of the decisions. In both instances “*R*” is a narrower (a more specific) application of *Optigen* than is *Kittel*, but in all important respects these three cases line up neatly, one after the other.

Kittel simply requires that the “... taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT ...”³⁴ *Kittel* does not require the taxpayer’s transaction to be fraudulent, nor does it require the fraudulent activity to be an activity that the taxpayer directly participates in, or that his direct customers, or suppliers engage in. The *Kittel* question is whether or not the taxpayer’s *transaction* is *connected* with the fraud, and then whether or not the taxpayer was aware or should have been aware of this *connection*. *Kittel* does not operate on a next-person-in-line principle; “*R*” does.

The rule in “*R*” is narrower than the rule in *Kittel*. “*R*” does concern the next person in line. “*R*’s” question is whether or not there are “... genuine reasons to assume that the intra-Community acquisition corresponding to the supply at issue might escape payment at the destination ...”³⁵ We only look at the immediate customer. Will this customer escape payment?

“*R*” does not have a “known or should have known” rule. Unlike *Kittel* which dealt with brokers that *knew* of the fraud (*Kittel*), and brokers that *did not know* of the fraud (*Ricolta*), but where the court was willing to fashion a *should have known* rule, in “*R*” there is only a rule dealing with *known* verses *did not know*. We have no idea if the court will fashion a *should have known* rule in the “*R*” fact pattern.

This point is one of the very interesting issues in this perfect storm of fraud enforcement that we will be witnessing. How will the courts (and ultimately the ECJ) respond when a taxpayer making an intra-Community supply *does not know*, but *should have known* that the intra-Community acquisition corresponding to the supply at issue might escape payment of VAT in the destination Member State? This would fully embed *Kittel* analysis in the “*R*” line of cases.

Under “*R*” (as currently enforced) it is necessary for the tax authority to demonstrate *genuine reasons* for its *assumption* that fraud may occur based on knowingly fraudulent acts affirmative performed by the supplier. If this proof is made, then the tax

³³ *R*,” at ¶52 (emphasis added). See: *Transport Service*, at ¶¶ 20-21; *Optigen and Others*, at ¶54; *Collée*, at ¶22.

³⁴ *Kittel*, at ¶57.

³⁵ “*R*,” at ¶52.

authority can: (a) pre-emptively withdraw a taxpayer's right to zero-rate certain intra-Community supplies, and/or (b) retro-actively "require the taxpayer to pay" VAT on previously completed supplies made to certain foreign parties.

(3) Council Directive 2010/24/EU of 16 March 2010 *concerning mutual assistance for the recovery of claims relating to taxes, duties, and other measures*³⁶

The *Mutual Assistance for the Recovery of Claims* (MARC) Directive is a central component of the Commission's *short term* action plan that was set out in a January 12, 2008 Communication.³⁷ Implementing regulations clarify, but do not add substantively to the Directive.³⁸ The original version of MARC was adopted on March 15, 1976. It was amended several times before being codified in Council Directive 2010/55/EC. On January 1, 2012 Council Directive 2010/24/EU replaced the old Directive.³⁹

There is compelling evidence that old MARC needed to be updated. It simply could not keep pace with the rising tide of MTIC requests. In 2003 there were 3,355 MARC requests. By 2007 these requests had quadrupled to 11,794. Actual recovery rates were exceedingly poor. Only 5% of MARC-requested amounts were ever recovered. By 2007 VAT claims related to MTIC fraud accounted for 57.5% of all MARC requests. As a result it was clear that the VAT-related aspects of MARC were the primary problem, and quite understandably they received the most attention in the revision.⁴⁰

The sweep of MARC is broad, and mandatory. The requested tax authority "... shall provide *any information which is foreseeably relevant* to the applicant authority in the recovery of its claims."⁴¹ The requested tax authority must comply. Bank secrecy is no barrier. The requested tax authority cannot decline to supply information "... solely because this information is held by a bank, other financial institution, nominee, or person

³⁶ O.J. (L 84) 1 (2010).

³⁷ Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, *On a coordinated strategy to improve the fight against VAT Fraud in the European Union*, COM(2008) 807. The *long term* action plan contained in the same document presented measures that in "... ensuing discussions in the Council ... [were] regarded as more radical and could not be introduced in the short run." EU Commission, *Proposal for a Council Regulation on administrative cooperation and combating fraud in the field of value added tax (Recast)*, COM (2009) 427 (August 18, 2009) at 2. Other elements of the *short term* action plan included (listed at page 13): timeframe reductions, joint and several liability extensions, import VAT exemptions, a revision of VIES, shared responsibility for all Member State revenue, EUROFISC, and uniform chargeability on all intra-Community transactions.

³⁸ Commission Implementing Regulation (EU) No. 1189/2011 of 18 November 2011 *laying down detailed rules in relation to certain provisions of Council Directive 2010/24/EU concerning Mutual Assistance for the Recovery of Claims relating to taxes, duties, and other measures*, O.J. (L 302) 16 (2011).

³⁹ See: Tom O'Shea, *EU Adopts Recovery of Taxes Directive*, 58 TAX NOTES INT'L 475 (May 10, 2010) (providing a very good plain English description of the MARC).

⁴⁰ EU Commission, *Proposal for a Council Directive concerning mutual assistance for the recovery of claims relating to taxes, duties, and other measures*, COM(2009) 28 (February 2, 2009) at 2.

⁴¹ O.J. (L 84) 1 (2010) at Art. 5(1) (emphasis added).

acting in an agency or a fiduciary capacity.”⁴² A similar rule was adopted on February 15, 2011 with respect to administrative cooperation in direct taxation.⁴³

There are three main parts to MARC: rules on exchange of information; standardization of all notification documentation; mechanisms for assistance in the recovery of claims, and precautionary measures. Considerable effort has gone into making instruments uniform and encouraging uniform practices.⁴⁴

Exchange of information. Aside from traditional information requests,⁴⁵ Member States are now required to exchange information spontaneously.⁴⁶ Spontaneous disclosure in turn opens the door to permit officials from an applicant Member State to be present during administrative enquiries carried out on the territory of the requested Member State.⁴⁷

Notification documentation. MARC establishes standard forms for notifications and requires that Member States assist one another to assure proper delivery of tax, audit, and judicial notices within their jurisdiction.⁴⁸

Recovery of claims and precautionary measures. Uniform instruments for enforcement of claims⁴⁹ and precautionary measures⁵⁰ are at the heart of MARC. The intent is to reduce enforcement delays to a minimum. The speed with which MTIC fraudsters can complete their crime compels accelerated enforcement.⁵¹ In this area

⁴² O.J. (L 84) 1 (2010) at Art. 5(3). The reasons allowed for declining the request to supply information are limited and set out in Art. 5(2)(a)-(c):

- information that the requested Member State would not be able to obtain for itself on similar claims arising within its own jurisdiction;
- information that would disclose commercial, industrial or professional secrets; or
- information the disclosure of which would be liable to prejudice the security of, or be contrary to the public policy of the requested Member State.

⁴³ Council Directive 2011/16/EU of 15 February *on administrative cooperation in the field of direct taxation and repealing Directive 77/799/EEC*, O.J. (L 64) 1, at Art. 18(2).

⁴⁴ Instruments permitting enforcement or precautionary measures, the notification documents related to these measures, and the translation of documents.

⁴⁵ O.J. (L 84) 1 (2010) at Art. 5 (the requirement is to make “any administrative enquiries” [Art. 5(1)] needed to provide this information, and the Member State is not allowed to raise bank secrecy as a barrier [Art. 5(3)]).

⁴⁶ O.J. (L 84) 1 (2010) at Art. 6.

⁴⁷ O.J. (L 84) 1 (2010) at Art. 7. This article essentially allows joint audits. It allows officials from the requesting authority to be present in administrative office, during administrative hearings, enquiries, and court proceedings. Foreign officials can assist with individual interviews and record examination.

⁴⁸ O.J. (L 84) 1 (2010) at Arts. 8 & 9. Aside from physical delivery assistance, the requested Member State is required to make sure that the formalities of national law are complied with.

⁴⁹ O.J. (L 84) 1 (2010) at Art. 12.

⁵⁰ O.J. (L 84) 1 (2010) at Art. 16(1).

⁵¹ A full MTIC cycle can be completed in an afternoon and the money from the fraud can be on deposit within thirty days. Fraudsters can disappear long before the tax authority secures the records of suspect transactions. At the height of the UK MTIC fraud in computer chips the *Guardian* newspaper interviewed a fraudster.

[MTIC fraud] is Britain's fastest-growing criminal enterprise, ... Among the [criminals is] a man who likes to be known as Colin, a genial wheeler dealer, ... and his mate

MARC can be characterized as a set of firm rules with exceedingly generous exceptions – so generous in fact that the rules seems to vanish on application.

For example, MARC indicates that, “[t]he applicant authority may *not* make a request for recovery [or precautionary measures] if and as long as the claim and/or the instrument permitting its enforcement in the applicant Member State are contested ...”⁵² This rule sound tight and restrictive – until you get to the exceptions. The exceptions are broad. In practice MARC will allow requests for precautionary measures can be lodged very early in an investigation. The only condition is that they be accompanied by a “reasoned” request.⁵³ In other words, one simply needs to attach an explanatory letter to the basic form to qualify for an exception that will allow precautionary measures to be taken.

Similarly, the normal rule is that “appropriate recovery procedures in the applicant Member State”⁵⁴ *must be* utilized before a request for recovery or precautionary measures is made. But once again there are exceptions. Notably, if it becomes obvious that (a) local assets are insufficient in light of the size of a potential recovery,⁵⁵ or if it appears that (b) domestic recovery actions would present a “disproportionate difficulty,”⁵⁶ then MARC will waive the domestic-procedures-first rule.

Finally, in a breathtakingly sweeping provision, MARC allows precautionary measures that are not (yet) the subject of an instrument that would allow enforcement to

"Andy", said to be "a bit of an anorak" when it comes to computers. "He's the technical expert," Colin explained. "I'm into banking, investments, things like that." Each afternoon, hunched over a couple of PCs in his apartment ... Andy spins the wheels of carousel fraud, ... "You can turn the carousel in just 10 minutes, and then you just have to wait 30 days for the money to come in," says Colin. "You can run it round five companies but there are up to 300 that can be used. Each spin can give you up to 200,000 pounds. The longest it stays in any bank account is two hours. ... You can move money so fast. The scale of it is beyond comprehension, you have no idea how much money is being made." ... The downside, as Colin and Andy discovered late last year, is that carousel fraud is becoming increasingly attractive to violent criminals. ... "Andy had a knock on his door [one day] and then he found he was having to pay out to some really heavy people ... I thought he was going to get cracked. He didn't get cracked, but, ..." [said Colin].

Ashley Seager & Ian Cobain, *Carousel fraud: Bogus deals keep Customs in a spin: Smart criminals stay ahead of investigators Russian mafia and IRA linked to swindles*, GUARDIAN (May 9, 2006) available at: <http://www.guardian.co.uk/uk/2006/may/09/ukcrime.ashleyseager>

⁵² O.J. (L 84) 1 (2010) at Art. 11(1) (emphasis added). The broad exception for a “reasoned request” in the context of the general prohibition is a simple way of saying that MARC will allow an administrative (forms only) process to develop around settled, or no longer contested claims, but that “something more” is needed if there is an on-going dispute. The problem is, there is no indication on what this “something more” is. Standards are lacking.

⁵³ MARC does mandate that “if the results of contestation is subsequently favorable to the debtor, the applicant authority shall be liable for reimbursing any sums recovered, together with any compensation due, in accordance with the laws in force in the requested Member State.” O.J. (L 84) 1 (2010) at Art. 14(4)(third sub-paragraph).

⁵⁴ O.J. (L 84) 1 (2010) at Art. 11(2).

⁵⁵ O.J. (L 84) 1 (2010) at Art. 11(2)(a).

⁵⁶ O.J. (L 84) 1 (2010) at Art. 11(2)(b).

begin in the applicant Member State.⁵⁷ Thus, an unripe domestic claim can be reconstituted internationally. This is allowed, even though for the taxpayer this may involve proceedings in a foreign language and a foreign judicial system. MARC states:

At the request of the applicant authority, the requested authority shall take precautionary measures, if allowed by its national law and in accordance with its administrative practices, to ensure recovery where a claim or the instrument permitting enforcement in the applicant Member State is contested at the time when the request is made, or where the claim is not yet subject of an instrument permitting enforcement in the applicant Member State, in so far as precautionary measures are also possible, in a similar situation, under national law and administrative practices of the applicant Member State.⁵⁸

Two minor points need to be added. MARC allows the costs of recovery to be charged to the taxpayer if the amounts that are requested under a MARC procedure are not freely paid.⁵⁹ Assistance under MARC is not mandatory for claims that are over five years old,⁶⁰ or for claims that are under €1,500.⁶¹

HYPOTHETICALS

This section sets out six hypothetical fact patterns that when taken together illustrate both (a) how *Kittel* is applied today (primarily in domestic contexts) and then (b) how *Kittel* (aligned with “R,” and MARC) is set for a comprehensive assault on missing trader fraud. This is a perfect storm. The hypothetical examples are arranged to show four stages of *Kittel* development. We are currently at the first stage.

In a nutshell, the argument presented through these hypothetical examples is that *Kittel* is not for *domestic-only* application. *Kittel* is not jurisdictionally limited, and it responds just as effectively to multi-jurisdictional missing trader fact patterns as it does to domestic patterns. Secondly, it argues that “R” is an effective backstop to *Kittel* when tax authorities attack missing trader fraud across Community borders. Third, it argues that MARC provides sweeping cross-jurisdictional investigative assistance to any Member State that is pursuing recovery from a fraudster, or group of fraudsters. And finally, it argues that because Member States are under an affirmative obligation to pursue missing traders throughout the Community to protect the *common system of VAT* from assault by criminals, these tools are being readied for use in a wide-ranging wave of MTIC enforcement efforts throughout the Community.

For ease of presentation, all hypothetical examples will draw on the same basic fact pattern of six businesses selling to one another over three Member States. *Kittel*

⁵⁷ This measure is designed to counter-act efforts by organized fraudsters to turn insolvent before an enforcement action can be undertaken.

⁵⁸ O.J. (L 84) 1 (2010) at Art. 16.

⁵⁹ O.J. (L 84) 1 (2010) at Art. 20. This measure is intended to encourage tax authorities to commit significant resources to MARC efforts.

⁶⁰ O.J. (L 84) 1 (2010) at Art. 18(2).

⁶¹ O.J. (L 84) 1 (2010) at Art. 18(3).

Stage 1 will draw on the early part of this fact pattern (A, B, C, & D), Stages 2, 3 and 4 will utilize the latter part (C, D, E, & F). The basic pattern is:

Assume three UK businesses. Business A sells goods to business B which adds value and sells to business C. The A-to-B and B-to-C transactions occur in the UK. Assume further that C dispatches⁶² the goods to D, in France. The French business, D, then dispatches the goods to E, in Slovenia. E re-sells the goods to Slovenian business F.⁶³ E will be a missing trader.

KITTEL STAGE 1 – Kittel today

Stage 1 is the basic *Kittel* application. It uses the black letter holding in *Kittel* to deny an input credit based on a *connection* to fraud. Stage 1 is a supply-side (not customer-side) fact pattern. Supplies *purchased* by the taxpayer incur VAT. The VAT is paid and this payment creates the right to an input credit on the taxpayer's VAT return. The taxpayer is either a broker,⁶⁴ or a buffer⁶⁵ in these examples.

There are two hypothetical examples at this stage: Hypo I involves a broker; Hypo II involves a buffer.

Hypo I. Assume that C purchases goods from B, pays VAT, and then dispatches the goods to D in France. Also assume that C *knows* or *should have known* that the B-to-C transaction was *connected* with a scheme earlier in the chain to fraudulently evade the payment of VAT (a prior trader in the chain is a missing trader). Under these facts, the UK tax authority should deny C's input credit on C's VAT return.

This denial will effectuate a full recovery of the VAT that was due (but not remitted) earlier in the chain.

This is literally the *Kittel* fact pattern. The ECJ is very clear about what needs to be done in a *Kittel* fact pattern: "... it is for the national court to refuse that person entitlement to the right to deduct."⁶⁶ There are a large number of cases in the UK that follow the basic *Kittel* fact pattern.⁶⁷

⁶² "Dispatch" is the term used throughout the EU to describe a transaction from one Member Country to another Member Country. It is the functional equivalent to an "export," but that term is used for transactions with non-EU Member States.

⁶³ The hypothetical patterns developed here transaction prices and VAT rates will not be included. The common situation is for goods to be sold and re-sold at very small price increments. This ind of detail needlessly complicates the discussion.

⁶⁴ "Broker" is a term used in missing trader parlance to denote the trader who dispatches the goods out of the Member State. A broker will pay VAT on a domestic purchase, and then reclaim the VAT paid when the goods are dispatched, because an intra-community supply qualifies for exemption (it is zero-rated).

⁶⁵ "Buffer" is a term used in missing trader parlance to denote an intermediary, a taxpayer who is involved in the chain of domestic transactions between the actual missing trader [commonly a taxpayer who received the goods in an intra-community acquisition from a taxpayer in another Member State] and the buffer who dispatched the goods out of the country in an intra-community supply.

⁶⁶ *Kittel*, at ¶61.

⁶⁷ See for example the February 28, 2012 decision of *Vantage Link Corporation Limited v. HMRC*, [2012] UKFTT 202 (TC) where the court upheld the denial of input tax in 38 transactions. In each case Vantage

Hypo II. Assume C is engaged in the import/export business (making balanced intra-community acquisitions and intra-community supplies). As a result, C's VAT return regularly offsets input and output VAT from different commercial chains. C rarely pays much VAT or seeks a significant refund. C is a contra-trader.⁶⁸

Assume that C deals with two distinct commercial chains: a dirty chain⁶⁹ from which it purchases goods and uses them to make intra-Community supplies, and a clean chain⁷⁰ into which it sells goods that it acquires in intra-Community acquisitions. The dirty chain runs X-to-Y-to-Z-to-C. X acquires goods from another Member State in an intra-Community acquisition, does not remit VAT on its sales to Y, and then disappears. The clean chain runs from C-to-B-to-A.

The concern in this hypothetical is with A.

Taxpayer A paid VAT to B on its purchases in the clean chain. *Kittel* indicates that if A *knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT*, then the tax authority should deny A's input credit. In this case the burden of proof for the tax administration is steep, but *Kittel* still applies.⁷¹ If some of this proof needs to come from other EU jurisdictions,

Link was a broker seeking a refund because it was making exempt intra-Community supply. Thirty-four of the transactions led to the same Cypriot company (Macdelta Ltd.), and HMRC suggested that the remaining four to JD Telecom UK Ltd. were destined for Macdelta based on inferences in the evidence. These thirty-eight trades represented almost all of Vantage Link's trading activity for three tax periods. Large sums of money transferred quickly through the entire commercial chain leading to Vantage Link. A single off-shore bank held all accounts and transferred large sums in such a short period of time that the court concluded that the trading activity was not real commerce, but a scheme to defraud the Treasury.

⁶⁸ A "contra-trading" is a term used in missing trader parlance to denote a broker that balances input and output amounts from intra-community acquisitions and intra-community supplies such that the domestic VAT return filed has a minimal amount due.

⁶⁹ "Dirty chain" is a term used in missing trader parlance to denote a commercial chain that includes a missing trader.

⁷⁰ "Clean chain" is a term used in missing trader parlance to denote a commercial chain that contains no fraud or other tax irregularities.

⁷¹ This burden has been met in a large number of cases in the UK, frequently with the assistance of detailed banking records from the First Curacao International Bank (FCIB) showing back-to-back trades happening within minutes of each other through complex commercial chains a day or so before critical tax returns in the fraud scheme are due. When all of the parties in a chain, or chains, have accounts at the same off-shore bank, and where all proceeds (including the VAT) are kept off-shore the evidence of knowledge gets compelling. For example, in *Excel RTI Solutions Limited (in Administration) v. HMRC* [2010] UKFTT 519 (TC) the VAT Tribunal found that evidence from FCIB provided such compelling proof of fraud and actual knowledge that further legal analysis on the application of *Kittel* to the facts was not needed. In a very recent decision (April 10, 2012), *Sound Solutions (Europe) Limited v. HMRC* [2012] UKFTT 251 (TC) at ¶13 the court notes:

There are a substantial number of deals in each of the trades often exceeding 7 traders and amounting to deals valuing £10,000,000 or more so that the profit, using the above example to the fraudsters might be of the order of £8,570,060. At no point are the fraudsters at risk. The money passes through the FCIB very quickly, often in 1/2 hour and appears to be orchestrated by the fraudsters. The money they had to introduce, in this example £1,124,554, is returned to them in that time scale together with £92,828.75 the VAT paid to C by D.

including banking or financial data,⁷² then MARC will be of considerable assistance after January 1, 2012. Requests for assistance cannot be denied,⁷³ and requests for precautionary measure will immediately tie up foreign assets.⁷⁴

The tax authority will need to show that A, who is in a different commercial chain from the fraudster (X), who may not have even been dealing in the same kinds of goods as the fraudster, and who did not deal directly with the contra-trader (C) nevertheless *knew or should have known* that the A-B transaction was *connected with* fraudulent evasion of VAT. In this case, A would be providing the positive VAT flow that the contra-trader (C) needed to offset the VAT due in the dirty chain.

Contra-trading cases have been very important in developing the *connected with fraud* language in *Kittel*. Arguments based on the French language version of *Kittel* have been raised, suggesting that *connected with* means that there must be a direct and immediate connection. The UK courts have rejected these arguments.⁷⁵ The ECJ has not considered them, although it might have occasion to do so during the perfect storm.

The way the UK sees *Kittel* it is not knowledge of the *fraudster*, nor is it knowledge of the *fraud* that is important. The critical point is the taxpayer's knowledge of his own transaction. Does this contemplated transaction make commercial sense, or is the only way to understand *why it is occurring* is to see that it *must be* a step in a larger fraud scheme. It is this fraud that would be facilitated by going forward. Direct connection to the fraud is not necessary.

KITTEL STAGE 2 – The gathering storm

Kittel-based enforcement efforts in the Community have not visibly moved into Stages 2, 3, and 4. There are indications that there is movement in this direction, but audits are not complete and cases have not entered the judicial system. We are at the early stages of this storm system.

⁷² O.J. (L 84) 1 (2010) at Art. 5(3).

⁷³ O.J. (L 84) 1 (2010) at Art. 5(1).

⁷⁴ O.J. (L 84) 1 (2010) at Art. 16.

⁷⁵ The language of the *Kittel* case is French. In the original judgment the key phrase was “il participait à une opération impliquée dans une fraude à la TVA,” and this was rendered in the English version of the judgment as “he was taking part in a transaction connected with fraudulent evasion of VAT.” The argument is that “impliquée dans” connotes a much more proximate involvement in the fraud than the English translation of that phrase, “connected with.” Thus, a better way to translate the phrase “impliquée dans” would be “**aimed at**.” If this analysis is accepted, then *Kittel* would be confined to situations where the taxpayer had some direct knowledge of the fraud or the fraudster. It is a much narrower analysis and would restrict applications of *Kittel* in contra-trading cases.

In some petitions this argument is extended to “R.” The language of “R” is German, however, the French version of the question put to the ECJ by the German courts included the phrase “*il participait à une opération impliquée dans une fraude à la TVA*” and the English translation of the question in the English version of the ECJ judgment was “he was participating in a transaction **aimed at** evading VAT.” The courts have not been persuaded by this argument whenever it is raised. See for example, *Spearmint Blue Limited v. HMRC*, [2012] UKFTT 103 (TC) at ¶¶28-37; *POWA (Jersey) Limited v. HMRC*, [2012] UKFTT 50 (TC) at 26; *Blue Sphere Global, Ltd. v. HMRC*, [2009] EWHC 1150 (Ch) 22 May 2009 at ¶18; and *HMRC v. Livewire Telecom Limited & HMRC v. Olympia Technology Limited*, [2009] EWHC 15 (Vh) (16 January 2009) at ¶¶ 57-61.

Two things are different in a Stage 2 *Kittel* case: (a) the fraud is found on the *supply* side rather than the *customer* side, and (b) rather than having the fraud as a *domestic* event, the fraud arises in a *different* Member State.

Stage 2 *Kittel* takes advantage of the lack of temporal or jurisdictional limitations in the ECJ decision.⁷⁶ *Kittel*'s linchpin is whether or not the taxpayer's transaction is *connected* to fraudulent evasion of VAT, and whether or not he knows or should have known about this *connection*. It is not important "when" or "where" the fraud occurs, it could be before or after the current transaction, and it could be within the taxpayer's Member State or in any of the other Member States of the Community. In the hypothetical example below the taxpayer is a broker.

Hypo III. Assume that E in Slovenia intends to be a missing trader after he sells the goods he has received from D in an intra-Community supply. E receives the goods from the UK, but they arrive in Slovenia through D (in France). D is the conduit. F pays Slovenian VAT to E, and then E disappears without remitting the tax collected.

Assume that C knows or should know of the fraud that is planned in Slovenia. Under these facts, D (in France) is a buffer. C did not sell directly to E, (perhaps) because C wanted to disguise the relationship. The C-to-D transaction then, is just the first part of a VAT-free conduit constructed by the fraudsters to get UK goods into Slovenia. A much longer conduit could have been constructed by running tax-free sales through a number of Member States.⁷⁷

Kittel should apply on these facts. The *Kittel* holding (paraphrased below) fits well. *Kittel* (in paraphrase) indicates:

If it is ascertained that C (in the UK), having regard to objective factors, knows or should have known that by its *sale* (from C to D), he was participating in a transaction connected with fraudulent evasion of VAT (E's intent to go missing after selling to F in Slovenia), then the UK should refuse entitlement to the right to deduct the input tax (the tax paid by C in the B-to-C transaction under which it secured the goods in the UK).⁷⁸

⁷⁶ One of the significant differences between *Kittel* and joint and several liability provisions in local law is this flexibility. Although joint and several liability provisions are authorized [VAT Directive Art. 205] and have been approved by the ECJ [*Vlaamse Oliemaatschappij NV v. FOD Financiën*, Case C-499/10 (21 December 2011)] not all Member States impose third-party liability for VAT purposes. Currently seventeen of the twenty-seven Member States do so: Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Romania, the Slovak Republic, Slovenia, Spain and the United Kingdom. [IBFD, *EU VAT Compass 2009/2010* at Part Three 10.4]. Limitations on joint and several liability differ country-by-country.

⁷⁷ For example, the Court of Auditors reports one case of carousel fraud involving €2.1 billion and involving eighteen Member States. Notices from the European Union Institutions and Bodies, Court of Auditors, SPECIAL REPORT NO. 8/2007, *concerning administrative cooperation in the field of value added tax, together with the Commission's replies* O.J. (C-20) 1 (January 25, 2008) at ¶4.

⁷⁸ *Kittel*, paraphrase of ¶59 [the word *sale* has replaced the word *purchase* in the original].

If there is no tax loss in the UK, does the UK have an enforcement obligation? The answer, from a number of sources is “yes.” The Commission has indicated that the EC Treaty requires enforcement,⁷⁹ the European Parliament has called on all Member States to remove any legal barriers that would impede this kind of cross-border enforcement,⁸⁰ and the VIES system is not only premised on this kind of cooperation,⁸¹ but it has been recast to make this kind of cooperation explicit – each Member State is obligated to protect the revenue of other Member States.⁸²

This question (whether or not the UK has an enforcement obligation) can also be approached from an ECJ perspective. It seems clear that the ECJ sees *Kittel* and “R” as different patterns in the same fabric. Both *Kittel* (which limits the right to deduct VAT) and “R” (which limits the right to exempt intra-Community supplies) are premised on each Member State’s obligation to protect the *common system of VAT*. Each Member State relies on the fiscal neutrality, legal certainty, and the proper functioning of the VAT to protect the legitimate commercial expectations of its citizens.⁸³ As a result, the ECJ

⁷⁹ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud*, COM (2006) 254, at 6.

Article 10 of the EC Treaty obliges Member States to take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising from Community acts, which include administrative cooperation, and that Article 280 obliges Member States to co-ordinate their actions in order to protect the financial interests of the Community.

⁸⁰ European Parliament resolution of 4 December 2008 *on the European Court of Auditors’ Special Report No. 8/2007 concerning administrative cooperation in the field of value added tax* (2008/2151(INI)) (2010/C 21 E/03), at ¶33.

Stepping up cooperation between judicial authorities

[The EU Parliament] Calls on Member States to remove legal obstacles in national law which hamper cross-border prosecution, in particular in cases where the VAT losses occur in another Member State;

⁸¹ Council Regulation (EC) No. 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax and repealing Regulation (EEC) No. 218/92.

⁸² Council Regulation (EU) No. 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (recast). O.J. (L-268) 1, at prefatory statements “whereas 4.” Art 7 states (emphasis added):

For the purposes of collecting the tax owed, Member States should cooperate to help ensure that VAT is correctly assessed. They must therefore not only monitor the correct application of tax owed in their own territory, but should also provide assistance to other Member States for ensuring the correct application of tax relating to *activity carried out on their own territory but owed in another Member State*.

⁸³ When dealing with the right of deduction in *Kittel* the ECJ states at ¶¶48-49 & 55:

The rules governing deduction are meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures neutrality of taxation of all economic activities, whatever their purpose or results, [citations omitted] ... According to the fundamental principle which underlies the common system of VAT, and which follows from Article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components [citations omitted] ... Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively [citations omitted]. It is a matter for the national court to refuse to allow the

does not limit enforcement obligations to individual Member States and their identified taxpayers. The obligation is Community-wide.

KITTEL STAGE 3 – the search for assets

When contrasting *Kittel* Stage 2 and Stage 1 with *Kittel* Stage 3 cases, the most notable difference is who holds the money. In most Stage 2 and Stage 1 fact patterns the tax authority is holding a refund that the government refuses to pay out, because the taxpayer's right to deduct input credits (or zero-rate a supply) has been denied. In Stage 3 there is no outstanding refund.

Without money-in-hand, the government's interest in MARC is heightened. Notably, the precautionary measures provisions become of great interest.⁸⁴ In fact, it appears that parts of MARC may have been drafted with Stage 3 *Kittel* cases in mind.

In Hypo IV the taxpayer is a buffer.

Hypo IV. This hypothetical factually follows Hypo III, but instead of focusing on what C (in the UK) knew or should have known, it is concerned with D (in France). Other facts remain the same.

There are two ways to approach Hypo IV. One is through *Kittel*, the other is through "R." The direction taken depends on which of two additional sets of facts are proven.

right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends [citations omitted].
When dealing with the right to exempt intra-Community supplies "R" the ECJ is even more specific at ¶¶48 & 52:

The presentation of false invoices or false declarations and any other manipulation of evidence is liable to prevent the correct collection of the tax and, therefore, to compromise the proper functioning of the *common system of VAT*. ... [if] there are *genuine reasons to assume* that the intra-Community acquisition corresponding to the supply at issue might escape payment of the VAT in the destination Member State, notwithstanding the mutual assistance of and administrative cooperation between the tax authorities of the Member States concerned, the Member State of departure is, in principle, *required* to refuse to grant the exemption to the supplier of the goods and to *require* that supplier to pay the tax subsequently in order to ensure that the transaction in question does not escape taxation altogether. In accordance with the fundamental principle of the common system of VAT, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components [citations omitted, emphasis added].

⁸⁴ Of particular note would be precautionary measure that may not even be allowed in the applicant's Member State. For example under MARC, Art 16 [O.J. (L 84) 1 (2010)]:

At the request of the applicant authority, the requested authority shall take precautionary measures, if allowed by its national law and in accordance with its administrative practices, to ensure recovery where a claim or the instrument permitting enforcement in the applicant Member State is contested at the time when the request is made, or where the claim is not yet subject of an instrument permitting enforcement in the applicant Member State, in so far as precautionary measures are also possible, in a similar situation, under national law and administrative practices of the applicant Member State.

(a) *Proving additional Kittel facts.* If it can be shown that D *knew or should have known* of the fraud planned in Slovenia, then *Kittel* would apply. Because D supplies goods to E it may not be difficult to make the further proof that the D-E transaction is *connected with* E's fraud.

If these elements are proven, the French tax authority should deny D's input VAT deduction. This deduction was taken as part of the reverse charge procedure D performed after it purchased the goods from C (in the UK). The nature of a reverse charge is that no net revenue is remitted until there is an onward taxable sale. In this fact pattern D's onward sale is a zero-rated intra-Community supply, thus the French government holds no VAT. Nevertheless, there is an input credit, and its denial under *Kittel* will produce an assessment.

(b) *Proving additional "R" facts.* In the alternative, if it can be shown that D took steps to disguise the transaction with E, then "R" might apply. It is not sufficient under "R" to demonstrate that the taxpayer *should have known* of a fraud, under "R" there needs to be an affirmative act that facilitates a fraud.

Common examples of such an act would be efforts made to disguise the transaction from tax authorities: drafting false or incomplete invoices, making false tax declarations, designing a tax-free conduit to bring UK goods to Spain, or otherwise manipulating evidence of the transaction with E so that the French or Spanish tax authority would have difficulty tracking the transaction.⁸⁵

If sufficiently strong affirmative acts are proven, then based on "R" France would be required to deny D's right to zero-rate its' intra-Community supply to E. French VAT would apply to the D-E transaction. "R" indicates that:

... with regard to particular cases in which there are *genuine reasons* to assume that the intra-Community acquisition *corresponding to the supply* at issue might escape payment of the VAT in the destination Member State, notwithstanding the mutual assistance of and administrative cooperation between the tax authorities of the Member States concerned, the Member State of departure is, in principle, *required* to refuse to grant the exemption to the supplier of the goods and to *require* that supplier to

⁸⁵ The EU Commission proposed to modify Article 205 of the VAT Directive to:

... impose a joint and several liability on the taxable person making the intra-Community supply, for the VAT due on the intra-Community acquisition of these goods in another Member State, in which he is not established, when he did not or not timely submit a recapitulative statement or when this recapitulative statement did not contain the relevant information.

The Council did not act on this part of the Commission's proposal, but if adopted it would effectively place in the VAT Directive a provision that would function like "R" in respect of VIES reports and recapitulative statements. Commission Proposal for a Council Directive amending Directive 2006/112/EC *on the common system of value added tax as regards tax evasion linked to import and other cross-border transaction*, COM(2008) 805 (January 12, 2008). *See also*: Ine Lejeune, Silvia Kotanidis & Ellen Cortvriend, *Joint and Several Liability relating to Intra-Community Acquisitions*, INT'L. VAT MONITOR 362 (Sept./ Oct. 2009).

pay the tax subsequently in order to ensure that the transaction in question does not escape taxation altogether.⁸⁶

KITTEL STAGE 4 – The Perfect Storm

Stage 4 *Kittel* creates a perfect storm. It does so for two reasons; reasons that may be overlooked when considering *Kittel* at Stages 1, 2, and 3. First, none of the amounts collected under Stage 1, 2 or 3 under *Kittel* or “R” are deductible VAT. Secondly, the real VAT losses have yet to be considered – these losses are recovered at Stage 4.

Stage 4 *Kittel* actions occur simultaneously with *Kittel*-based, or “R”-based enforcement actions at Stages 1, 2, or 3. They are brought by a foreign tax authority, and frequently against the same taxpayer as Stage 1, 2 or 3 actions are brought.

Dual tax recoveries/payments are a distinct possibility. For example, in Hypo IV the funds collected by France from D, whether under a denial of the input credit related to D’s intra-Community acquisition from C (under *Kittel*) or under a denial of the zero-rate on D’s intra-community supply to E (under “R”) are *not* deductible input VAT. These amounts were not deductible input VAT. The real tax losses in Hypo IV arose in Slovenia, not France. This is what Hypo V and VI are concerned with.

Hypo V. Using the same fact pattern as Hypo III and IV where C (in the UK) makes an intra-Community supply to D (in France), followed by D’s intra-Community supply to E (in Slovenia), the fraud occurs when F pays Slovenian VAT to E, and then E disappears without remitting the VAT to the Slovenia Treasury. What does the Slovenian revenue authority do?

Slovenia will pursue E, but if E has truly disappeared the Slovenian tax authority will pursue F. This will be a Stage 1 *Kittel* action. The Slovenian tax authority will assert that F *knew or should have known* that the E-to-F transaction was *connected* to fraud. If successful, Slovenia will recover the VAT that was due by denying F’s right to deduct input VAT.

Difficulties arise if F proves that they *did not know or have any means of knowing* about the fraud. F will be entitled to deduct input VAT (even if there is fraud in the commercial chain). The ECJ in *Kittel* indicates:

... the right to deduct input VAT of a taxable person who carries out such transactions likewise cannot be affected by the fact that, in the chain of supply of which those transactions form part, another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing (*Optigen*, paragraph 52).

The same conclusion applies where such transactions, without that taxable person *knowing or having any means of knowing, are carried out in connection with fraud committed by the seller.*⁸⁷

⁸⁶ “R,” at ¶52.

Hypo VI. Assume the same facts as in Hypo V and that F is able to prove that it *did not know or have any means of knowing* about the fraud. Assume also that the missing trader (E) is nowhere to be found.

In this instance the only recourse for the Slovenia tax authority is to bring an action against D under Slovenian joint and several liability provisions,⁸⁸ or directly under

⁸⁷ *Kittel*, at ¶¶44-46 (emphasis added).

⁸⁸ There are difficulties under Slovenian joint and several liability rules as currently drafted. The most notable difficulty is that Slovenia has limited joint and several liability to “taxable persons identified for VAT purposes in Slovenia.” A careful fraudster would make sure that D was not identified for VAT purposes in Slovenia, but to the extent there are ambiguities in the application of this provision one would expect there to be litigation, with notification under MARC and precautionary measures taken as well. Article 76b of the Slovenian VAT Act states:

(1) *Every taxable person identified for VAT purposes in Slovenia* shall be jointly and severally liable to pay VAT when the objective circumstances show that he knew or should have known that he was involved in transactions aimed at avoiding the payment of VAT.

(2) If the tax authority determines that the supply of goods or services is an integral part of the transactions aimed at avoiding the payment of VAT, it notifies the taxable person taking part in these transactions of the existence of such circumstances and his liability to pay VAT if he continues to be involved in such transactions. As from the date of receipt of the notification from the tax authority, the taxable person shall be deemed to have been aware of the fact that the purchase involved him in transactions aimed at avoiding the payment of VAT.

(3) Notwithstanding the provisions of the act regulating the protection of confidential tax information, the tax authority shall, acting at the request of the taxable person to whom the supply was made, notify this taxable person whether his supplier had submitted a VAT return.

There could be efforts to expand joint and several liability to cover all taxable persons identified for VAT in the Community. Some concept like that employed in Hungary of the “participating taxable person” in the Hungarian VAT Act, at Section 151;

(1) Where:

- a) goods are resold several times, and they are dispatched as a consignment or transported directly from the first supplier inline addressed to the name of the last customer in line; or
- b) the supply of services is carried in the supplier's own name, but on behalf of others;

all of the taxable persons involved in the above-specified transactions (for the purposes of this Section hereinafter referred to as “participating taxable person”) shall be subject to joint and several liability for the payment of VAT that could be charged to any other participating taxable person, which participating taxable person, however, failed to pay the VAT in part or in full.

(2) The provisions contained in Subsection (1) may be implemented subject to the following conditions:

- a) the participating taxable persons must be registered in the domestic territory or are required to register in the domestic territory; and
- b) the participating taxable persons must be affiliated.

(3) The aforesaid liability may be enforced irrespective of whether the participating taxable person is considered non-taxable based on his legal status governed under this Act.

Kittel. D may already be under audit by French authorities for the same transactions, but this does not matter.

As considered in Hypo IV, there are two ways for the French tax authority to proceed against D. They could either:

- (a) deny D's input deduction on its intra-Community acquisition from C (proving that D knew or should have known of the fraud under *Kittel*) or they could
- (b) deny D's zero-rate on its intra-Community supply to E (proving affirmative acts taken by D that gave "genuine reasons to assume that the intra-Community acquisition corresponding to the supply at issue might escape payment of the VAT in the destination Member State").

Based on the same facts, and dealing with the same transactions there could be a French recovery, followed by a Slovenian recovery. The French audit files will prove the Slovenian case. The Slovenian tax authority simply needs to make a request under MARC, Article 51. The French tax authority "... shall provide *any information which is foreseeably relevant* to the [Slovenian] authority in the recovery of its claims."⁸⁹

It is more likely however, that the Slovenian tax authority would approach the French tax authority early on under MARC and pursue a joint audit. Traditional information requests, and requests to be present during the French audit of D would be normal.⁹⁰ Slovenia would work with the French tax authority to notify D of the Slovenian legal processes moving ahead in their country.⁹¹ In addition, the Slovenian tax authority would seek precautionary measures so that D's assets would be available to fund a recovery.⁹²

For D this is a perfect storm. The French assessment will function like a penalty. The French amounts are not deductible input VAT. The French amounts are due because D cannot satisfy objective tests related to input credits or zero-rating supplies.

The Slovenian assessment would also not be deductible. Even though the amount paid is VAT, D is not the taxpayer who is entitled to deduct it. The deduction belongs to the party who made the intra-Community acquisition (E).

This is double taxation. It could be triple taxation if a companion case was brought by the UK against C on the basis that C (like D) either *knew or should have known* that the C-to-D transaction was connected with fraudulent evasion of VAT (*Kittel*).

Businesses may actually prefer expanded joint and several liability rules, because at least here there would be only one full recovery, not multiple assessments for amounts that may easily exceed the VAT due through the entire commercial chain.

⁸⁹ O.J. (L 84) 1 (2010) at Art. 5(1) (emphasis added).

⁹⁰ O.J. (L 84) 1 (2010) at Arts. 5-7.

⁹¹ O.J. (L 84) 1 (2010) at Arts. 8-9.

⁹² O.J. (L 84) 1 (2010) at Art. 16(1).

The ECJ was fully aware of these multiple taxation issue, and it approved double tax results in both the *Kittel* and “R” contexts. The ECJ seems to have left it up to the national courts to resolve any unfairness on a case-by-case basis, or is waiting for the question to be brought to it directly. That issue is sure to be coming during the storm.

The UK courts have seen this argument, and have directly approved double recovery in a number of cases. *Red 12 Trading* is an example. In that case the taxpayer was the broker in forty-six transaction chains each dealing with mobile phones, and each leading back to a missing trader. *Red 12 Trading* was denied input tax credits of £2,672,748.50, but argued that a recovery of this amount would be excessive. It overlapped with partial recoveries made by HMRC against buffers in some of the same forty-six commercial chains.

In denying this request for relief the court conceded that double taxation was a distinct possibility under *Kittel*, and that it saw no problem with it:

In *Kittel* the court did not indicate that the right to deduct is only lost to the extent of the tax lost, nor that it might be regained to the extent that the tax authority is able to recover the tax lost by assessing another trader who is able to, and does, pay. It may be inferred from *Kittel* that a trader with the requisite knowledge who enters into a transaction of the kind under consideration forfeits the entire right to deduct regardless of the measure of the tax lost, a desirable outcome as a means of discouraging fraud.⁹³

The same issue was addressed in *Fonecomp Limited*. In *Fonecomp* was also a cell phone broker. Input tax deductions of £183,951.30 were denied by the HMRC in two “Deals,” both of which concerned various versions of Nokia phones. *Fonecomp*, like *Red 12 Trading*, indicated that a portion of the assessment under *Kittel* had already been the subject of an earlier assessment and recovery against a different trader in the same commercial chain.

The VAT Tribunal indicated that double recovery was *not* a problem – “VAT is a transaction by transaction tax. ... Once it is established that a taxpayer has participated in fraudulent evasion, the non-existence of his right to that input VAT is not a penalty.”⁹⁴

⁹³ *Red 12 Trading v. HMRC*, UK VAT V.20900 (December 12, 2008) at ¶76.

⁹⁴ *Fonecomp Limited v. HMRC*, [2012] UKFTT 102 (TC) (February 3, 2012) at 58, 60 & 61 indicates (emphasis added):

As will later appear HMRC assessed Klick on the basis that it was not entitled to input tax credit in respect of the purchases made from Softlink. The assessment was made on the basis of the *Kittel* principle: HMRC alleged Klick knew its transactions were connected to Softlink’s default. The question therefore arose as to whether that assessment precluded the denial of input tax to the appellant whose input tax represented some of the very input tax, which had been denied to Klick. ...

We agree with HMRC that it does not. The ECJ in *Kittel* propounded an objective test for the question of whether a person was entitled to input VAT credit on his purchase. *VAT is a transaction by transaction tax*. The question is whether input tax is deductible on the particular transaction by reference to the circumstances of that transaction. If an objective test is satisfied input VAT is deductible. If it is not it is not.

The fact that it also was not deductible VAT paid by the taxpayer who would pay it was also not a problem for the court.

CONCLUSION

MARC in conjunction with the ECJ decisions in *Kittel* and “*R*” give unprecedented powers to the tax authorities of the Member States to deal with missing trader fraud. With so many avenues for recovery: *Kittel*, “*R*,” as well as joint and several liability, are all turbo-charged for cross-border applications by MARC. MARC’s enhanced investigative and enforcement powers allow/compel an easy flow of information, notification and protective measures among the member States. Multiple recoveries are a very distinct possibility.

The EU VAT does not have a mechanism that assures one recovery, and neither the ECJ nor the judiciary of the member States seem anxious to find one. This may all be the result of the severity of the missing trader problem coming home to roost, but it is not good for legitimate business. Unfortunately we may witness a perfect storm. One cannot help but think that there is a better way forward.

The actions of HMRC in relation to other persons in the chain are not relevant to that transaction.

In particular *Kittel* does not impose a penalty. Rather it limits and circumscribes the rights to deduct input VAT. *Once it is established that a taxpayer has participated in fraudulent evasion, the non-existence of his right to that input VAT is not a penalty.*