VAT Fraud: MTIC & MTEC - The Tradable Services Problem

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VAT FRAUD: MTIC & MTEC—
THE TRADABLE SERVICES PROBLEM

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Tradable services – VoIP termination services, mobile minutes, software as a service (SaaS), or almost any service bought or sold in the “cloud” – are a distinct class of taxable supplies. These service-based supplies both resemble and differ fundamentally from goods. They also differ from services that are consumed-on-purchase (consumed services).

Restaurant meals, auto repairs, or house painting services are examples of consumed services. These services are rarely re-sold – they are consumed by the first-purchaser. Tradable services differ from consumed services. Tradable services are designed from the beginning for re-sale. They are hybrid supplies that behave commercially like goods, but have functional attributes that make them hard to distinguish from services generally. When determining the place of supply/place of taxation for these kinds of supplies, their hybrid character presents difficulties. These difficulties are a doorway for fraud in some VAT/GST regimes.

Tradable services are not defined, distinguished or otherwise identified as a class of supplies in any VAT/GST. Jurisdictions that adopt the EU VAT as a model have more of a problem with this omission than do those modeled after the New Zealand GST. Under EU rules tradable services are highly vulnerable to both (a) missing trader intra-community (MTIC) fraud, and (b) missing trader extra-community (MTEC) fraud. In fact, MTEC fraud is unique to tradable services, and to the EU rules. MTEC cannot arise under the New Zealand GST.

In jurisdictions where missing trader fraud in tradable services is a problem, two approaches can be taken to prevent it. The jurisdiction could either: (a) adopt a statutory

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1 An excellent definition and discussion of the economics of cloud computing, and software as a service is provided by the UC Berkeley Reliable Adaptive Distributed Systems Laboratory:

Cloud Computing refers to both the applications delivered as services over the Internet and the hardware and systems software in the datacenters that provide those services. The services themselves have long been referred to as Software as a Service (SaaS). The datacenter hardware and software is what we will call a Cloud. When a Cloud is made available in a pay-as-you-go manner to the general public, we call it a Public Cloud; the service being sold is Utility Computing. We use the term Private Cloud to refer to internal datacenters of a business or other organization, not made available to the general public. Thus, Cloud Computing is the sum of SaaS and Utility Computing, but does not include Private Clouds. People can be users or providers of SaaS, or users or providers of Utility Computing.

2 The common understanding is that there are two major VAT/GST models in use among the 170 or more jurisdictions that have a multi-stage consumption tax. The smaller group follows the New Zealand model. Aside from New Zealand this group includes Australia, Canada, South Korea, Singapore and South Africa. Alain Charlet & Jeffrey Owens, An International Perspective on VAT, 59 TAX NOTES INT’L. 943, 945 (Sept. 20, 2010).
design] solution. This would require that a clear definition of tradable services be added to the law and that these services be treated as a discrete class of services to which New Zealand-type place of supply/place of taxation rules would apply. The alternative is to (b) adopt a technology-based administrative solution without a major (substantive) tax law change. The leading solutions in this area are the VAT Locator Number (VLN) system and the certification of tax software proposal offered under the D-VAT.  

Considered only within the EU, options are more limited. The reason is that MTIC fraud thrives in goods as well as tradable services in the EU. It would not make sense to resolve the extra-Community (MTEC) and the intra-Community (MTIC) aspects of missing trader fraud in tradable services and the leave intra-Community (MTIC) fraud in goods fully alive. Such a solution would just chase fraudsters from tradable services into goods. As a result, within the EU one of the technology-based solutions (broadly applied either to (a) all transactions within a vulnerable market, or (b) throughout the entire VAT/GST system) is preferable.

**MTIC & MTEC – DEFINED & DISTINGUISHED**

**MTIC.** MTIC fraud arises when a business makes an intra-Community purchase without paying VAT, collects VAT on an onward sale, and then “disappears” without remitting the tax. MTIC is a “EU-only” fraud. MTIC relies on VAT rules specific to intra-Community sales of goods, and companion rules for intra-Community supplies of services. MTIC fraud is most common in high-value/low-volume goods – computer chips and cell phones are the classic examples.

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3 There are a large number of proposals to resolve MTIC fraud. There are no proposals to resolve MTEC fraud applied to tradable services. This paper makes the first proposal to resolve MTEC that this author is aware of. Most proposals to resolve missing trader fraud consider fraud in goods, and almost all of them are statutory not administrative fixes. Very significant (and difficult to adopt) changes are at the heart of most proposals. See: Richard T. Ainsworth *Tackling VAT Fraud: 13 Ways Forward,* 45 59 TAX NOTES Int’l 1205 (Mar. 26, 2007) (outlining the twelve major proposals for resolving MTIC fraud through a substantial re-design of the EU VAT, and proposing a technological solution based on a fully digital VAT).

4 There are a number of circumstances in every VAT system where standard business-to-business transactions occur without VAT. Most notable are transactions for sales of goods between Member States in the EU. Another common instance is a services transaction between two VAT jurisdictions. The standard result in these cases is for the purchasing business to self-assess the VAT due (called a reverse charge).


6 [HOUSE OF LORDS, EUROPEAN UNION COMMITTEE, STOPPING THE CAROUSEL: MISSING TRADER FRAUD IN THE EU (REPORT WITH EVIDENCE)](http://www.parliament.uk/documents/communities/euro/cj0707/cj0707-01.pdf) HL Paper 101(May 25, 2007) 7 (indicating that HMRC believes in 2006 that MTIC is predominantly a fraud in cell phones and computer chips). But see: Fabrizio Borselli, *Pragmatic Policies to Tackle VAT Fraud in the European Union,* Int. VAT Monitor (Sept./Oct. 2008) at 333 (observing that data from the Office of National Statistics reported a significant reduction in MTIC fraud adjustments in the first quarters of 2006 corresponding with a rise in UK VAT receipts, but Borselli observes that this data only reflected efforts in the cell phone and computer chip market and that most likely MTIC had moved on to other markets undetected – and indeed it had as 2006 was the year when MTIC began in the EU CO2 markets, although it was not detected until 2010).
Traditionally MTIC has taken advantage of the zero-rating of intra-Community supplies of goods, although recently it appears to have moved into intra-Community supplies of services. This fraud easily migrates (from one EU jurisdiction to another), and mutates (from one kind of supply to another) when it is pursued. Fraudsters have found the techniques learned in one market to be extremely easy to transfer into another. For example, MTIC has been an effective fraud with goods as wide ranging as xenon bulbs, automobiles, and earth moving equipment.

The key ingredient for MTIC (and MTEC as well) is making purchases of tradable supplies without paying across VAT/GST. This is not as difficult to accomplish, as it may seem. There are a large number of opportunities in every VAT/GST regime to structure transactions so that a purchase can be made without immediately paying over the tax. Agility is required next, because a fraudster must now charge tax on an onward sale, pocket the tax, and disappear.

It is not necessary that the exempt purchaser be a business (although it commonly is), just as it is not necessary that the transaction be in goods (although again, it commonly is). The key is that the “tax free” supply is re-sold by a business (because only a business can charge VAT) at a profit. The margin on re-sale essentially amounts

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Article 20 RVD [formerly Article 28a(3)] defines the intra-Community acquisition of goods as the right to dispose as owner of movable tangible property dispatched or transported to the person acquiring the goods by or on behalf of the vendor or the person acquiring the goods, in a Member State other than that in which the dispatch or transport of the goods began. Article 138(1) [formerly Article 28c(A)(a) 1st paragraph] requires the Member State making the supply to exempt the transaction (with full right of deduction) – sometimes called “zero rating.” Article 83 [formerly Article 28e(1) 1st paragraph] requires the Member State of acquisition to impose a tax based on the same factors used to determine the taxable amount for the supply of the same goods within that Member State. Article 195 [formerly Article 28g(1)(f)] places the obligation to pay the tax on the buyer. Thus, a reverse charge is the result. The buyer (rather than the supplier) is obligated to remit the tax. The goods are received “tax free.”

8 Violetta Krasnowska-Salustowicz & Wojciech Surmacz, VAT Spins, and We With It (VAT się kręci, a my z nim) Newsweek Polska (Mar. 21, 2010) (indicating that the largest tax fraud in Poland involving xenon light bulbs for automobiles where sales were recorded in several months that were larger than the annual demand in the entire European Union) available at: http://www.newsweek.pl/artykuly/wydanie/1171/vat-sie-kreci-a-my-z-nim_55162_1 (in Polish).

9 Richard T. Ainsworth, Tackling VAT Fraud: Car Flipping and Computer Chips on a Carousel, 46 TNI 267 (Apr. 16, 2007) (discussing the largest GST fraud in Canada involving the sale of automobiles through tax exempt members of First Nations); Richard T. Ainsworth, Car Flipping in the UK: The VAT Fraud Marketplace and Certified Solutions, 47 TNI 1157 (Sept. 24, 2007) (discussing how the same fraud in automobiles was replicated in the UK but instead of using the GST exemption given to members of the First Nation, the UK fraudsters took advantage of the VAT exemption provided to handicapped individuals and applying it in sales of high end auto like Lamborghini, Ferrari and Maserati).

to collected, but unremitted VAT/GST. For example, non-traditional missing trader frauds have taken advantage of exemptions for handicapped individuals that purchase automobiles in the UK (through 2007). The same fraud pattern can be found under the Brazilian IPI and ICMS, and in the Canadian GST (where the exemption involved is not for medically handicapped individuals, but for indigenous people who took delivery of newly purchased vehicles on a reservation). Frequently when individual exemptions are involved criminals are “hijacking” the qualifying person’s tax-exempt status.

**MTEC.** MTEC fraud arises when a business makes an extra-jurisdictional purchase (an “importation”) of services without paying VAT, collects VAT on an onward sale of the service, and then “disappears” without remitting the tax.

MTEC is very similar to MTIC. However, where MTIC is only possible when there is an *intra-Community* transaction in goods or services; MTEC, on the other hand, involves *extra-Community* transactions [(a) between Third Countries and Member States, and (b) between two Third Countries that have adopted the EU VAT as a model]. MTEC only occurs in *tradable services.*

Goods are not used in MTEC frauds because of the role that Customs plays in cross-border trade. When *goods* are imported VAT/GST is collected by Customs (there is no reverse charge). The VAT/GST due on “imported” *services* cannot be collected in the same manner.

Under the EU model this absence of Customs involvement in “imported” services is resolved by the place of supply/place of taxation rules. For tradable services this is the

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12 The federal IPI (*Imposto sobre Productos Industrializados*) is 25% and the state level ICMS (*Impostos Sobre Circulação de Mercadorias e Prestação de Serviços*) is 12% (in Sao Paulo). Both apply to automobile transactions, and both are reduced to 0% for handicapped individuals.

For example, Law nº 8.989, February 24 of 1995, valid until December 31 of 2009 (as extended by article 69 of Law 11.196, November 21st of 2005) (granting an exemption (“*isenção*”) for IPI (the federal tax) on sales of cars to disabled persons, and although granted as an *exemption* the law (in Art. 4) it permits the producer to keep the credits on inputs of the car sold – in effect zero-rating the transaction). This law has undergone a number of changes over the years. Four important development have occurred:

1. Initially there was a limitation on the power of the vehicle (limited to 127 HP) and only limited only to cars that used renewable fuel. After Law 10.754, of October 31 2003 those requirements were abolished;
2. Initially the exemption was only for physically disabled people. After Law 10.690, from June 16 of 2003, the exemption was extended to people with visual problems, mental severe or profound, or autistic problems. As a result, for federal purposes (IPI), the car may now be purchased, directly by the disabled or through a person who legally represents him or her, and the car itself may be operated by another;
3. After Law 10.690, Art. 5 (June 16, 2003) it is a requirement that the disabled person prove personal financial capability to purchase the vehicle that is intended to be acquired.

Initially the exemption could be used only once every 3 years by each disabled person. After Law 11.196, from November 21, 2005 this period was reduced to 2 years.

13 Indian Act, R.S.C., ch. I-5 § 87 (1985) (Can.).
buyer’s location, and services acquired in this manner are subject to a self-assessment – in other words, a reverse charge (but only if the buyer is a business). Thus, there can be a purchase (“importation”) without VAT/GST of tradable services, an onward sale where VAT/GST is collected, and then an opportunity to disappear with the VAT/GST in hand.

A variant of MTEC has proven very useful for money launderers. Because the object of money laundering is to move large sums on money out of a country (through apparently legitimate transactions), and because a high volume MTEC fraud relies on bringing large amounts of money into a country (in transactions that attract VAT), a circular flow of funds can be constructed whereby the proceeds of VAT fraud are used to finance the cleaning of “dirty” money. This cycle creates a carousel of money riding on the successive “import” and “export” of services. If the services themselves are fictitious the carousel is nearly impossible to detect. Auditors may find an accurate money trail, but they have a very difficult time verifying that the services bought and sold (for VAT purposes) actually existed (or were ever used). This is particularly difficult when the end buyer (the final consumer) reportedly resides in a remote overseas location.

As of November 2010, MTEC fraud has been positively identified in two markets – CO2 permits and VoIP services. In both cases the discoveries are recent, even though the structural flaw in the EU VAT that allows MTEC has been in place since 1977. In

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14 When the Commission submitted its proposal for the Sixth Directive cross-border supplies of intangible services (Art. 9(2)(e) services) were subject to an exemption (in the jurisdiction of the supplier) and a reverse charge (in the jurisdiction of the business buyer). See: Commission of the European Community, Proposal for a Sixth Council Directive on the harmonization of legislation of Member States concerning turnover taxes COM(73) 950 (June 20, 1973). This treatment matches the post-1991 treatment for the cross-border supply of goods. However, when the Sixth Directive was adopted a different approach was used for these services – a deeming provision changed the place of supply from the seller to the buyer’s jurisdiction. In Amendments of October 11, 1974 the Commission added paragraph 3 to proposed Article 10:

For the purposes of charging tax on supplies referred to in Article 2(3) the place where the service is received shall be deemed to be the place where the business of the person receiving the service is established or, in the absence of such place, the place where he has his permanent address.

Article 21(1)(b) requires that the reverse charge must be applied when these services are rendered by a taxable person established in the Community to a taxable person in another Member State or by a taxable person established outside the Community.

15 Customs is an effective barrier to MTIC (in goods). This has always been understood. It was the dismantling of customs clearance for intra-Community transactions in goods in 1991 [1991 O.J. (L 376) 1] that has long been recognized as the event that opened the doors to MTIC (in goods) in the EU. Every one of the thirteen major proposals for eliminating MTIC in the EU refers back to this event. See, Richard T. Ainsworth, Tackling VAT Fraud: 13 Ways Forward, 45 TAX NOTES INTL. 1205 (Mar. 26, 2007). The Commission itself anticipated the MTIC problem (in goods) six years before the customs borders came down. See: White Paper COM(85) 310 final, 52 available at: http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf. Interestingly, the very same MTIC-facilitating rules have been in the Sixth Directive since 1977 (when the Sixth Directive was adopted) in the realm of tradable services. Until recently, no one seems to have noticed.

16 Although the common assumption is that MTIC began in goods (migrating from gold, to computer chips, and mobile phones) and then morphing into services (CO2 permits and VoIP), but this does not need to be the case. The statutory provisions allowing MTEC (and MTIC) fraud in tradable services were in place in 1977, and it was not until 1991 that MTIC in goods was possible. Thus, the morphing of this fraud may
the following sections this paper will consider missing trader frauds in these two markets, and then present the New Zealand and then the leading technology-based solutions to missing trader fraud. As these frauds are not confined to the EU, neither will be the application of these solutions.

CO2 MTIC & MTEC FRAUD

The EU CO2 Trading System. On October 13, 2003 the European Parliament and the Council set out rules for trading greenhouse gas emission allowances.\(^{17}\) The Directive follows from the UN Framework Convention on Climate Change\(^ {18}\) and the Kyoto Protocol.\(^ {19}\) The intent is to reduce greenhouse gas emissions by 8% relative to 1990 levels through trading CO2 permits.

The trading system began on January 1, 2005. Under the system industrial operations (such as combustible installations, coke ovens, oil refineries, glassworks, brickworks, ceramic product manufacturing installations and paper mills) are not allowed to operate unless the installation operator possesses permits issued by the competent authority. The operator surrenders permits annually. The operator must surrender a quantity of emission allowances equal to the facility’s total emissions during the year.\(^ {20}\)

Each Member State has an allocation plan and distributes emission certificates to facilities within its jurisdiction.\(^ {21}\) Emission allowances are mutually recognized among Member States, they are transferrable among persons (natural and legal), both inside and outside the EU. The intent is to use the marketplace to regulate greenhouse gas emissions through the tradability of the certificates.

For example, if a facility uses obsolete technology they will be allocated a relatively high number of emissions certificates in contrast with a facility that has more efficient production processes. Expansion of the efficient processes will create a shortage of emission allowances and these operators will endeavor to secure more permits by purchasing them from less efficient operators. The EU has appointed a Central Administrator who maintains an independent transaction log that monitors all sales activity in permits.\(^ {22}\)

The leading European exchange for the spot trading of emissions credits is BlueNext in Paris.\(^ {23}\) CO2 permits can be bought and sold on this exchange on a regular

have been from services into goods, rather than from goods into services, although we have no evidence of this trajectory.


\(^ {20}\) One emission allowance conveys the right to emit one ton of carbon dioxide.

\(^ {21}\) National allocation plans are available at: http://ec.europa.eu/environment/climat/emission/emission_plans.htm

\(^ {22}\) Available at: http://ec.europa.eu/environment/climat/emission/citl_en.htm

\(^ {23}\) Globally, there are 20 exchanges. They can be broken down into five geographic groups:
basis regardless of the place of establishment of the buyer and seller. BlueNext exemplifies a highly efficient securities market, and was itself central to the speed with which MTIC allegedly swept through the CO2 market.

**CO2 permits are tradable services.** Because trade in greenhouse gas emissions was to commence on January 1, 2005, France requested that the VAT Committee consider the VAT treatment of the issuance and the trade in greenhouse gas emissions allowances. The question was taken up in two meetings of the committee, the first on March 26, 2004 and the second on May 27, 2004.

Three types of transactions were considered: (1) the VAT treatment of allowances sold (allocated) by Member States to operators, (2) the VAT treatment on transfers of allowances between operators, and (3) the VAT treatment on transfers by individuals/ or by operators as financial instruments. The way the second question was answered determined the results of the others, and opened the door for MTIC/MTEC fraud in CO2 permits.

The reason for the second meeting of the VAT Committee on this topic was that “most of the delegates who commented on this subject [in the first meeting] expressed reservations about the Commission’s working paper.” After revisions the Commission’s proposals were adopted at the second meeting.

Although “… one delegate considered that the transfer of allowances [among operators] could be exempt from VAT under Article 13(B) of the Sixth Directive, … all the delegates who spoke agreed with the Commission and France that the transfer of greenhouse gas emission allowances between operators were services subject to VAT. The place of taxation of the supply of such services is determined by Article 9(1) or 9(2)(e) of the Sixth Directive concerning transfers and assignments of copyrights, patents, licenses, trade marks and similar rights. The later provision applies in particular

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**Europe** (1) European Climate Exchange; (2) OMX Nordic Exchange; (3) EEX – European Energy Exchange (Eurex); (4) EXAA – Energy Exchange Austria; (5) Bluenext – (formerly Powernext) (NYSE Euronext and Caisse des Depots); (6) Climex (Amsterdam); (7) Climate Spot Exchange (London);

**North America** (8) CCX – Chicago Climate Exchange; (9) The Green Exchange (NYMEX); (10) CCE – Canadian Climate Exchange (Winnipeg Commodities Exchange); (11) MCEX – Montreal Climate Exchange; (12) Toronto Stock Exchange

**South America** (13) Brazil Mercantile Futures Exchange

**Asia** (14) MCX – Multi Commodity Exchange of India; (15) HKEx – Honk Kong Stock Exchange; (16) ACX – Asia Carbon Exchange (Singapore); (17) Beijing and UNDP Exchange; (18) Tokyo Stock Exchange Group and the Tokyo Commodity Exchange

**Australia** (20) Australian Climate Exchange

24 The VAT Committee is an advisory committee on VAT under VAT Directive, Art. 398. The VAT Committee consists of representatives of the Member States and of the Commission. Certain provisions of the Directive require that the VAT Committee be consulted before certain measures are applied. However, the Committee is merely an advisory body, although originally it was the intention to apply the procedure of a regulatory nature. Nevertheless its “decisions”, which are not published, significantly influence the day-to-day application of the VAT.

when the recipient of a supply of services is a taxable person established in a different Member State to the supplier.”

The Commission could not agree that operator-to-operator sales of CO2 permits were financial transactions. It could not find a provision under Article 13(B)(d) [currently Article 135(1)(f) on “debts” or “other securities”] where they would fit. Because exemptions are always narrowly construed, the outcome was unanimous: The delegations agreed unanimously that the transfer of greenhouse gas emission allowances as described in Article 12 of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003, when made for consideration by a taxable person is a taxable supply of services falling within the scope of Article 9(2)(e) of Directive 77/388/EEC. None of the exemptions provided for in Article 13 of Directive 77/388/EEC can be applied to these transfers of allowances.

If we return to the earlier discussion of the place of supply rules for intangible services, what the decision of the VAT Committee means is that (a) CO2 permits are tradable services; (b) even though the service (allowing the emission of CO2) is performed in the jurisdiction issuing the permit; (c) the place of supply is deemed to be the jurisdiction of the business buyer of the permit. Set into examples, the four practical permutations of this decision are:

- **Intra-Community CO2 transaction.** When a French business holding excess CO2 permits sells them to a UK business, the French seller will zero-rate the sale and the UK buyer will perform a reverse charge.
- **Community “export” CO2 transaction.** When a French business holding excess CO2 permits sells them to a Turkish business, the French seller will zero-rate the sale and the Turkish buyer will perform a reverse charge. (Turkey is not a member of the EU, but its VAT closely follows the EU VAT).
- **Community “import” CO2 transaction.** When a Norwegian business holding excess CO2 permits sells them to a UK business, the Norwegian seller will zero-rate the sale and the UK buyer will perform a reverse charge. (Norway is not a member of the EU, but its VAT closely follows the EU VAT).
- **Extra-Community CO2 transaction.** When a Norwegian business holding excess CO2 permits sells them to a Swiss business, the Norwegian seller will zero-rate

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26 Id., at ¶ 2 (emphasis added).
28 Supra note 14.
29 VAT Act, Art. 262 ter (1)(1º) (FR).
30 VAT Act (1994) Sch. 4A & Sch. 5, ¶ 10 (UK).
31 VAT Act, Art. 262 ter (1)(1º) (FR).
32 VAT Act, Arts. 1(1)(a) & 8(b) (Turk); Ministry Regulation on VAT, No. 89, Official Gazette of 21 September 2003. *See also: Croatia, Montenegro, Norway, Russia, Serbia Switzerland & Turkey, 2009 INT. VAT MONITOR* (Feb. 1, 2009).
33 VAT Act, §16(1)(a) (NO).
34 VAT Act (1994) Sch. 4A & Sch. 5, ¶ 10 (UK).
the sale\textsuperscript{35} and the Swiss buyer will perform a reverse charge.\textsuperscript{36} (Neither Switzerland nor Norway is a member of the EU, but both countries have VATs that closely follow the EU VAT).

**MTIC and MTEC fraud in CO2 permits.** It is a short step from the above decision to identify the vulnerability of VAT systems modeled on the EU VAT to missing trader fraud. In the *intra-Community* transaction set out above, the UK business would simply need to make an onward sale of the CO2 permit within the UK, collect VAT on the sale and disappear without remitting the tax. This is a classic example of MTIC fraud in tradable service.

In each of the other examples – *community “export”* transactions; *community “import”* transactions; and *extra-community* transactions – missing trader fraud is equally possible. Each permutation sets the stage for MTEC fraud. A potential fraudster (the Turkish, UK, and Swiss buyers respectively) acquires the CO2 permit “VAT free” not through an intra-Community exemption, but through a companion aspect of the same place of supply rules. All these buyers need to do is re-sell the CO2 permit domestically and go missing with the VAT to complete the fraud.

The global spread of MTEC fraud is more than theory. MTEC fraud in CO2 permits has already crossed from the EU into Norway, riding on the back of the Norwegian adoption of EU VAT rules for the definition of CO2 permits as tradable services\textsuperscript{37} and the related place of supply rules for cross-border supplies of services.\textsuperscript{38} On March 26, 2010, the Brazilian police arrested two individuals named Pankinao (case No. 10-113554ENE-OTIR/07). These cases are expected to go to trial in late November or December 2010. Personal E-mail communication Bjørn Haugan (reporter for the Norwegian newspaper VERDENS GANG) November 11, 2010 (on file with author).

Accusations against Kenneth Andresen are that he received stolen property (CO2 permits) worth more than 500 million krone ($84 million) through Import Global Consulting Company and Green Energy Plus (charging VAT on onward sales but not remitting it). [Bjørn Haugan, KLINAKVOTESAKEN: 54-åring siktet for heleri av 500 mill. (TRADING CASE: 54-year-old charged with fencing of 500 million, VERDENS GANG) (Jan. 7, 2010) available at: http://e24.no/makro-og-politikk/article3715527.ece (in Norwegian)].

Essentially, the companies are “missing traders,” businesses that bought zero-rated CO2 permits, sold them onward in Norway (with VAT) and failed to file returns or remit VAT of 127 million krone ($21 million) in one allegation. [Margaret Assev, SKATT ØST: Siktet for klimasvindel på 127 mill. (TAX EAST: Individuals Charged in Climate Scam of 127 million, VERDENS GANG) (Jan. 7, 2010) available at: http://e24.no/lov-og-rett/article3538562.ece (in Norwegian)].

Green Energy Plus has the classic profile of a “missing trader.” It has a company address at an old factory site in Oslo, no logo on the building, and no employees at the address. The neighboring business (Norwegian Kennel Club) has never seen or heard of the company, and calls to the switchboard refer calls to the owner in London, UK. But when reporters when to the London address of the company there was no one around. [Bjorn Haugan & Margaret Assev, Ingen à finne (No check) VERDENS GANG (Feb. 26, 2010) available at: http://e24.no/lov-og-rett/article3538565.ece (in Norwegian)].

\textsuperscript{35} VAT Act, §16(1)(a) (NO)

\textsuperscript{36} VAT Act Arts. 10(2)(b) & 45 (CH).

\textsuperscript{37} VAT Act §§1-3 & 3-1 (indicating that a CO2 permit is a tradable service in the same manner as it is under the EU VAT).

\textsuperscript{38} In the Oslo, Norway District Court a series of cases involving Norwegian VAT frauds in CO2 permits is underway. Kenneth Andresen (case No. 10-045454ENE-OTTIT/07) is charged, but is living in Addis Ababa, Ethiopia, and his son Øyvind Andresen is in custody. Related cases involve Daniel Kristian Pankinaho (case No. 10-113554ENE-OTIR/07). These cases are expected to go to trial in late November or December 2010. Personal E-mail communication Bjørn Haugan (reporter for the Norwegian newspaper VERDENS GANG) November 11, 2010 (on file with author).

Electronic copy available at: https://ssrn.com/abstract=1708080
2010 Norway adopted a reverse charge mechanism on the domestic sale of CO2 permits, effectively following the lead of Denmark, the Netherlands, Spain France and the UK.  

**VoIP MTIC & MTEC FRAUD**

*VoIP, phone-cards and other services.* There are a great number of services sold through the internet. Many are services sold for re-sale. VoIP termination services, and phone-cards that provide access to protected/proprietary content are two examples. When these services are performed in one jurisdiction and sold to businesses in another jurisdiction for domestic resale – opportunities for MTIC and MTEC arise. The Italian investigation, Operazione “phuncards-broker,” is a case study of the MTIC/MTEC fraud in this area.

**VoIP.** VoIP (voice over internet protocol) is a general term for a family of transmission technologies concerned with the delivery of voice communications over IP networks such as the internet. There are retail and wholesale markets for VoIP. Although the market is being driven by retail demand, the major areas for VoIP MTIC and MTEC fraud are in the wholesale market.

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In March the Norwegian Pollution Control Agency seized 114,500 CO2 allowances valued at 12 million kroner, and charged three more companies registered on the Danish exchange with Norwegian VAT fraud in CO2 permits. [Bjorn Haugan & Margaret Assev, MULIG KLIMAKVOTESVINDEL: Millionbeslag i klimakvoter (POSSIBLE TRADING FRAUD: Million Seizures in quotas) VERDENS GANG (Mar. 24, 2010) available at: http://e24.no/makro-og-politikk/article3578515.ece (in Norwegian)].


41 Fiona Chau, Wholesale VoIP posed for takeoff: As VoIP Gains Credibility Around the Globe, Carriers Identify an Opportunity in the Growing Wholesale Market, Telecom Asia (March 2007). Referencing an independent market study by In-Stat, and interviews with the authors:

According to a report released in January by In-Stat Research, wholesale VoIP is poised to grow around the world. "As retail VoIP expands, wholesale VoIP will accelerate quickly," says Bryan Van Dussen, In-Stat analyst. "The largest segment remains international VoIP, but we expect the market for local [US] services to surge from 12% of all revenues to 27% by 2010"

In-Stat found that in the US where VoIP is extremely popular, consumer VoIP adoption will drive wholesale VoIP revenues to $3.8 billion by 2010 from $1.1 billion in 2006. International wholesale VoIP termination/origination revenues, however, are experiencing declining growth rates, according to In-Stat. The research firm also predicts that long-haul wholesale VoIP will experience significant migration from TDM services during the next few years and account for a majority of the international market by 2009.

Electronic copy available at: https://ssrn.com/abstract=1708080
At the retail level, it is relatively easy to see how VoIP functions. There are origin and termination functions. The VoIP retailer provides both services for a fee – or in the case of retailers like Skype basic services are free with an option to purchase premium service.

At origin, an individual with a high-speed internet connection engages a VoIP provider to allow him to make calls over the internet. The reason for doing so is almost always the cost savings. The critical piece of equipment that the consumer needs to connect a telephone through the internet is a broadband telephone adaptor. The adaptor is connected on one end to the consumer’s telephone and on the other to the consumer’s cable/DSL modem or router. The adaptor splits the high-speed broadband connection allowing both data and voice to travel over the same internet line. With a headset the consumer can also make calls directly from his computer. Mobile phones can be VoIP enabled. In this case, when a long distance call is placed the mobile phone automatically routes the call through the internet.

This market is set for expansion. For example, Airspan built the first WiMAX mobile technology platform. This WiFi network uses the 2.5 GHZ Band, and allows users to access broadband almost anywhere in the world. WiMAX will enable VoIP, Video and internet access without roaming charges.

Available at: http://findarticles.com/p/articles/mi_m0FGI/is_3_18/ai_n19041281/?tag=content;col1. See also: Peter Coles & Thomas R. Eisemann, Skype HARVARD BUSINESS SCHOOL CASE STUDY 9-806-165 (Dec. 3, 2009) 3

When it was acquired by eBay, Skype had 54 million registered users and 2.7 million premium service customers. eBay projected that Skype would generate $60 million in revenue during 2005 and $200 million in 2006. Long-term operating margins were expected to equal 20% to 25% of revenue. [Imran Khan, eBay, JP Morgan Equity Research 5 (Sept. 29, 2005)] Those estimates proved reasonably accurate; by the ends of 2008, Skype had over 400 million registered users, with revenue of $191 million in 2006, increasing to $550 million in 2008. [eBay 2008 ANNUAL REPORT 1 & 51].

Multiple responses were allowed.

43 Clearwire of Seattle, Washington is in the process of constructing another WiMAX 4G network. Clearwire recently reported to the SEC that it was encountering funding problems in the current recession, but nevertheless boast Google, Intel, and many of the largest US cable TV operators as strategic investors. Paul Taylor, Shares slide as Clearwire future in doubt, FINANCIAL TIMES (November 6/7, 2010) 9.

44 Airspan Solution for the 2.5 GHz Band, (undated) (indicating that the reason Airspan selected the 2.5GHz band is that “it is one of the most widely available in the world … throughout the US, Europe, Asia, and several countries in Latin America and Middle East …” available at: https://ssrn.com/abstract=1708080
At termination (the other end of the call) the consumer’s voice transmission exits the internet and the VoIP service provider performs the adaptor’s function in reverse. The voice transmission is securely transferred into the local telephone network (land line; computer terminal; or mobile phone). It is this termination service that the local VoIP service provider must secure from another (foreign) provider, and which it re-sells to its customers.

The reason for VoIP’s cost saving is that the internet is free (after payment of a minimal access charge). Communicating through a public switched telephone network (PSTN) is much more expensive. The cost for using land lines increase over longer distances; but for VoIP distance is irrelevant. Time-division multiplexing (TDM) made PSTN more efficient for a while, but even at extremely high-density levels PSTN/TDM remains a land lines based technology that cannot compete. The industry believes that VoIP will replace PSTN/TDM.

VoIP termination - a tradable service. Vendors in the VoIP market buy and sell termination minutes. Termination minutes represent the service of providing access to a specified communications network for a measured period of time. The service is fully performed in the jurisdiction where the minutes are used.

This is not a labor-intensive industry, so aside from an initial investment in switching equipment, most of the service vendor’s effort goes into selling the commodity – finding (through other sources) or providing (through its own equipment) minutes that can be secured at low cost and re-sold slightly higher. Minutes sell for fractions of a penny through highly competitive exchanges that operate almost entirely over the internet.

There are a large number of exchanges, but all of them are unregulated. One of the most active is VoIP Business Forum. It characterizes itself as the “market place for VoIP minutes, hardware and software.” There are two main auction sites for minutes,

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45 With TDM two or more bits or streams of information appear to travel simultaneously through one communication channel. In fact what TDM does is to organize voice so that multiple streams physically take turns using the same channel. In the EU 30 voice streams are common; in the US the norm is 24. It is possible to achieve higher order multiplexing of up to 120 channels.
one to buy VoIP minutes (VoIP Origin), the other to sell VoIP minutes (VoIP Termination).

On January 25, 2010 the part of this exchange where parties bought VoIP minutes had 22,360 discrete listings on 430 pages (52 requests to buy per page). The part where parties sold VoIP minutes had 25,064 discrete listings on 482 pages (52 offers to sell per page). Most buy or sell lines were in fact multiple listing. For example, one buyer of minutes (VoIP Origination) was looking minutes in Liechtenstein, the United Arab Emirates and Australia; one seller of minutes (VoIP Termination) was seeking to sell minutes in India, Pakistan, Bangladesh, Sri Lanka and the Philippines.

Heavy buyers of minutes include well-known companies like Skype, and lesser known companies like VoIP Innovations, or aql. VoIP providers need minutes at termination to complete their service. Minutes can be offered for sale directly, or through a broker. Brokers will bundle and unbundle minutes to meet the needs of a buyer.

VoIP termination minutes are tradable services. When transactions in VoIP termination cross international borders, the same four permutations considered under tradable CO2 permits arise:

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49 Skype is a major player in this market. By mid-2008 100 billion VoIP minutes had been logged on Skype, and at any one given time there are 10 million simultaneous users on Skype. All of these calls need voice termination services. See: Michael Arrington, Google/Skype Acquisition or Partnership Imminent? Tech Crunch (on-line journal) Apr. 1, 2008, available at: http://www.techcrunch.com/2008/04/01/googleskype-acquisition-or-partnership-imminent/
50 VoIP Innovation, located in Pittsburg Pennsylvania, has an extensive carrier-grade voice network with coverage in over 7,000 rate centers across the US. Available at: http://www.VoIPinnovations.com.
51 Aql is a UK company, located in West Yorkshire. It provides global VoIP to Deutsche Bank, Motorola, Merck Pharmaceuticals, Stagecoach Group Plc, Man Financial, The Salvation Army and BP. Available at: http://www.aql.com/telecoms/wholesale-voice.
52 VoIP-Info.org lists hundreds of companies providing VoIP termination services in each of the EU Member States, each of which need to buy minutes over the net either directly from seller or through brokers. Available at: http://www.VoIP-info.org/wiki/view/VOIP+Service+Providers+Business+Europe
53 See for example see: VoIP Wholesale Brokers at http://www.voipwb.com/. This web page invites new brokers to sign up with the following introduction:

It’s no surprise that VoIP is taking over the world of telecommunications. Now you have the opportunity of a lifetime – the chance to be an important part of the fast-growing, highly lucrative industry. You can now capture your share of this non-stop growth. But unlike other wholesale brokers, you don’t need to invest tens of millions of dollars to have your own Vonage-type business.

• **Intra-Community VoIP transaction.** When a French business holding French termination minutes sells them to a UK business, the French seller will zero-rate the sale and the UK buyer will perform a reverse charge.

• **Community “export” VoIP transaction.** When a French business holding French termination minutes sells them to a Turkish business, the French seller will zero-rate the sale and the Turkish buyer will perform a reverse charge.

• **Community “import” VoIP transaction.** When a Norwegian business holding Norwegian termination minutes sells them to a UK business, the Norwegian seller will zero-rate the sale and the UK buyer will perform a reverse charge.

• **Extra-Community CO2 transaction.** When a Norwegian business holding Norwegian termination minutes sells them to a Swiss business, the Norwegian seller will zero-rate the sale and the Swiss buyer will perform a reverse charge.

**MTIC and MTEC fraud in VoIP.** Once again, after a business buyer secures VoIP termination minutes “VAT free” it is a short step to missing trader fraud. In the *intra-Community* transaction set out above, the UK business (a VoIP broker) would simply make an onward sale of the termination minutes within the UK, collect VAT on the sale and disappear without remitting the tax.

In each of the other examples – *community “export”* transactions; *community “import”* transactions; and *extra-community* transactions – missing trader fraud is just as likely. Each is an example of MTEC fraud. The potential fraudster (the Turkish, UK, and Swiss buyers respectively) acquires VoIP termination minutes “VAT free” under applicable place of supply rules. All the buyer (VoIP broker) needs to do is re-sell the termination minutes domestically and go missing with the VAT to complete the fraud.

**Operazione “phuncards-broker.”** On February 23, 2010 Italian prosecutors alleged that Telecom Italia SpA and FastWeb SpA carried out one of that nation’s largest VAT frauds ever. *Phuncards-broker* was a MTIC/MTEC fraud embedded in a global money-laundering scheme. During 2003 and then 2005 through 2007, the VAT fraud alone (allegedly) cost Italian taxpayers €400 million.\(^{54}\)

There are two distinct parts to **Operazione “phuncards-broker.”** The first concerns phonecards (*phuncards*) that provide access to proprietary (presumably pornographic) content (a service); the second (*broker*) concerns similar on-line content provided through the phone. In both cases the actual services involved appear to be fraudulent – neither the phone cards nor the content were real. End-users could not be found.

**Phuncards.** The phonecard fraud begins with two companies in the US.\(^{55}\) These companies sell the *rights* to make proprietary phonecards to Telefox, s.r.l., an Italian company. These cards give the purchaser the right to access (for a limited time) digital

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\(^{54}\) Stacey Meightry & Sabrina Cohen, *Billionaire Is Sought In Sweeping Fraud Probe*, WSJ at B4 (Feb. 24, 2010).

\(^{55}\) Global Telephone Service LLC is headquartered on Bayshore Drive, Coconut Grove, Florida; Worldwide Telecommunications Service LLC was based in Dover, Delaware.
content over the internet. Telefox is required to reverse charge the Italian VAT (20%). It does not do this. Telefox becomes a “missing trader.” No returns are filed. No tax is remitted.

Telefox re-sells these rights to two other Italian companies (buffers). These pay Telefox for the rights (including Italian VAT). These companies then subcontract with two other Italian companies to produce the cards. The cards are never made. However, the rights (allegedly embedded in the cards) are re-sold again to FastWeb Spa., Italy’s second largest broadband provider. FastWeb pays for the rights (including Italian VAT) and then exports the cards to a group of UK companies.

This is an intra-community transaction. The UK companies immediately re-export these cards outside the EU. Effectively this export eliminates the VAT obligation in the UK. FastWeb is the only entity to make a profit on these sales. It records a 7% profit on the sales to the UK. All other transactions are at cost, and under credit purchase agreements.

Although there are intra-Community aspects to this fact pattern, this is a case of MTEC fraud. FastWeb is the only legitimate company in this chain. It never deals directly with the fraudster (Telefox). Buffers protect FastWeb on all sides (two Italian re-selling companies, two Italian card-making companies, three UK buyers). FastWeb deducts input credits for 20% Italian VAT on its purchases, makes a reliable profit on the resale, and zero-rates its onward sales to the UK.

FastWeb can say it saw nothing wrong with the transactions it engaged in. FastWeb does not file for a refund because it is “VAT positive” (it has collected more VAT on other transactions than it has in overall VAT credits). The UK firms reverse charge their purchases, but immediately zero-rate the export of the card.

Broker. This is the larger of the two frauds uncovered. There is every reason to believe that actual VAT losses far exceed the prosecutor’s estimate of €338,838,040.64.

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56 CMC Italy s.r.l.; Web Wizard s.r.l.
57 Graf Plastics Division in Rozzano (Milan); Print Media in Gallarate (Varese).
58 Any one of three companies in the Kenworthy Group: LBB Trading Ltd.; Premier Global Trading UK Ltd., or Fulerum Trading UK Ltd.
59 Novellist International Ltd., a British Virgin Islands company; Fulerum Trading USA LLC, a US company.
60 If payment for the phonecards represented prepaid telephone traffic, then it would be likely that the UK firms would be liable for Italian VAT. If the phonecard transactions involve payments for a future service (access to a website with content protected by copyright law – assumed to be adult content), then tax would be due in the jurisdiction of final distribution. The fraudsters sought several legal opinions, and determined that Italian VAT did not apply. The sale was payment for a future service, and a UK reverse charge should apply. Operazione “Phuncards-Broker,” supra note 40, at 229 and at 241 & 242 recording the e-mail of Carlo Focarelli to Bruno Zito and Andrea Conte on October 26, 2002.
61 The €338,838,040.64 figure is the sum of VAT losses from Telecom Italia of €297,890,902.48, FastWeb of €38,595,102.63, 1-Globe of €1,690,339.84 and Planetarium of €957,624.63. There are at least two other entities involved in the fraud where VAT losses have occurred, but proof of the losses is not adequate – the “paper companies” of Telefox International Ltd. and Global Phone Network Ltd. Operazione “Phuncards-
FastWeb and Telecom Italia (the largest Italian telecommunications company) are involved as middlemen. Although VAT losses are substantial, these MTEC fraud chains are constructed primarily to launder money from illegal activities of the Ndrangheta mafia (a crime syndicate from the toe of the Italian boot).62

Two Italian companies (Telefox International Ltd. and Global Phone Network s.r.l.) purchase high value, protected or copyrighted pornography63 from a Panamanian company.64 The content is a "tradable service." End-users can access the content on the internet through a computer or a mobile phone. Neither Telefox International nor Global Phone Network complies with Italian tax obligations. They are the "missing traders."65

Telefox International and Global Phone Network re-sell the Panamanian content to two other Italian companies66 and collect 20% Italian VAT. The amount paid back in royalties to Panama for content that is re-sold is the full amount collected in the onward sale (the sale price plus the 20% Italian VAT).67 The financial pass-through is complete.

The intermediary Italian companies sell the Panamanian content (as well as VoIP termination minutes) to FastWeb and Telecom Italia.68 Both FastWeb and Telecom Italia pay for the content and pay Italian VAT on these purchases (which they later deduct).

FastWeb and Telecom Italia then re-sell the Panamanian content once again. Four upstream aggregators69 located within other Member States buy it.70 This intra-Community sale allows the transaction to be zero-rated out of Italy and subject to a reverse charge in the other Member State.


62 Stacy Meightry & Sabrina Cohen, Billionaire Is Sought In Sweeping Fraud Probe, WSJ at B5 (Feb. 24, 2010); Operazione “Phuncards-Broker,” supra note 40, at 220. VAT fraud seems to have been the specialty of two members of the Ndrangheta, Carlo Focarelli and Gennaro Mokbel. The investigation indicates that these individuals have been for, “…fifteen years operating in the area of tax fraud at the highest level, benefiting from a proven and sophisticated laundering of proceeds from the VAT fraud in particular. They are acting more or less always with the same methods, and have succeeded in recent times, to infiltrate areas of high liquidity, increasing in exponentially and consequently the profitability of their criminal social and economic danger.” Operazione “Phuncards-Broker,” supra note 40, at 226.

63 Operazione “Phuncards-Broker,” supra note 40, at 281, n. 143.

64 Coriano Capital SA was incorporated on November 17, 2003, has a legal representative in a local law firm, and its owner is simply listed as a non-resident.

65 Operazione “Phuncards-Broker,” supra note 40, at 260.

66 I-Globe s.r.l.; Planetarium s.r.l.


68 Both I-Globe and Planetarium utilized the technical equipment of TLC Italy Ubique Ltd with a “…mandate to assist the relations between the supplier [I-Globe and Planetarium] and the customer [Fastweb],” Operazione “Phuncards-Broker,” supra note 40, at 272. Computer seized by Italian authorities at TLC Italy Ubique were instrumental in this investigation.

69 Aggregators assist telecommunications companies achieve revenue goals by directing traffic through their systems. In this case however the aggregators dealt only with end-users seeking the Panamanian content and termination services that FastWeb and Telecom Italia had previously secured.

70 Diadem (UK) Ltd.; Acumen (UK) Ltd.; Acumen Europe OY (Sweden); Accrue Telemedia OY (Sweden).
The aggregators in this case (apparently) did not know the identity of the end-users. Calls “appeared” to come from either from Tuvalu\textsuperscript{71} or Iridium,\textsuperscript{72} but other than asserting that these sales were to users outside the EU the aggregators could never demonstrate that the end-users were real. There is no proof that anyone actually paid for any call that the aggregators directed to FastWeb and Telecom Italia.\textsuperscript{73}

This is \textit{not} to say that there were \textit{not} real money flows involved. A separate part of the investigation demonstrates that huge amount of money circulating in this fraud that most likely came from illegal activities of the Ndrangheta mafia. In one nine day turn of the carousel a commitment of €1,945,030 in “dirty” money generated net VAT receipts of €326,836\textsuperscript{74} with aggregate expenses of €82,180.09 [€53,900 retained by Telecom Italia, and €28,280.09 by each of the other entities]. Thus, the Ndrangheta netted profits of €244,655.91 from their “money cleaning service.”

\section*{NEW ZEALAND GST}

MTEC fraud in \textit{tradable services} cannot occur under the New Zealand GST.\textsuperscript{75} The reason is statutory design. Unlike the EU VAT the New Zealand GST distinguishes the place of supply/place of taxation for services based on whether the supplier is a resident and non-resident supplier.\textsuperscript{76} There are presumptions, and then exceptions.

The place of taxation for supplies of services by non-residents is presumed to be outside of New Zealand. In contrast, the place of taxation for supplies of services by residents is presumed to be New Zealand.

Both presumptions can be over-ridden. The non-resident’s presumption is over-ridden if the services are actually performed in New Zealand,\textsuperscript{77} and the customer is a final consumer, or if the customer is a business then there must be a written agreement among the parties\textsuperscript{78} that the transaction is to be treated as taxable in New Zealand.\textsuperscript{79} Only in

\textsuperscript{71}Tuvalu is a small island in the South Pacific. It has a population of just over 12,000 with a land mass of just over 10 square miles. It is the third smallest country by population and fourth by size.

\textsuperscript{72}Iridium Satellite LLC owns the largest group of satellites used to provide voice and data coverage to satellite phones, pagers and integrated transceivers. It covers the entire surface of the earth.

\textsuperscript{73}The investigators were “… unable to identify an ‘end-user’ who had seen a charge on a bill for a call where a number was placed from Tuvalu or Iridium …” Operazione “Phuncards-Broker,”\textit{supra} note 40, at 282. In fact the Internal Audit report of FastWeb reported that Colin Dines, of Diadem was similarly concerned. He asked for, “… evidence, for example, of the origin of the traffic that is delivered to an end-user in Tuvalu …” FastWeb told him that this information could not be disclosed because it was “commercially sensitive.” Operazione “Phuncards-Broker,”\textit{supra} note 40, at 286.

\textsuperscript{74}The VAT receipts are net €326,836 because as long as the VoIP MTIC is going on I-Globe will file a return that will remit VAT. In this case I-Globe received €328,020 from Telecom Italia, and paid €326,836 to Telefox International. Thus, a positive VAT return was most likely filed remitting €1,184.


\textsuperscript{76}GST Act 1985 (NZ), § 8(2).

\textsuperscript{77}GST Act 1985 (NZ), § 8(3) (the service must be physically performed in New Zealand by a person who is in New Zealand at the time the service is performed).

\textsuperscript{78}GST Act 1985 (NZ), § 8(4).
these cases will the place of taxation for services performed by a non-resident deemed to be in New Zealand. For residents the over-rides move the place of supply outside of New Zealand. Each over-ride is specified in a statutory list of zero-rated exports (which is not important for this discussion).

MTEC and MTIC fraud in tradable services arises under the EU VAT when a non-resident (a resident of another Member State, or a resident of a Third Country) supplies a service to a EU established business. Even though the service is actually performed in another jurisdiction the EU rules deem the place of supply/ place of taxation to be within the buyer’s jurisdiction, and require VAT to be paid (under a reverse charge) by the “importer” of the tradable service. The same rules apply to all subsequent buyers of the tradable service.

These rules set up the MTIC/MTEC sequence. They allow the “importer” of tradable services to collect VAT on a subsequent sale and disappear without completing the reverse charge or remitting VAT on the subsequent sale. New Zealand treats this situation very differently. Consider how New Zealand treats the following tradable services: CO2 permits, VoIP termination services, and the service content in the Operazione “phuncards-broker” investigation.

CO2 permits under New Zealand rules. CO2 permits are deemed to be tradable services under the EU VAT. The service that is being traded is the permission (granted by the government that issues the certificate) to release a specified amount of CO2 into the atmosphere. If this permit (initially issued to a domestic business) is traded across a border, into a jurisdiction that has a GST under New Zealand rules, there will never be a tax imposed. This tradable service will never be performed in any jurisdiction other than the jurisdiction that issued the certificate.

This result only makes good sense. CO2 permits are issued to businesses, traded among businesses, and are only “used” by businesses. CO2 permits are not sold to final consumers. Transactions in CO2 permits should yield no net VAT/GST revenue to any government. If the EU VAT rules are working perfectly they reach exactly the same result as the New Zealand GST.

VoIP under New Zealand rules. In VoIP the tradable service is the termination service. Termination services are always performed in a foreign jurisdiction for the benefit of the domestic caller. (Domestic calls do not need to be placed through the internet, they are relatively inexpensive if made directly through the local telecommunications provider).

Under the New Zealand GST the only way for (foreign) VoIP termination services to be taxable in New Zealand is if the New Zealand buyer is a registered person,

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79 GST Act 1985 (NZ), § 8(3) (this means that if the seller is a non-resident, the buyer is a registered business in New Zealand, and the services are performed in New Zealand, but if there is no written agreement, then the services are presumed to be taxable outside of New Zealand).
and there is a written agreement among the parties to apply New Zealand GST. Otherwise no GST is due.

Although it is possible for a private person to purchase VoIP termination, this seems unlikely. In such a case the EU VAT would endeavor to collect revenue from the foreign termination service provider on the basis that this business is making a EU supply. The New Zealand GST however, would collect nothing.

*Operazione “phuncards-broker” under New Zealand rules.* The *Operazione “phuncards-broker”* MTEC frauds were constructed around two *tradable services*. Both (allegedly) involved sales of protected or copyrighted pornography. *Phuncards* concerned these *rights to services* embedded in plastic cards that may not have been manufactured; *broker* simply digitized this same service, allowing access to content through the net and mobile phones. VoIP termination services were sold (in addition) to the legitimate traders (Telecom Italia and FastWeb) by the “buffer” companies.

Both of the *Operazione “phuncards-broker”* chains are constructed of elaborate sets of business-to-business transactions in *tradable services* inside and outside the EU. The suggestion is (although proof is missing on this point) that the sales to final consumers are made by businesses outside the EU to customers that are also outside the EU. The design of these structures abuses the EU place of supply rules in tradable services. These structures facilitate the perfect “missing traders” – businesses with no assets, no inventory, and no traceable sales. The master design of *Operazione “phuncards-broker”* even included “buffer” firms that help the legitimate traders (Telecom Italia and FastWeb) to meet their due diligence requirements under *Kittel*.81

Once again, because all the EU transactions in *Operazione “phuncards-broker”* are business-to-business, no net revenue is expected in any Member State. Properly functioning, the EU VAT and the New Zealand GST will return the same result – no VAT is due. However, where the New Zealand GST achieves this result without losses, the EU VAT has lost in excess of €400 million in just one MTEC fraud.

**TECHNOLOGY SOLUTIONS**

There are other ways to solve MTIC/MTEC fraud, notably technology solutions that do not require (significant) statutory changes. There are two good reasons for considering other solutions: (1) statutory changes to fundamental aspects of a tax system are notoriously difficult to bring about, and (2) within the EU solving MTEC in *tradable

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80 In *phuncard* it was Novellist International in the British Vergin Islands, and Fulcrum Trading US in the USA that (allegedly) made sales of the phonecards to individual consumers. In *broker* the four aggregators (Diadem (UK) Ltd.; Acumen (UK) Ltd.; Acumen Europe OY (Sweden); Accrue Telemedia OY (Sweden)] collected demand from other businesses that in turn (allegedly) had clients in Tuvalu or on Iridium.

81 *Alex Kittel v. Belgium*, Case 439/04 (July 6, 2006). The due diligence requirement essentially requires purchasers to examine whether or not their counterparty are is likely to be engaged in fraud:

… 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.
services (which would happen if the New Zealand place of supply/place of taxation rules were adopted for tradable services) would only encourage the fraudsters to migrate to goods where there are over forty markets still highly susceptible to MTIC. 82

MTIC and MTEC are technology-intensive frauds. Thus, it only stands to reason that technology will offer solutions, probably some of the best solutions.

A transaction in tradable CO2 services can be completed in minutes, 83 and huge sums can be stolen in a few days. One MTIC fraud case involving computer chips netted £81,857,263 in 14 days. 84 Funds from missing trader frauds pass at lightning speed through domestic and foreign banks (Dubai, India, Hong Kong, Pakistan, China and Russia are common transit points). When a withdrawal is made (in cash) on the other side of the world the stolen VAT becomes impossible to recover, and the supply in tradable services that supported the fraud has evaporated. 85

The two leading technology-based solutions to MTIC/MTEC fraud are (1) the VAT Locator Number (VLN) system, 86 and (2) the software certification provisions in the Digital VAT (D-VAT). 87 There are important differences between these solutions. The VLN is a mandatory system that focuses on securely tracing every supply (whether of goods or services). The D-VAT in contrast is a voluntary system that certifies the accuracy of the computer software that determines the tax and assures that the correct tax is charged, collected, and remitted.

VLN

The VAT Locator Number system is the simplest of the two technology solutions. It is the least disruptive to the current VAT system. It was formulated and proposed by Dr. Michael Cheetham at the House of Lords hearings, May 25, 2007. 88 The VLN solution is a very targeted solution. It is only looking at MTIC/MTEC fraud.

83 Aline Robert, La fraude a la TVA du CO2 se revele gigantesque, La Tribune 22 (Dec. 16, 2009) (in French, original and translation on file with author) (discussing that the average time for a MTIC transaction to be closed out on the BlueNext exchange in Paris is 15 minutes.)
85 Financial Action Task Force, Laundering the Proceeds of VAT Carousel Fraud (Feb. 23, 2007) (see for example the £36m UK carousel, based in southern Spain which had Swiss bank accounts, but where funds are eventually withdrawn in cash in Hong Kong, and others funds invested in Spanish real estate are later old and re-invested in Las Vegas after passing through the Commonwealth of Dominica and Gibraltar).
86 House of Lords, European Union Committee, Stopping the Carousel: Missing Trader Fraud in the EU (Report with Evidence) HL Paper 101 (May 25, 2007) 7 (testimony of Dr. Michael Cheetham setting out the VLN proposal).
87 Richard T. Ainsworth, Carousel Fraud in the EU – A Digital VAT Solution, 42 Tax Notes Int’l. 443 (May 1, 2006) (setting out a fully digital solution for MTIC fraud)
88 Supra, note 86.
The most significant policy change made by the VLN proposal is the denial of a buyer’s input credit if a seller pays VAT on an invoice with an invalid VLN (or no VLN at all). The most significant procedural change is that businesses would need to secure a VLN (when selling supplies) or validate an opposing trader’s VLN (when purchasing supplies). In most cases compliance will be completely automated. Accountancy software platforms would make automated requests for VLNs from a central (government) computer system, and make automatic validation requests in the same manner. Each link in the commercial chain would be given a number, and the numerical sequence would follow the goods (or services) from initial manufacture through to final consumption. A back-up system where VLNs could be secured through an internet web site or a call center would be available.  

The VLN system requires the seller on each transaction to secure and print on the invoice an encrypted VLN. This number would be unique to a specific transaction (based on the essential data elements of the invoice, and prior related VLNs from transactions up the commercial chain). The VLN number will be attached to the invoice, either numerically or as a bar code that can be scanned and read with an optical reader. The advantage of a bar code and optical reader capabilities is that a trader can quickly scan the VLN bar code into a national database to verify the VLN.

A similar fraud prevention system is in place in Brazil, where it has proven to be highly reliable. In Brazil invoices receive a digital bar code at the inter-state border (from a federal computer feed). The bar code is used to validate the invoice and the physical transit of the goods.

Two examples of how the VLN works may be helpful. The first involves a standard cross-border sale within the EU. The second explains what happens if a trader sells without a VLN (or there is a break in the chain of valid VLN numbers).

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89 Dr. Michaels Cheetham, Personal e-mail communication (April 25, 2010) (on file with author).
90 A similar bar code is added to each cash register receipt issued by Quebec restaurants under their enforcement effort directed against Zappers. The Sales Recording Module (SRM) is a device that secures ECR data and uses it to digitally sign each receipt with a bar code that can be read with a hand-held optical scanner. This will allow short inspections – where an auditor in a thirty-minute visit, observes that customers are receiving receipts, and then quickly verifies (with the scanner) that the receipts being issued are recorded in the SRM. Full inspections can follow in cases of irregularities. Gilles Bernard, Solutions for the Under-reporting of income in the Restaurant Sector, Federation of Tax Administrators Annual Conference, Denver Colorado (June 2, 2009) powerpoint slides at 15-17 (on file with author).
91 A number of Brazilian states and the federal government signed an agreement on September 30, 2005 to create (1) the "e-invoice" ("Nota Fiscal Eletrônica") and (2) the "auxiliary document of the e-invoice" ("Documento Auxiliar da Nota Fiscal Eletrônica"). AJUSTE SINIEF N.º 07 DE 30 DE SETEMBRO DE 2005 available at: http://www.sef.rj.gov.br/legislacao/tributaria/convenios_ajustes_protocolos/confaz/ajustes/2005/aj05007.shtml. On December 20, 2005, through the ATO COTEPE/ICMS N.º 72 DE 20 DE DEZEMBRO DE 2005 http://www.sef.rj.gov.br/legislacao/tributaria/convenios_ajustes_protocolos/confaz/pareceres_ecf/2005/ato072_05.shtml, the structure of the e-invoice was established and testing was initiated with nineteen companies and those companies and six states. The program has been deemed a success and has been extended.
When there is a break in the VLN number sequence, the automatic response of the next trader in line is to pay the seller for the supply, but pay all of the VAT to the tax authority. This is the only action that will allow him to secure a VLN that will allow him re-sell the purchased supplies afterwards. No VAT is ever paid to a business that sells without a valid VLN. MTIC is eliminated. The commercial chain continues uninterrupted. The merchant that sold without a VLN might be penalized (and that business may find it more difficult to secure VLN's in the future as government risk assessments would suggest that this trader needs careful oversight).

Example #1
VLN Import Fact Pattern

If business B-1 in France sells goods or service to a business (B-2) in the UK, B-1 will zero rate and B-2 will request a VLN (for the reverse charge) from HMRC (VLN-1). The VLN request will include the essential elements of the invoice received from B-1. The HMRC will perform a risk assessment, and if B-2 is deemed to be a low risk importer (the risk we are concerned with is whether or not B-2 is likely to “go missing”), then a VLN number will issue.

VLN-1 is an encrypted identifier that will be integrated into all subsequent VLN's in this chain. The B-2 to B-3 transaction will be accompanied by VLN-2. It will be requested by B-2, and will include within its encryption not only data related to the B-2/B-3 transaction, but data from VLN-1. This allows HMRC to re-construct a full digital trail of the chain, if necessary. B-3 will not be allowed a deduction for VAT paid if either there is no VNL on the invoice B-3 receives, or if the VLN it receives on the invoice is invalid.
Chart #1

VLN-1&2 – encrypted numeric & scanned bar code on invoice identifying vendors, goods & trail.
One number merges all data.

Automated request for a “reverse charge” VLN followed by a request for a re-sale VLN (essential elements of invoice)
- Good/service code
- Quantity
- Price paid
- Vendor ID
- Vendee ID

Confirming the VLN – OK to pay VAT?

Electronic copy available at: https://ssrn.com/abstract=1708080
Example #2
Sale Without Valid VLN Fact Pattern

As before (B-1, a business in France sells goods or service to business B-2 in the UK; B-1 will zero rate; B-2 applies for a VLN for the reverse charge) B-2 receives VLN-1 from HMRC after a risk assessment determines that B-2 is a low-risk-to-go-missing importer.

However (for some reason) B-2 re-sells to B-4 without securing a re-sale VLN. In this situation B-4 would be unlikely to pay VAT to B-2, because B-4 would be denied a VAT deduction for the amount paid. Instead, if B-4 wants to complete the trade it will pay the VAT directly to the Treasury, effectively performing a reverse charge. B-4 will now receive (from HMRC’s Computer System) a VLN number that will allow it to deduct the VAT upon re-sale.

When the re-sale occurs B-4/B-5 there will be a request for a VLN for this transaction (it may be that quantities are different for the B-2/B-4 transaction; changes could have been made in the product, but everything will be reflected in the new VLN). With this new VLN (which would associate back to the VLN B-4 received from HMRC, and also to the VLN B-2 got from HMRC) it will be possible to make a sale to B-5, impose domestic VAT, and remit it in the normal manner.
Certified tax software and a conditional change in the standard place of supply rules can also solve MTIC/MTEC fraud. Certified software is currently being used in the US retail sales tax by 23 states under the Streamlined Sales and Use Tax Agreement (SSUTA). The same software mechanisms could be applied to the VAT to solve missing trader fraud.

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92 These twenty-three states are divided into two groups, the full members, and the associate members. A full member state is a state that is in compliance with the Streamlined Sales and Use Tax Agreement through its laws, rules, regulations, and policies. Those states are: Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin (as of Oct. 1, 2009) and Wyoming. An associate member state is a State that has achieved substantial compliance with the terms of the Streamlined Sales and Use Tax Agreement taken as a whole, but not necessarily each provision, and there is an expectation that the state will achieve compliance by January 1, 2008. Those states are: Ohio, Tennessee, and Utah, see http://www.streamlinedsaletax.org (last visited Jan. 24, 2009).

Similar to the VLN proposal the D-VAT proposal changes the place of supply (and thereby the party who was required to remit the tax) based on whether or not the businesses involved in the transaction employed certified tax software. Under the VLN the determinant was whether or not a valid VLN appears on the invoice.

Certified tax software solution. Governments would need to develop a testing regime for the certification of enterprise-level transaction tax software. To be certified the software would need to be comprehensive – capable of: (a) determining the correct tax rate for each transaction and calculating the VAT amount due, (b) posting this amount on the appropriate invoice, (c) linking each VAT input or output amount to the correct VAT return, and (d) completing the VAT return accurately and authorizing the remission of taxes due. In addition, the software will need to verify whether or not the companion system (the system used by the other trader) is also certified.

Business use of certified software is voluntary. In some instances however, notably when an enterprise is heavily engaged in transactions deemed inherently prone to missing trader fraud – like tradable emissions permits, cell phones, or computer chips – a jurisdiction might make use of certified software a mandatory condition of doing business. In addition, in judicial proceedings the government could seek (as a fraud remedy) the mandatory use of certified software by a firm “going forward,” because of proven instances of fraud in the past.

[hereinafter SSUTA] (providing for fully digital compliance with sales and use taxes through certified intermediaries and certified software solutions).

94The SSUTA certification process involves measuring software against three third party standards; (1) the AICPA’s SAS 94 [AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, PROFESSIONAL STANDARDS, Vol. 1 AU § 319 The Effect of Information Technology on the Auditor’s Consideration of Internal Control in a Financial Statement Audit, as amending SAS No. 55 Consideration of Internal Control in a Financial Statement Audit]; and (2) the US- GAO Federal Information Systems Control Audit Manual [U.S. GOVERNMENT ACCOUNTING OFFICE, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, FEDERAL INFORMATION SYSTEMS CONTROL AUDIT MANUAL, (FISCAM) Vol. 1 (GAO-AIMD12.19.6) available at http://www.gao.gov/special.pubs/ai12.19.6.pdf]. In addition, software developers must comply with (3) ISO Number 17799 [INTERNATIONAL ORGANIZATION FOR STANDARDIZATION, ISO 17799: INFORMATION TECHNOLOGY, SECURITY TECHNIQUES, CODE FOR INFORMATION SECURITY MANAGEMENT (ISO/IEC 17799:2005)]. A discussion of similar standards for certification and accreditation of software can be found in the recent O.E.C.D. materials [Electronic Commerce: Facilitating Collection of Consumption Taxes on Business-to-Consumer Cross-Border E-Commerce Transactions, O.E.C.D. (Feb. 11, 2005) at 9 & 17-18 available at http://www.oecd.org]. Indicating that, “… a global intermediary may be based in one country and would undertake intermediary activities in as many countries as suppliers are required to collect and remit consumption taxes on behalf of e-commerce suppliers. In cases where satisfactory levels of approval or financial security are evident, countries could be more relaxed …”. The OECD discusses a range of government “approvals” for tax accounting software. At one extreme is “accreditation,” an approval process functions simply as a mechanism to “formally identify” software that meets certain criteria of acceptability. At the other extreme is “certification,” an approval process that designates software as “an officially authorized mechanism to perform specified functions.”].

95 This was the approach taken by Judge Lise Gaboury of the Court of Quebec in the fraud case against the 28 restaurant chain Casa Grecque. In this instance the fraud involved installing an automated sales skimming program called a Sales Zapper in the point of sale system (the networked electronic cash register). In the Budget Speech of March 23, 2006 the Minister of Revenue had announced the adoption of an automated system [module d’enregistrement des vents] that would be voluntary until 2011. Judge
Four examples. If jurisdictions were to adopt a certified tax software regime there are four permutations of possible transactions among enterprises using certified and non-certified tax software solutions. They are set out below.

This solution is applicable globally, within an economic community, or by a single jurisdiction. Assume a taxable transaction between two businesses (X and Y) where the parties are in different jurisdictions. The transactions involved could be the sale of goods or tradable services. Under standard EU VAT formulations, the transaction will be zero-rated leaving X’s jurisdiction and subject to a reverse charge entering Y’s jurisdiction.

If only Y is using a certified system, there should be no MTIC/MTEC problem with this transaction. A certified system will always perform a required reverse charge regardless of the certification of the other party’s system. Y’s VAT return will be properly prepared along with all related reports, and the funds will be properly remitted to the government. Problems arise when X is not using a certified system. The following four permutations summarizes these applications:

X certified; Y certified. If X and Y are both using certified systems the zero-rating and the reverse charge will be properly made, reported, and the VAT remitted to Y’s government. This is true even if the transactions are occurring in suspect classes of supplies (cell phones, computer chips CO2 certificates or VoIP).

X not certified; Y certified. If X is not using a certified system and Y is using a certified system, then Y will reverse charge. The only question will be whether X’s jurisdiction will allow a zero-rating in this case. Y’s certified system will perform a reverse charge, but there needs to be a way for X’s tax authority to confirm this directly.

If X was engaged in making supplies in a MTIC/MTEC prone industry, then the transaction might be questioned immediately. X’s tax authority might consider it a “Community-duty” to deny zero-rating to X on the basis that it was not assured that the buyer in Y’s jurisdiction was making a reverse charge. The question would likely come down to whether or not X’s jurisdiction is willing to accept Y’s certification as proof that X had fulfilled a due diligence obligation to verify that Y was not participating in missing trader fraud. If so, then X should be allowed to zero-rate the sale even without a certified system.

X certified; Y not certified. If X is using a certified system and Y is not, then X’s system must be programmed to recognize this. X’s system should not allow this transaction to be zero-rated. This would be particularly important if it occurred in a

Gaboury noted that the system was expected to be available by October 1, 2008 and required all of the Casa Grecque restaurants to adopt it at this time as a condition of remaining in business. Revenue Quebec, Des restaurants de la chaîne Casa Grecque coupables de fraude fiscal (in French only) available at: http://www.revenu.gouv.qc.ca/eng/ministere/centre_information/communiques/ev-fisc/2006/10juillet.asp
suspect class of supplies. X’s system would instead be programmed to impose the domestic tax.

Y would then be in a difficult situation. Potentially Y’s purchases would be burdened with the VAT of two jurisdictions. Y would remain obligated to comply with the reverse charge in its own jurisdiction, and it would be paying VAT in X’s jurisdiction on the same supply. Y would need to file for a refund in X’s jurisdiction. In this situation Y would most likely either seek a domestic supplier (who would charge domestic VAT) or install its own certified system. This is the desired result in suspect supplies.

**X not certified; Y not certified.** If neither X nor Y uses a certified system, the risk of MTIC/MTEC is very high. In this situation there is no way for X’s jurisdiction to be sure that the X-Y transactions are not part of MTIC/MTEC frauds, and it might then condition the right of X to deduct VAT paid on suspect classes of supplies (cell phones, CO2 permits, VoIP) until it verified that VAT was collected on all re-sales of the supplies. Once again, Y would be in a difficult position of being required to pay over VAT to X as well as reverse charging the supply.

In a certification regime that extends throughout a federal system (like the EU or Canada) notification that a system was certified would be automatic, handled through a secure on-line connections. A central government database would immediately verify the certification.

Dual notifications would also be expected. In the above examples it is equally important that X’s system know about the status of Y’s system, as it is that Y’s system knows about X’s status. There are a variety of ways this cross-verification can be accomplished, but the most proven and secure would be through the use of public key infrastructure (PKI). X’s system would access the public key associated with Y and use it to confirm the status of Y’s system. With this knowledge, X would then draft an invoice with or without VAT and forward it to Y. If there were errors, Y’s system would be checking the invoices received for the status of its suppliers before it paid over VAT.

In a sense this is simply automated due diligence. But in another sense, it is certified due diligence.

**VLN versus D-VAT solution.** Both the VLN and the D-VAT solve MTIC fraud in goods as well as MTIC and MTEC in tradable services. The VLN has a strong government presence, whereas the D-VAT is a private sector solution. The VLN is mandatory, whereas the D-VAT is voluntary.

96 PKI is information technology infrastructure that enables users of a basically unsecure public network (such as the Internet) to securely and privately exchange data through the use of a public and a private cryptographic key pair that is obtained and shared through a trusted authority. In this case the trusted authority would be the Member State that certifies the transaction tax software in the target entity.
More importantly, the VLN can be a stand-alone solution for a single country if there is a heightened concern about MTIC/MTEC fraud. Nothing more is needed than a request for a VLN on importation to set the system into motion. With the D-VAT a high level of cross-border cooperation needed among trading parties. In addition, a central certification authority/mechanism is needed to make the cross-border verification of status workable. This later function could be performed at the Community level by a sub-directory of the Commission, or there could be an agreement among the Member States to accept the certifications of other Member States.

One further point in contrast – under the VLN the government can immediately stop any commercial chain of goods or services by blocking the issuance of VLN numbers. This might be necessary if a risk assessment of a particular trader strongly suggested fraud. The government could not directly intervene under the D-VAT.

CONCLUSION

VATs and GSTs have always been vulnerable to missing trader frauds – some, more so than others. At its core this is smuggling. The earliest versions of this fraud in the EU involved smuggling gold across the Luxembourg border, selling it (with VAT) in another Member State, and then disappearing.97

When the EU dismantled its internal borders and changed the place of supply rules for goods in 1991 it was no longer necessary to smuggle goods through customs to carry out MTIC frauds. MTIC moved quickly into high value goods that could be traded easily in gray markets. The goal now was to complete huge financial transactions (the higher the value – the larger the VAT) and move the related goods quickly to complete the sale. Speed is necessary to keep ahead of filing obligations (quarterly or yearly) and the inquiries of the tax authorities. Technology plays a significant role in helping fraudsters move faster.

The genius of tradable services for the fraudsters is that, unlike goods, they do not need to be physically moved to complete a transaction. As a result, missing trader fraud, which began in heavy-to-transport gold bars, then moved into high value/low weight computer chips, is now comfortably at home in tradable services (digital supplies). These supplies trade like goods, move like lighting, and evaporate on use. What could be better?

What is even more troubling is that missing trader frauds in tradable services utilize EU VAT provisions that are not limited to intra-Community transactions. As a result, this form of missing trader fraud (MTEC) is present wherever a jurisdiction models its VAT on the EU template.

97 A.A. Aronowitz, DCG Laagland & G. Paulides, VALUE-ADDED TAX FRAUD IN THE EUROPEAN UNION 75-76 (1999) (discussing how gold was smuggled from Luxembourg where the VAT rate was 0% into other member states where it could be sold with VAT). Awareness of the gold smuggling problem eventually resulted in the adoption of a special regime for gold. See: UK Parliament, Select Committee on European Union, TWENTIETH REPORT, Chapter 2: Tackling MTIC Fraud: Actions to Date, ¶ 38 (indicating that a “Special Accounting System for Gold” was introduced in April 1993 to combat VAT fraud in that market), available at: http://www.publications.parliament.uk/pa/ld200607/ldselect/ldeucom/101/10105.htm
Policy makers have clearly not come to grips with MTIC/MTEC fraud. The fiscal losses are staggering, but corrective movements are very slow. Estimates of losses are becoming commonplace in newspapers, journals and academic articles, but perhaps because the VAT/GST is a relatively hidden tax (from a consumer’s perspective) there does not seem to be any urgency to move against this fraud.

For example, missing trader fraud is so large in the EU that it distorts national trade statistics. The UK has made the measure of this distortion public. In 2006 the UK estimated that it had suffered MTIC losses of between £2.98 and £4.47 billion. The German government published similar estimates for German losses. Europol gave a “best estimate” in 2006 for MTIC fraud in the whole Community of €23 billion (annually). These are huge sums.

However, these figures are only estimates, and they are based entirely on goods transactions – mostly computer chips and cell phones. Estimates on missing trader fraud in tradable services are just beginning to be made public. For example, on the eve of the Copenhagen Climate Conference Europol estimated that there was an additional €5 billion in CO2 MTIC fraud (in some of the EU Member States). Other than the €400m

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99 H.M. Treasury, 2006 Pre-Budget Report: Investing in Britain’s Potential – Building Our Long Term Future 126 (Dec. 2006) Cm 6984, available at: http://www.hm-treasury.gov.uk/media/5CC/43/pbr06(cursorcontrol)completerep01439.pdf (indicating that “… attempted MTIC fraud was between 3.5 billion pounds and 4.75 billion pounds in 2005-06; with an estimated negative impact on VAT receipts during the year of between 2 billion pounds [or 2.98 billion euro] and 3 billion pounds [or 4.47 billion euro].”) See also: H.M. Revenue & Customs, Measuring Indirect Tax Losses – 2006 6 & 21-25 (Dec. 2006) available at: http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pagelibrary ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_026423 (setting out the methodology used to determine estimates in the 2006 Pre-Budget Report.)


in VAT that has (allegedly) been stolen in the Operazione “phuncards-broker” frauds, there are no public estimates of other MTEC losses.

Realizing that large numbers were not moving policy makers, some critics have sought results in small (human interest) stories. Banner headlines were made of the single computer specialist who effectively stole £81,857,263 in fourteen days (and got away with it, less £75,000 and 15 months in jail).103 Or, the story of the twenty-one year old who appeared to be selling 10% of the world supply in a particular kind of computer chip, when in fact he had only one box riding a MTIC carousel in UK-Irish trade.104 Still, nothing seems to be happening at a tax policy level.

Perhaps now that MTIC in goods has morphed into MTEC in tradable services – perhaps now that MTEC threatens every global VAT regime modeled on the EU VAT – perhaps now something may happen? If so, then the first thing that should be done is to take a close look at the New Zealand statute. New Zealand is immunized against MTEC in tradable services. It would be wise to see if New Zealand vaccine could be copied.

The second thing that should be done is to carefully consider the available technology solutions – particularly if it is a federal jurisdiction (like the US, the EU, or Canada) that is looking at adopting (or re-designing) a VAT/GST. Dr. Michael Cheetham’s VLN proposal and the certification of software systems (modeled on SSUTA) under the D-VAT are the leading contenders. These solutions protect against MTIC and MTEC in both intra-Community and extra-Community transactions.

To do nothing is not the answer. For jurisdictions with a VAT modeled on the EU’s – and there are only seven that are not – this is a very real issue. It is far more critical now that the Ndrangheta mafia has found the elegant simplicity of tradable services MTEC to be the ideal way launder money and turn a €400m profit while doing it. If the Ndrangheta can enlist Italy’s largest telecommunications company (Telecom Italia) and its second largest broadband provider (FastWeb) in this effort, then surely others can be persuaded to do the same.

The message for the US is also very clear – do not adopt the EU VAT as a tax reform template without carefully considering these frauds and adopting measure to pre-empt them.

103 Supra note 84.
105 New Zealand, Australia, Singapore, Canada, South Africa, South Korea and Japan are the exceptions.