

# **VAT FRAUD MUTATION, PART 2: CITIBANK AS A TRANSITION**

Boston University School of Law  
Law & Economics Paper No. 16-12

81 Tax Notes International 971

March 14, 2016

**Richard T. Ainsworth**  
Boston University School of Law

This paper can be downloaded without charge at:

<http://www.bu.edu/law/faculty-scholarship/working-paper-series/>

*VAT FRAUD MUTATION, Part 2:  
CITIBank as a Transition*

81 TAX NOTES INTERNATIONAL 971 (March 14, 2016)

Richard T. Ainsowrth

In the first part of this paper we considered a traditional MTIC fraud design (*push* MTIC) in a new MTIC fraud market (CO2 permits). The fraud in the *Dosanjh* case was swiftly put down by HMRC.

It is suspected that the lightning response by the UK authorities in this case is a sign that *Dosanjh*'s fraud needed to be, and was taken very seriously. The traditional design of this fraud did not mean it was a "garden variety" fraud. Sweeping arrests in the early morning hours of August 19, 2009, followed by year-long imprisonment without bail for seven individuals (only ten were involved in the operation of the companies) seems to suggest concern at the highest levels. News reports attribute the UK zero-rate directly to the *Dosanjh* case and reports circulated in 2012 that the decision to zero-rate on August 1, 2009 even brought the Attorney General out of her sickbed to authorize the law change.<sup>1</sup>

With *Dosanjh* out of commission, HMRC must have been concerned both that (a) someone would step in to fill the CO2 supplier's role, and that (b) the "blue chip" companies that had a "taste of the fraud" would be interested in continuing to purchase from fraudsters. Based on the size of its *Dosanjh*-purchases, CITIBank was the natural target for HMRC's follow-up surveillance.

It is suggested that this moment (May through July 2009) was an incubation period for MTIC mutation. Not only do we have buyers actively looking to buy we have sellers actively seeking to fill the vacuum left by *Dosanjh*. A new market is forming. The issue is control. First, who will control this sub-market (the CO2 *fraud* market) of the larger and legitimate CO2 market in the EU? Secondly, how would they control it?

Would we be looking at sellers (like *Dosanjh*) who *pushed* their fraudulent certificates on to willing buyers, or would we be looking at anxious buyers who would *pull* underpriced certificates into their global trading operations to reach performance goals.

---

<sup>1</sup> David Connett, *Carbon Credit Scam would have cost Britain £2bn*, THE INDEPENDENT (June 24, 2012) available at: <http://www.independent.co.uk/news/uk/home-news/carbon-credit-scam-would-have-cost-britain-2bn-7878760.html>

The Attorney General was ill in bed when British customs investigators turned up demanding urgent legal advice on a tax matter. But the matter wouldn't wait and they refused to go away.

Without the Government's senior law officer's immediate legal opinion, they warned, Britain faced being scammed out of £2bn.

Baroness Scotland was roused from her sickbed and confirmed that the trade minister, Stephen Timms, had the power to zero-rate VAT. Within 48 hours, investigators had blocked a loophole in a scheme set up with the laudable aim of combating climate change. Shrewd criminals were exploiting that loophole to rob the Exchequer of up to £1m a week

Would the control be direct and personal as in the *Dosanjh* case, or would it be indirect and economic-based where market forces would be manipulated to direct the CO2 flows.

This paper suggests that it is the later in both regards, and that the *CITIBank* case is transitional from Dosanjh's *push-type* (externally controlled) MTIC fraud, to the first example of a sustained *pull-type* (economically controlled) MTIC fraud in the *Deutsche Bank* case. The *Deutsche Bank* case (which is considered in the third part of this article) cannot be fully understood without grasping this transition.

## (2) *CITIBank* – a transitional case

The second case considered is *CITIBank NA v HMRC*.<sup>2</sup> The *CITIBank* litigation is in the very earliest stages. What we do know about the case is that *CITIBank* was involved in the purchase of CO2 permits from UK sellers in July 2009. Allegedly the sellers were missing traders, or part of fraud chains connected to missing traders. *CITIBank* re-sold these permits on the BlueNext and submitted claims for £9,893,821 in input credits. HMRC has denied the credits.

The details of these allegedly improper purchases of CO2 permits are not clear. *CITIBank* has object to HMRC's Statement of the Case (SOC) and Judge Barbara Mosedale in the First-tier Tribunal (Tax) agrees.<sup>3</sup> There is an appeal underway.

Nevertheless it is clear that HMRC is challenging input deductions associated with CO2 purchases made after July 8, 2009, directly or indirectly from one or more of the following suppliers:

- Bilta (UK) Ltd. (the SOC clearly alleges that input deductions attributable to sales from Bilta should be denied);
- Nathaneal Eurl Ltd. (the SOC clearly alleges that input deductions attributable to sales from Nathaneal Eurl should be denied);
- Westis Limited (the SOC has ambiguous allegation with respect to sales from Westis Limited);
- SVS Securities PLC (there are three pages of discussion in the SOC about a lack of SVS's due diligence, high turnover, and contrived transactions that are all related to fraud, but there is no clear allegation that *CITIBank* purchased tainted CO2 from SVS Securities PLC);
- Skyinformations (the HMRC admits that Skyinformations is not a supplier of CO2 to *CITIBank*, but there are eight paragraphs in the SOC that associate Skyinformations with CO2 fraud);
- Cantor CO2e (which has been bought by BGC Partners LP in 2011, is discussed with respect to input credits, but sales from Cantor CO2e have been denied, and it is not clear if there are alleged purchases by *CITIBank* from Cantor CO2e that are associated with fraud); and

---

<sup>2</sup> [2014] UKFTT 1063 (28 November 2014).

<sup>3</sup> HMRC has failed to allege dishonesty with clarity, and in some instances has not alleged the primary facts relied upon. *Id.*

- KO Brokers (which had been a supplier of CITIBank before July 2009, but which HMRC admits is not a supplier during the July 2009 time frame which comprises the this case).

*EU-ETS.* Without clarity in the allegations, it is difficult to chart out the (allegedly) fraudulent transactions in this case.<sup>4</sup> However, if we step back and examine CITIBank's transaction profile in July 2009 on the EU-ETS we can get a better idea of what it is that has attracted HMRC's attention.

CITIBank is registered on three carbon registries, (UK, France and Germany).<sup>5</sup> The same legal entity is the registrant in each jurisdiction - Citigroup Global Markets Limited (CGML). There are frequent transfers between the UK and French accounts of Citigroup, but there are no significant transfers involving the German registry.<sup>6</sup> Intra-company transfers are not a fraud concern because they are not taxable events. Assets are not being sold; they are just being moved among accounts of the same legal entity.

In the month of July 2009 CITIBank's intra-entity transfers are clearly identified in the EU-ETS, as are its external purchases and sales. Activity involves CGML (UK registry account) and CGML1 (French registry account). The German registry is not involved in July 2009 at all. The UK registry records purchases largely from UK sources of 7,580,001 CO2 permits. In fact, 6,277,923 CO2 permits are purchased from a single UK source, SVS Securities PLC. A small portion of these CO2 permits (1,425,000) is re-sold to UK entities. 77.30% are re-sold in intra-community transactions. 22.70% are re-sold to UK entities.

The largest number of these CO2 permits is transferred from CGML (UK) to CGML1 (FR). The transfer occurs in seven bundles. The entire CGML-to-CGML1 allotment of 3,840,000 CO2 permits is quickly re-sold on the BlueNext exchange (BlueNext Détention). Another smaller batch is sold to BNP Paribas (FR), and an even smaller allotment of 65,000 is sold to the Danish company STX Services. These are the critical cross-border transactions.

---

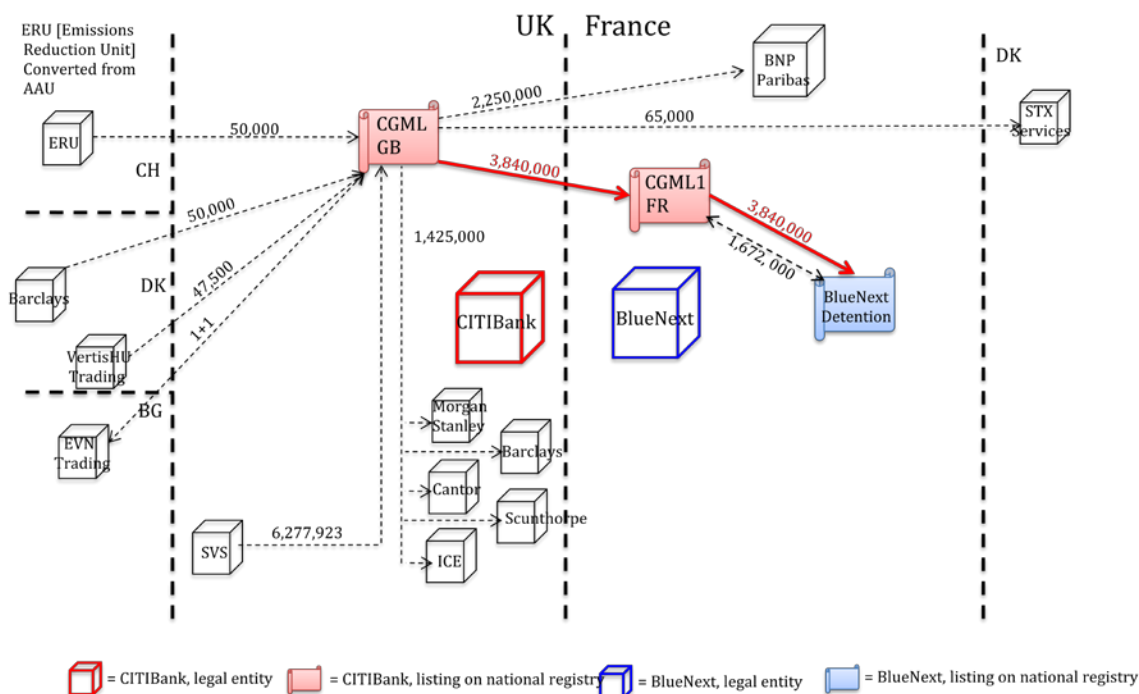
<sup>4</sup> Three levels of judicial review have occurred so far: (1) internal review at HMRC (after an assessment dates August 27, 2013); (2) Judge Barbara Mosedale at the First-tier Tribunal (argued November 3, 2014); (3) Judge Christopher Nugee at the Upper Appeal court in London (argued December 7 & 8 2015). See: Mike Szabo & Rebecca Hampson, *EXCLUSIVE: Citibank, UK taxman in legal spat over £10m bill linked to EU carbon market fraud*, CARBON-PULSE (December 7, 2015) available at: <http://carbon-pulse.com/13009/>; Rebecca Hampson, *HMRC allegations in £10m carbon tax fraud case "embarrassing", says Citibank lawyer*, CARBON-PULSE (December 9, 2015) available at: <http://carbon-pulse.com/13078/>; Kristina Reynolds, *HMRC Dishonesty Allegation "seriously flawed," RPC TAX TAKE* (January 14, 2015) available at: [http://www.rpc.co.uk/index.php?option=com\\_easyblog&view=entry&id=1354&Itemid=129](http://www.rpc.co.uk/index.php?option=com_easyblog&view=entry&id=1354&Itemid=129).

<sup>5</sup> The German registry seems to have been largely inactive. In the period between January 3, 2008 and April 30, 2012 only one transaction for one AAU is recorded. That transaction was between the German and the UK registries, and occurred on May 6, 2009. It appear that the transaction was a "test" as the same AAU went from the UK to the German account and then back from the German to the UK account the same day.

<sup>6</sup> Each registration lists the registrant as Citigroup Global Markets Limited, Citigroup Centre, Canada Square, Canary Warf E14 5LB, London, United Kingdom.

CITIBank will zero-rate the sales and take a full deduction for the UK VAT paid.<sup>7</sup> The transaction with the BlueNext is broken into 99 separate bundles.<sup>8</sup> See figure 5 below.

Figure 5  
 CITIBank (Citigroup Global Marketing Limited) purchase through CGML (GB),  
 Transfer to CGML1 (FR), and resale of CO2 permits to the BlueNext  
 July 2009 transactions (only) per EU-ETS records



This figure, and these details from the EU-ETS do not explain why HMRC was interested in CITIBank’s July 2009 trades in carbon permits. What else did HMRC know about CITIBank that made it suspect fraud? What did HMRC see in CITIBank’s July 2009 purchases and sales that made it suspect fraud?

First of all, HMRC knew that in the *Dosanjh* case CITIBank purchased more CO2 permits (1,853,000) during *Dosanjh*’s 69 days of fraud than the combined purchases of all the other major financial institutions (Royal Bank of Scotland, BNP Paribas, Morgan Stanley and Deutsche Bank). CITIBank was certainly on notice that it was involved in CO2 MTIC fraud through the *Dosanjh* litigation, if not through print and personal contact with HMRC.

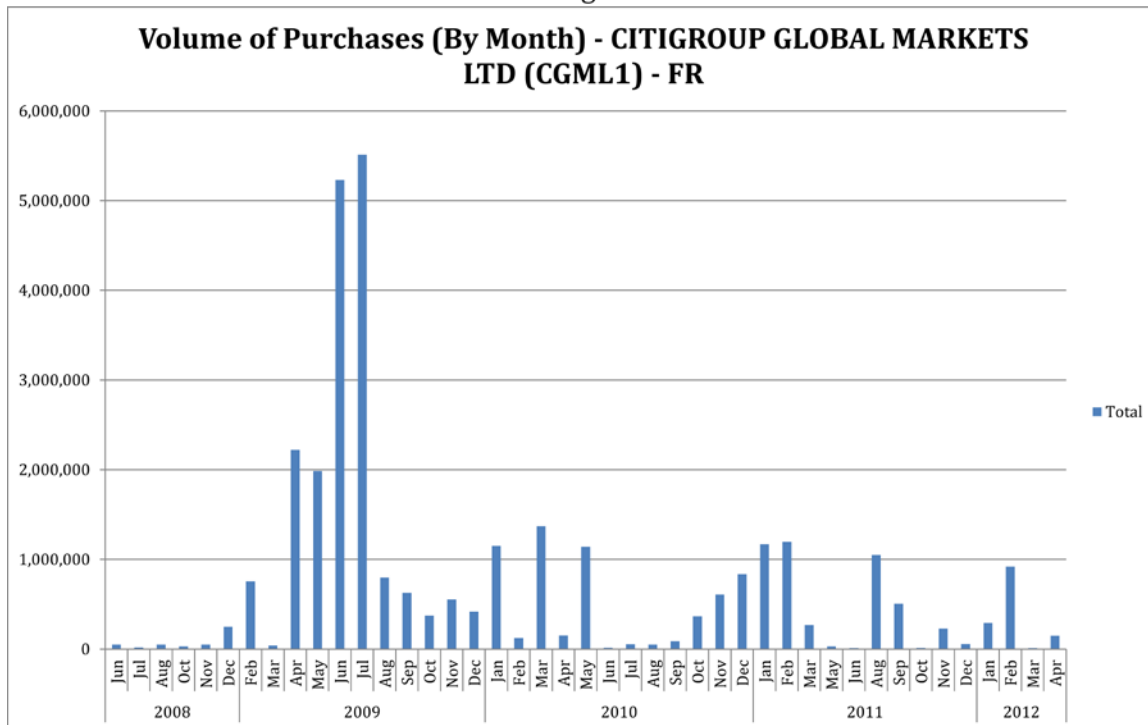
<sup>7</sup> Two other intra-community supplies are made in July 2009 by CITIBank through the CGML-GB registry. There is a sale of 2,250,000 AAU’s to the French bank BNP Paribas, and a small deal involving 65,000 AAU’s consummated with the Danish firm STX Services B.V.

<sup>8</sup> There is a curious round-trip transaction involving 1,672,000 CO2 permits that go from BlueNext Détection to CGML1 and then sold right back to BlueNext Détection during July 2009 also.

Secondly, if HMRC displayed the CITIBank data graphically it would see (in figure 6 for purchases and figure 7 for sales, both below), that there is a huge spike in CO2 activity in June and July 2009. These months are times of great ambiguity in the CO2 market. The French and Dutch VAT laws have just changed to prevent CO2 MTIC, and rumors abound that the UK will soon follow suit. When the UK VAT law does change on August 1, 2009 CITIBank's activity drops dramatically (suggesting that the previous market was artificial).

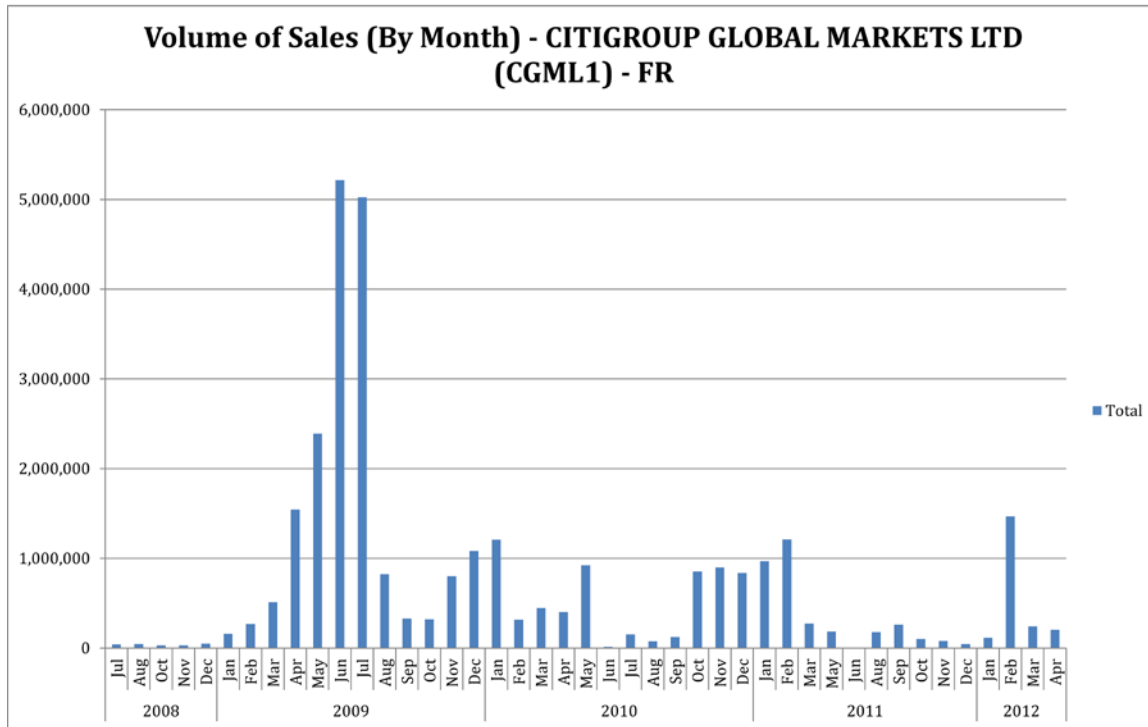
Nothing in the EU-ETS indicates why July was selected, as opposed to both June and July. There could be something in HMRC's strategic MTIC fraud case development that encourages the omission of the June data.<sup>9</sup>

Figure 6:



<sup>9</sup> The 5,059,369 CO2 permits that SVS sold to CITIBank was split between the UK registry (1,659,369) and the French registry (3,400,000). Deutsche Bank, in contrast, purchased a very modest 540,000 permits from SVS in July 2009.

Figure 7:



The third reason HMRC may have suspected that CITIBank was engaged in fraud may be that during the month of July 2009 a full 97.70% of the CO2 permits CITIBank resold came from SVS Securities PLC. In July, CITIBank was the second largest purchaser of CO2 permits from SVS. It purchased 14.87% of all permits sold by SVS that month. The number one purchaser in July 2009 was Deutsche Bank AG, London Branch, which purchased 23,546,627 permits or 55.78% of SVS’s July sales. If SVS were suspected of being a replacement for KO Brokers then HMRC may have had suspicions that CITIBank’s July sales were fraudulent.

Thus, in both the *CITIBank* case and in HMRC’s Deutsche Bank investigation HMRC may be simply following up on *Dosanjh*, by looking closely at the financial institutions that bought from KO Brokers to see if they continued to be involved in MTIC. If so, we may be looking at the moment when the *push-type* MTIC frauds (*Dosanjh*) begin to mutate into *pull-type* MTIC frauds (*Deutsche Bank*). If employees are found within financial institutions actively seeking replacement suppliers for *Dosanjh*’s KO Brokers, then we may be at the turning point. That question is not answered (yet).<sup>10</sup>

<sup>10</sup> Judge Barbara Mosedale observed ([2014] UKFTT 1063 (28 November 2014)) at ¶78:

At the hearing I understood that HMRC’s position is that at the moment they cannot be sure which individuals at Citibank knew what. Mr Kinnear considered that there might be (at least) one individual acting as an agent of the appellant whose state of knowledge amounted to ‘actual knowledge’ of connection to fraud and that therefore that knowledge should be imputed to Citibank; he accepted that it might be the case that, without any one individual having actual knowledge, different things were known by different people within Citibank, which, if such knowledge was considered in its totality, amounted to constructive knowledge

*CITIBank Conclusion.* It is difficult to provide a full assessment of the *CITIBank* case at this stage in the litigation. We have very few court-certified facts. HMRC alleges that CITIBank was engaged in CO2 MTIC fraud in the month of July 2009. We do not know if *CITIBank* represents a *push-type MTIC fraud* (where SVS is the active party *pushing* tainted CO2 into CITIBank), or if it is a *pull-type MTIC fraud* (where agents/employees within the bank are actively seeking to *pull* tainted CO2 permits into CITIBank to facilitate refunds at export).

Judge Barbara Mosedale in the First-Tier Tribunal (November 3, 2014) held that the government's case was not sufficiently particularized, and that a better Statement of the Case was needed. On December 7<sup>th</sup> and 8<sup>th</sup> 2015, the Upper Appeal Court Judge Christopher Nugee heard further arguments alleging errors in law. A written decision is expected.

---

by Citibank of connection to fraud, even if actual knowledge was not possessed by any single individual.