



VAT FRAUD IN AFRICA

AN INTRODUCTION

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OECD Africa Tax & Financial Crime Academy

VAT/GST Fraud Specialty programme 2023

SCOPE OF COVERAGE

Basics

- Relevance
- Basics of the VAT System

Fraud

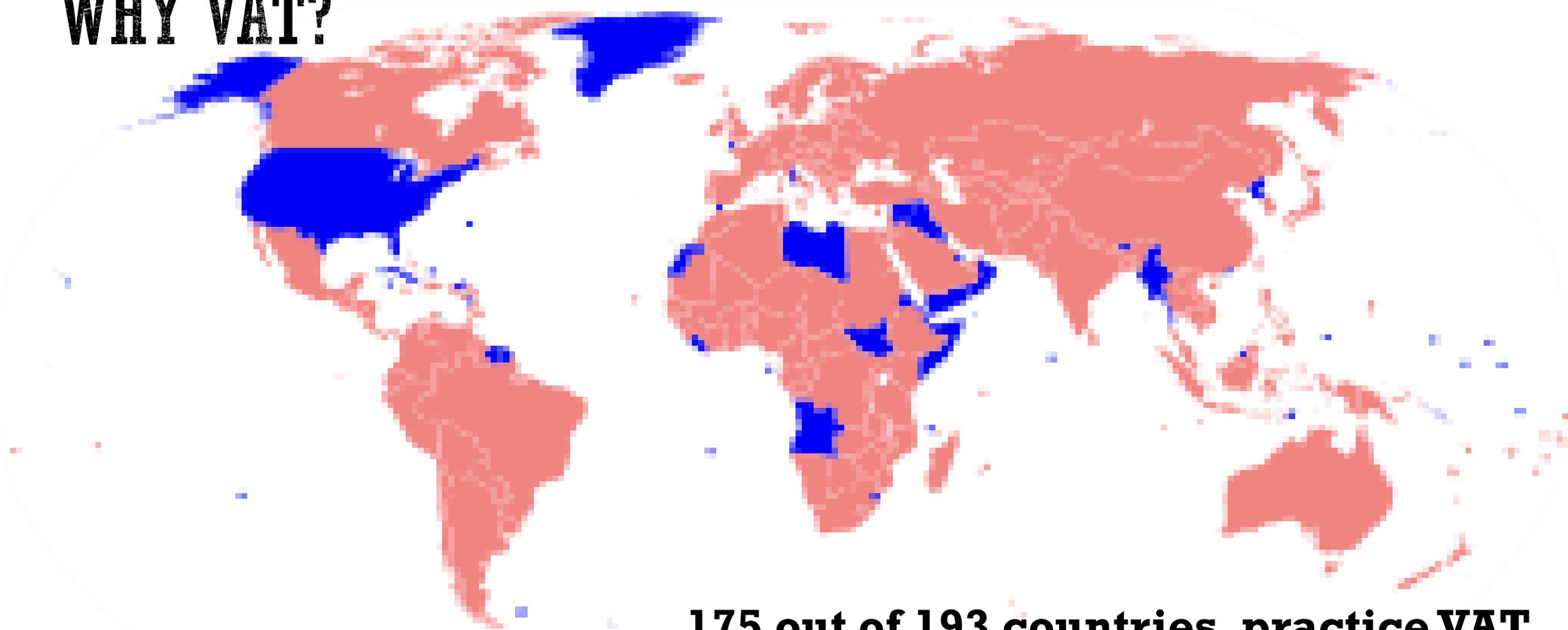
- Reasons for VAT Fraud
- Typologies / manifestations of VAT fraud

Case

- Case files
- Transactions prone to MT Fraud



WHY VAT?

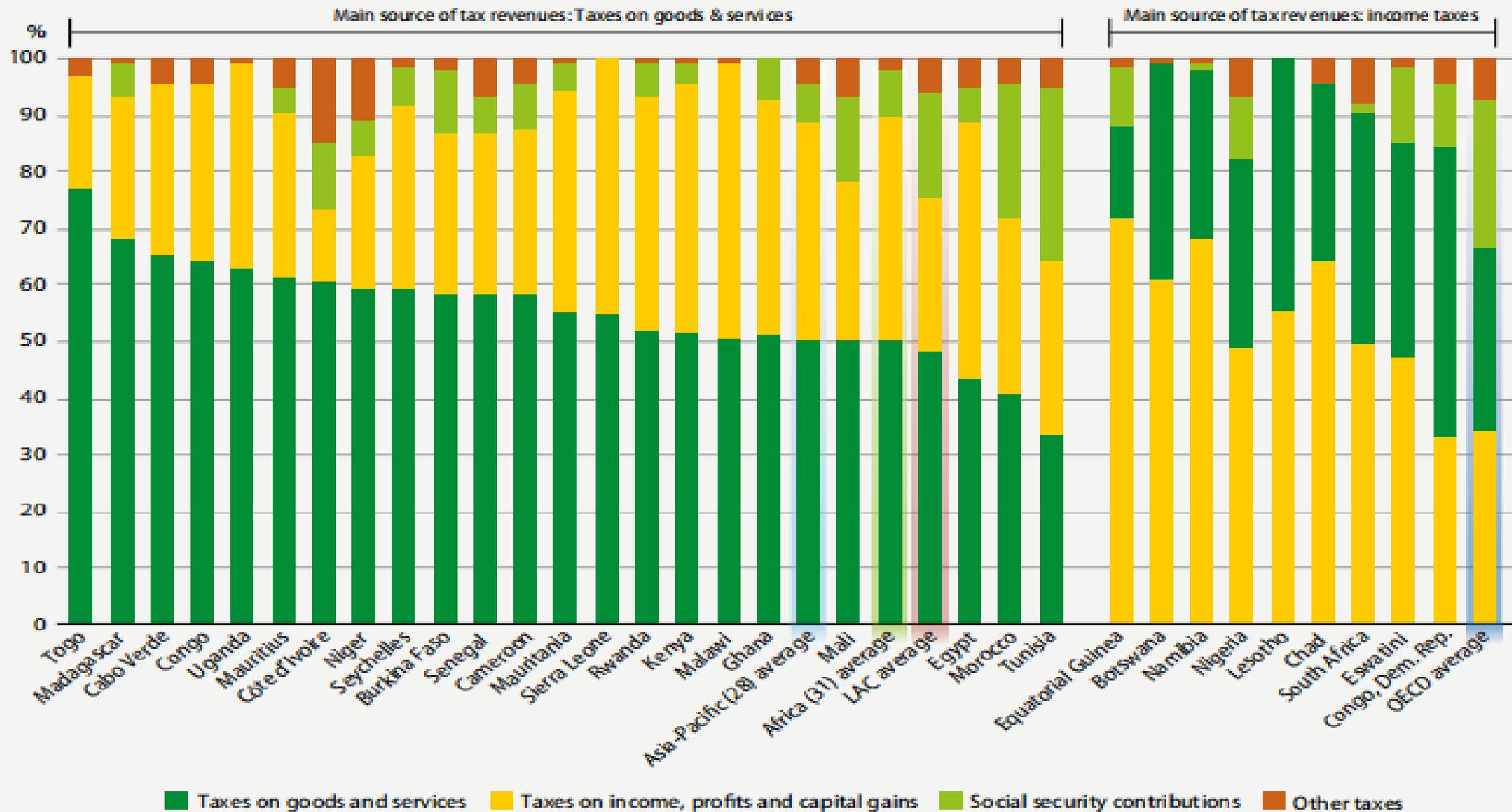


... 175 out of 193 countries practice VAT
... 45 out of 54 African countries with VAT

... VAT raises about a fifth of total tax revenues worldwide



Figure 3. Tax structures (% of total tax revenue), 2020



Source: OECD/ATAF/AUC (2022), Revenue Statistics in Africa 2022, oe.cd/revstatsafrica.



Figure 1. Tax structure in 2020 in Africa (31), Asia-Pacific, LAC and the OECD

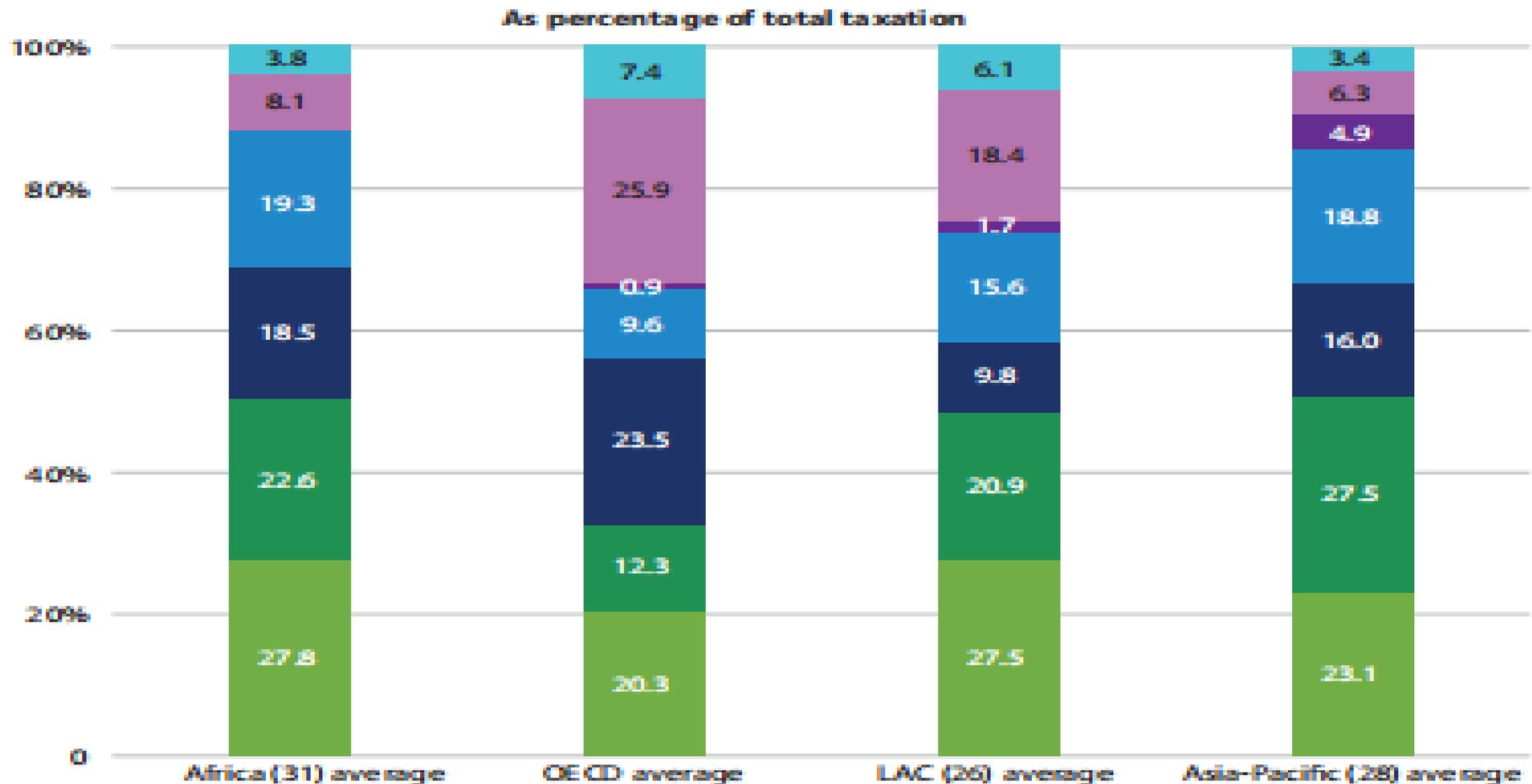
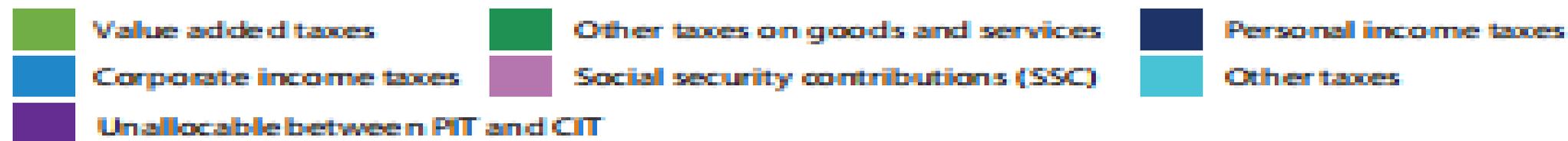
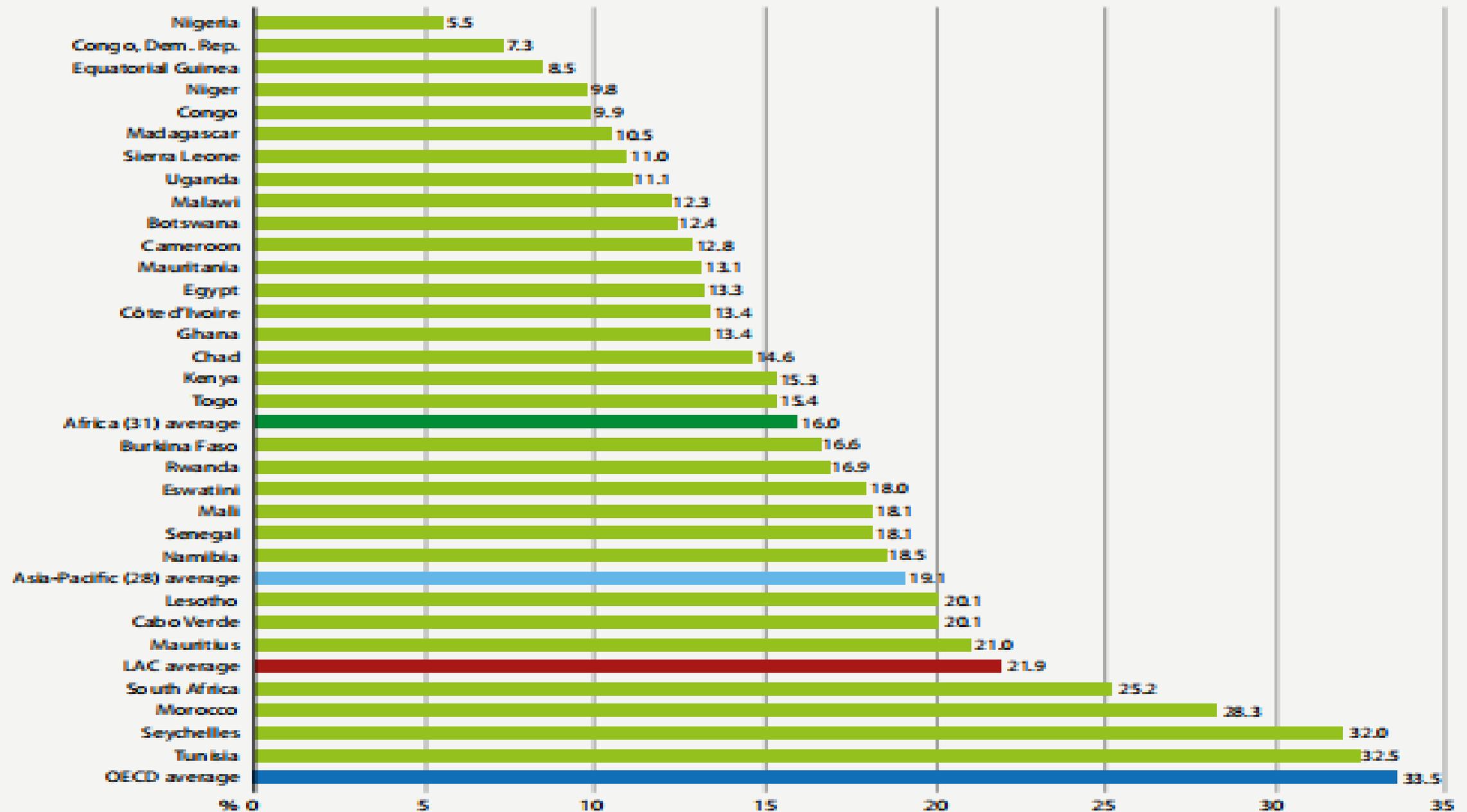
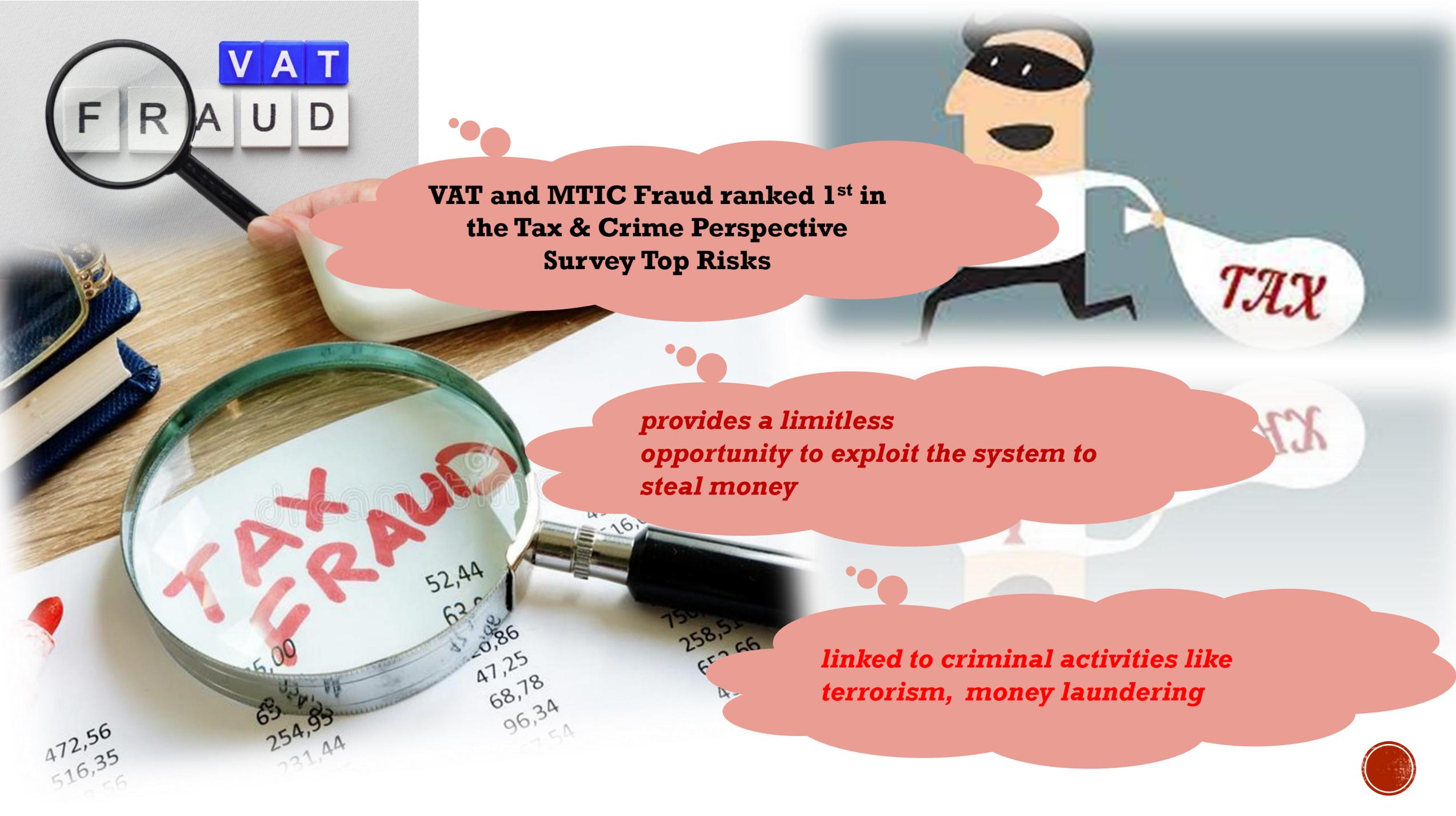


Figure 1. Tax-to-GDP ratios (total tax revenues as % of GDP), 2020



Source: OECD/ATAF/AUIC (2022), Revenue Statistics in Africa 2022, oe.cd/revestsafrica.





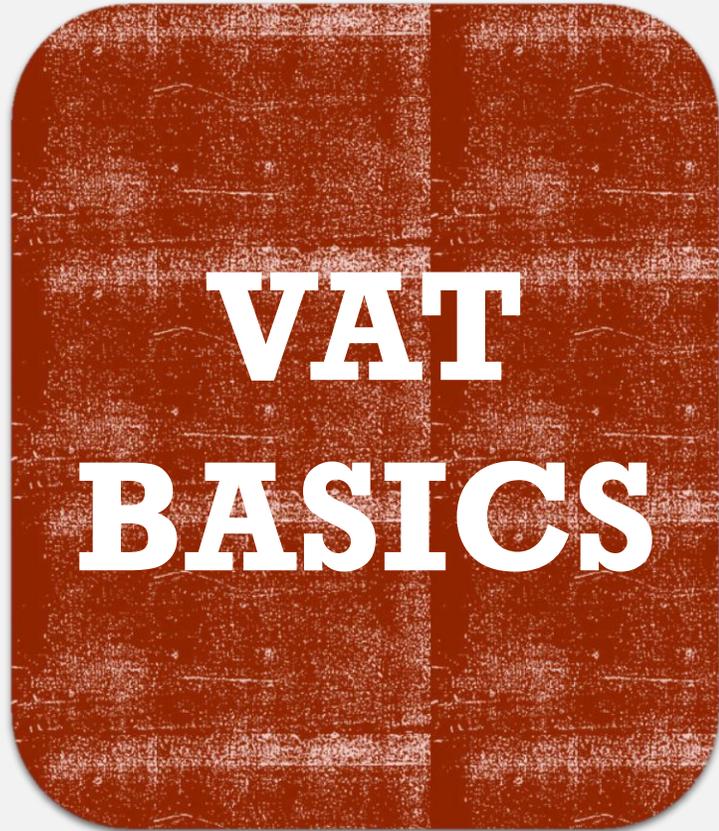
**VAT and MTIC Fraud ranked 1st in
the Tax & Crime Perspective
Survey Top Risks**

*provides a limitless
opportunity to exploit the system to
steal money*

*linked to criminal activities like
terrorism, money laundering*



VALUE ADDED TAX



- Tax on all commercial activities (subject to exceptions)
- Charged on the supply of goods and services
- Registered businesses are able to credit the VAT charged on their purchases (“input VAT”) against the VAT due on their sales (“output VAT”)
- Borne by final consumer. Remitted by registered suppliers.
- Exports are zero-rated



Timber dealer



Carpenter



Furniture Store



**VAT
BASICS**



Forest Farmer



Final Consumer



Timber dealer



INVOICE

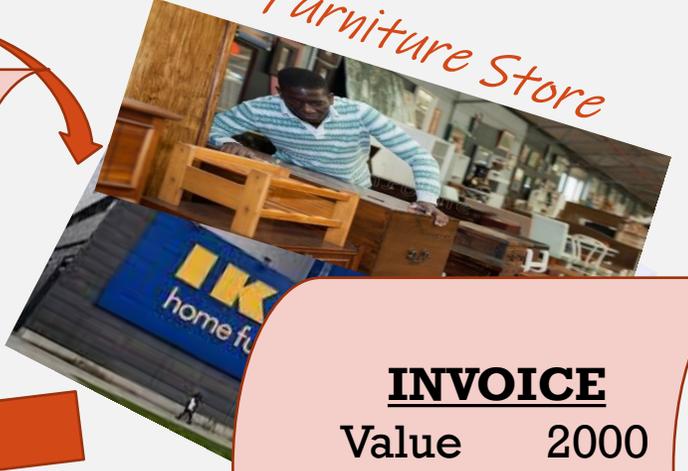
Value	1000
16% VAT	160
<u>Price</u>	<u>1160</u>



Carpenter

INVOICE

Value	1500
16% VAT	240
<u>Price</u>	<u>1740</u>



Furniture Store

INVOICE

Value	2000
16% VAT	320
<u>Price</u>	<u>2320</u>



INVOICE

Value	500
16% VAT	80
<u>Price</u>	<u>580</u>

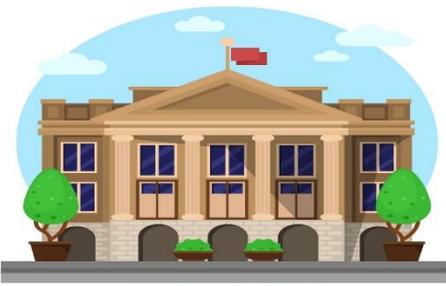
Remits
Shs.(160-80)=80

Remits
Shs.(240-160)=80

Remits Shs. 80

Remits
Shs.(320-240)=80

Forest Farmer



TAX OFFICE

Pay 2320
Tax
Shs.320



Final Consumer



BREAK-OUT SESSIONS

What makes the VAT system open / susceptible / prone to fraud?

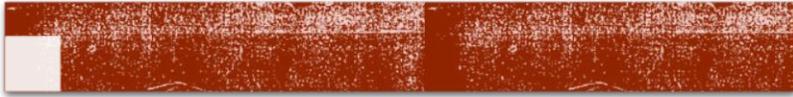
- Groups 1 & 2
- Groups 3 & 4

How does fraud present itself in VAT operations?



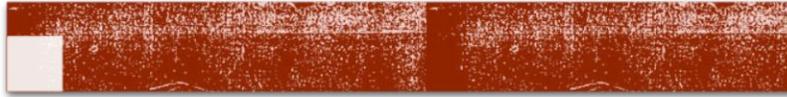
VULNERABILITIES OF THE VAT SYSTEM

Structural Factors



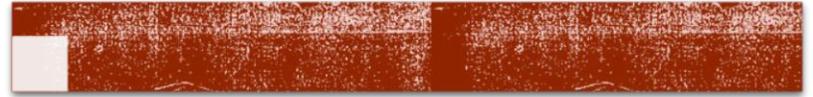
- Cash flow
- Competition
- Cost
- Profit maximization
- Cash economy
- Informal sector

Regulatory factors



- Weak laws
- Complex rules
- Weak enforcement measures
- Manual processes
- Self assessment
- Input-output system

Opportunistic factors



- Collusion and corruption
- Refund opportunity



TYPOLOGIES OF VAT FRAUD

Registration

- Failure to Register
- Threshold avoidance
- Identity theft

Reporting

- Misclassification of commodities
- Non-declaration / misclassification of imported goods – wrong tariff
- Under-reported sales
 - 2 sets of books
 - sales suppression
- Over-stated inputs
 - duplicate claims, - false claims

Payment / Refund

- Failure to file / pay
- Fraudulent refund claims



MANIFESTATIONS

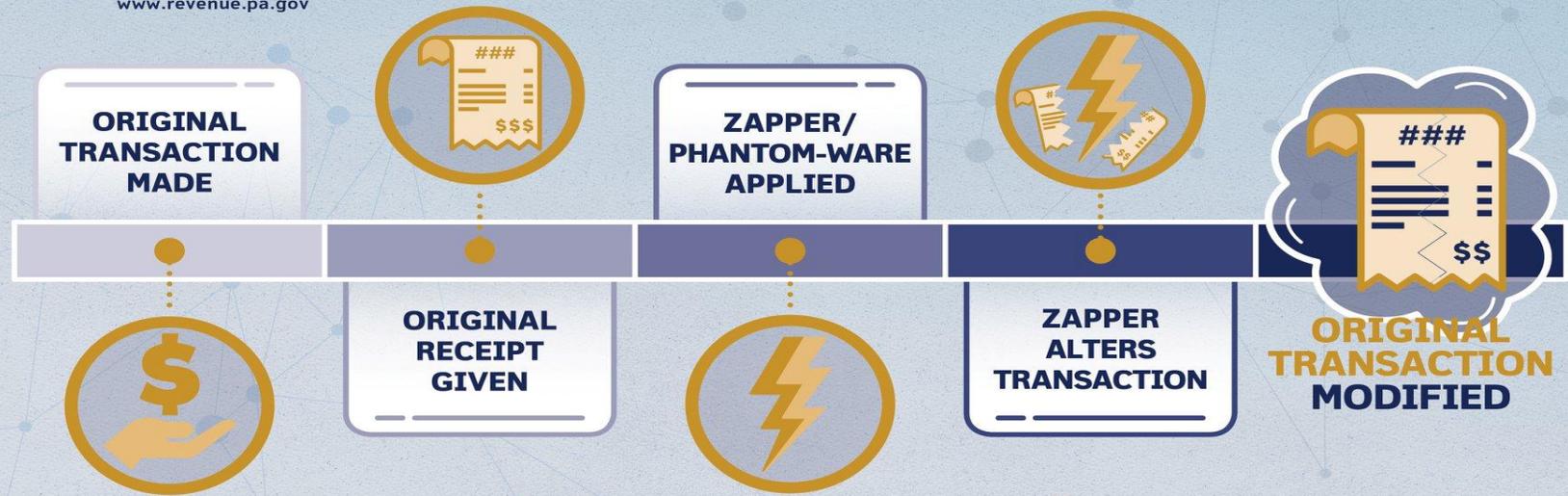


ELECTRONIC SALES SUPPRESSION:
A THREAT TO TAX REVENUES



Electronic Sales Suppression

a helpful timeline showing what happens from start to finish



Electronic sales suppression occurs when illegal software — known as zappers or phantom-ware — is used to falsify point of sale records.

The practice is widespread throughout the world and in Pennsylvania it annually results in millions of dollars in lost tax revenue.

ESS is a high-tech twist on removing cash from the till. It allows people to steal from unsuspecting consumers and creates a competitive disadvantage for honest business owners who follow the law.

A taxpayer may report only a proportion of sales, falsifying records and accounts to match, or may make some sales ‘off the books’ entirely.

Use of zappers and phantom-ware - illegal software used to falsify point of sale records.



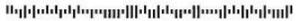
MANIFESTATIONS



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WEBSITEBACKUP COMPANY 0900
2375 E. CAMELBACK RD, SUITE 600
PHOENIX, AZ 85016



DATE	03/16/2015
ACCOUNT NUMBER	
COMPANY NAME	
AMOUNT	\$70.00

CUSTOMER SERVICE CONTACT

Monday - Thursday 8:00AM - 6:00PM PST
Friday 8:00AM - 4:00PM PST

(866) 273-7934 websitebackup.com

info@websitebackup.com

ACCOUNT SUMMARY

ITEM	PRODUCT DESCRIPTION	AMOUNT
001	Website Backup Service Plan - WebsiteBackup Pro Annual Charge	\$70.00
	- Incremental Backup (monthly) Included	\$0.00
	- Domain Name(s)	
	- Host Web Server (active)	
	- WWW Forwarding (active)	
	- Domain Masking (n/a)	
002	Max No. Web Pages (100) Included	\$0.00
003	Data Storage (2 GB) Included	\$0.00
	TOTAL	\$70.00

THANK YOU. WE APPRECIATE YOUR BUSINESS

FOLD & TEAR HERE PLEASE DETACH THE BOTTOM PORTION AND RETURN USING ENCLOSED ENVELOPE FOLD & TEAR HERE



REMIT TO:
WEBSITEBACKUP COMPANY 0900
2375 E. CAMELBACK RD, SUITE 600
PHOENIX, AZ 85016



DATE	03/16/2015
ACCOUNT NUMBER	
AMOUNT	\$70.00
AMOUNT ENCLOSED	\$

PAY BY CHECK OR MONEY ORDER ONLY.
Make payable to WEBSITEBACKUP COMPANY and include your account number on it. All checks will be deposited upon receipt.
DO NOT SEND CASH OR POST-DATED CHECKS.



Use of fictitious invoices:

Taxpayers will use non-existent purchases or inflate actual purchases for purposes of inflating their input credit.

In some other cases, taxpayers will claim using non-existent or exempt imports.

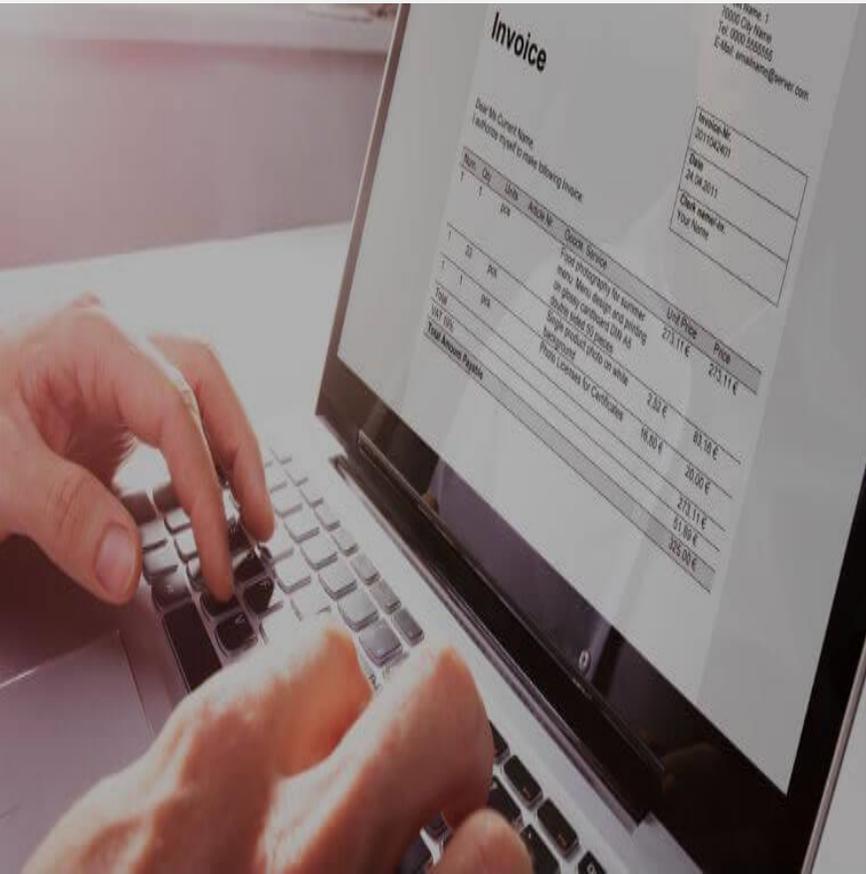
Taxpayers may introduce non-existent zero-rated sales to claim for refunds.



ATTENTION: Please check this box if the above address is incorrect or your billing address has changed. Indicate change(s) on reverse side.

HQZ-888 Page 1 of 2

MANIFESTATIONS



Registered Taxpayer
Ceiling Ltd - Seller

Makes a genuine sale to
James plus 18% VAT

Final Consumer
James - Buyer

Ceiling issues invoices of above sales to
Bill Ltd and Trust Ltd

Fraudulent
taxpayer
Trust Ltd

Ceiling declares
Output VAT
Bill and Trust
Claim input VAT

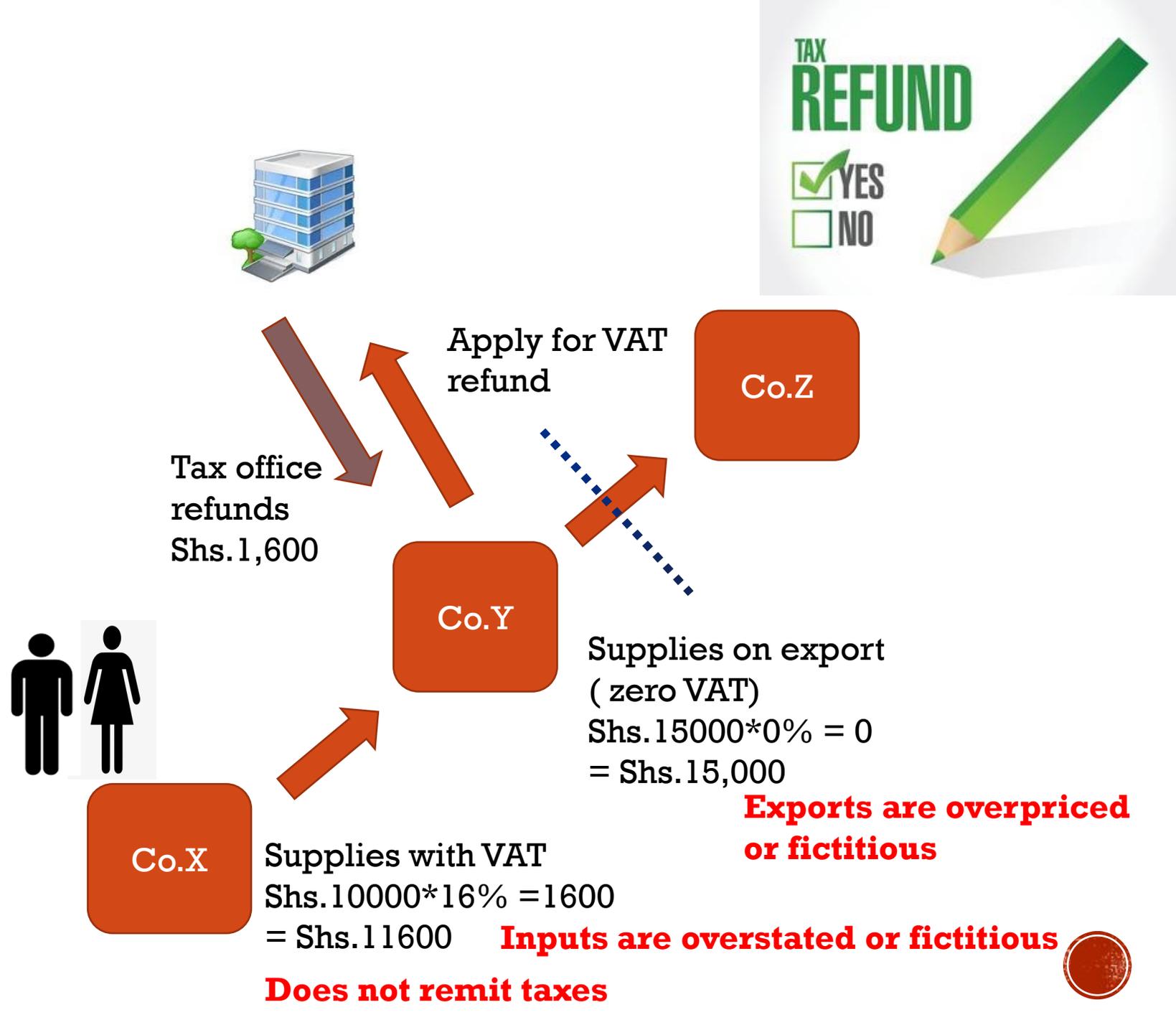
Fraudulent
taxpayer – Bill
Ltd

Invoice trading:

Bogus traders set up solely to generate invoices that allow recovery of VAT. Such “invoice mills” exploit the practical impossibility of crosschecking every invoice against evidence that earlier tax has been paid.



MANIFESTATIONS



MANIFESTATIONS



Defaulter

- Missing trader
- Acquirer
- Hijack trader
- Registers for VAT
- Fails to remit tax

Buffer

- Conceals trail
- Pays marginal tax

Beneficiary

- Also **Broker**
- Exports goods
- Claims refund
- Benefits from increased input tax credit



Missing Trader:

Fraudster registers for VAT, then purchases goods VAT-free overseas, then sells at VAT-inclusive prices domestically

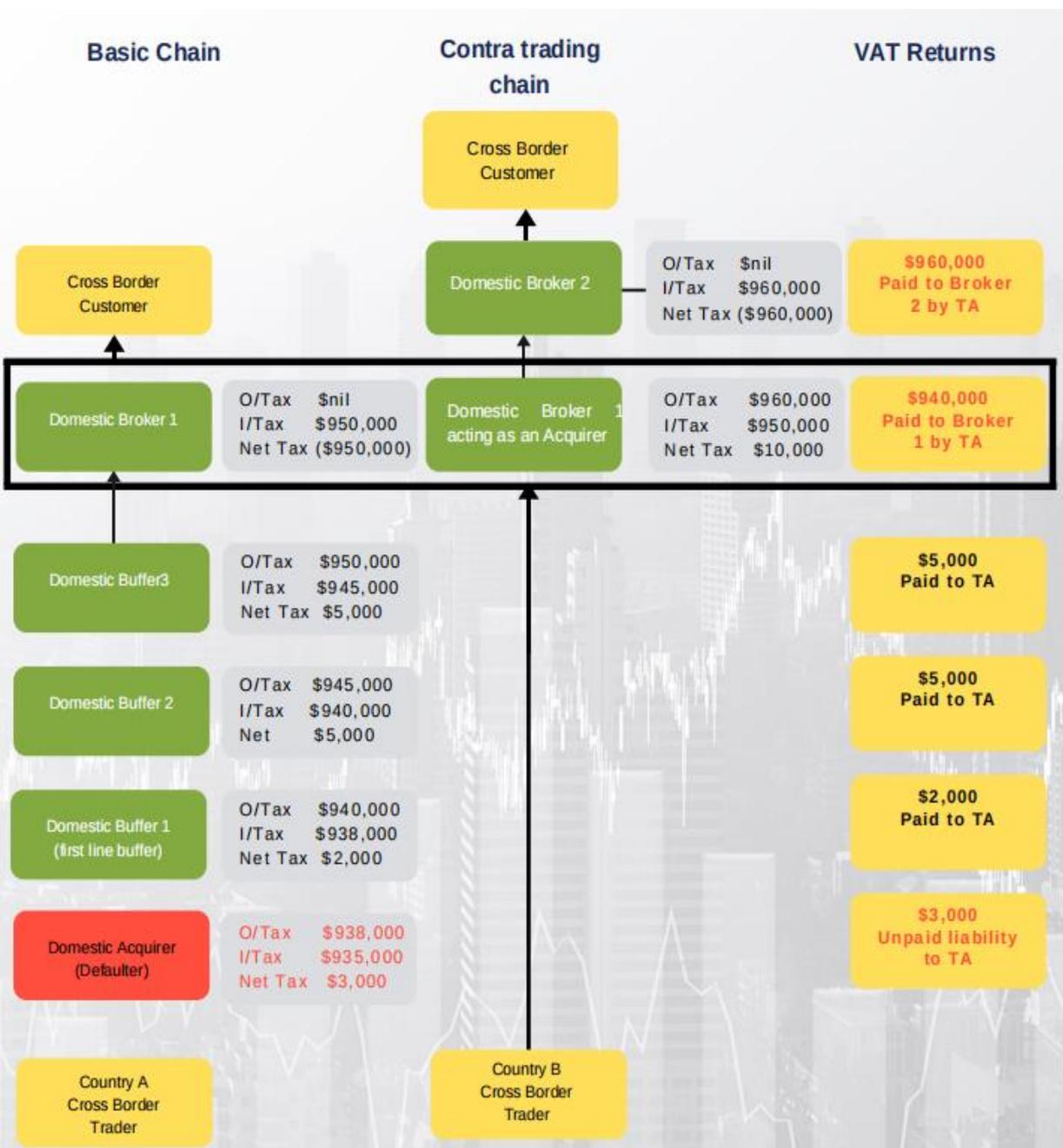
He later ceases operation and disappears without paying VAT due.

Beneficiary claims input tax passed on from missing trader (with buffers in between).

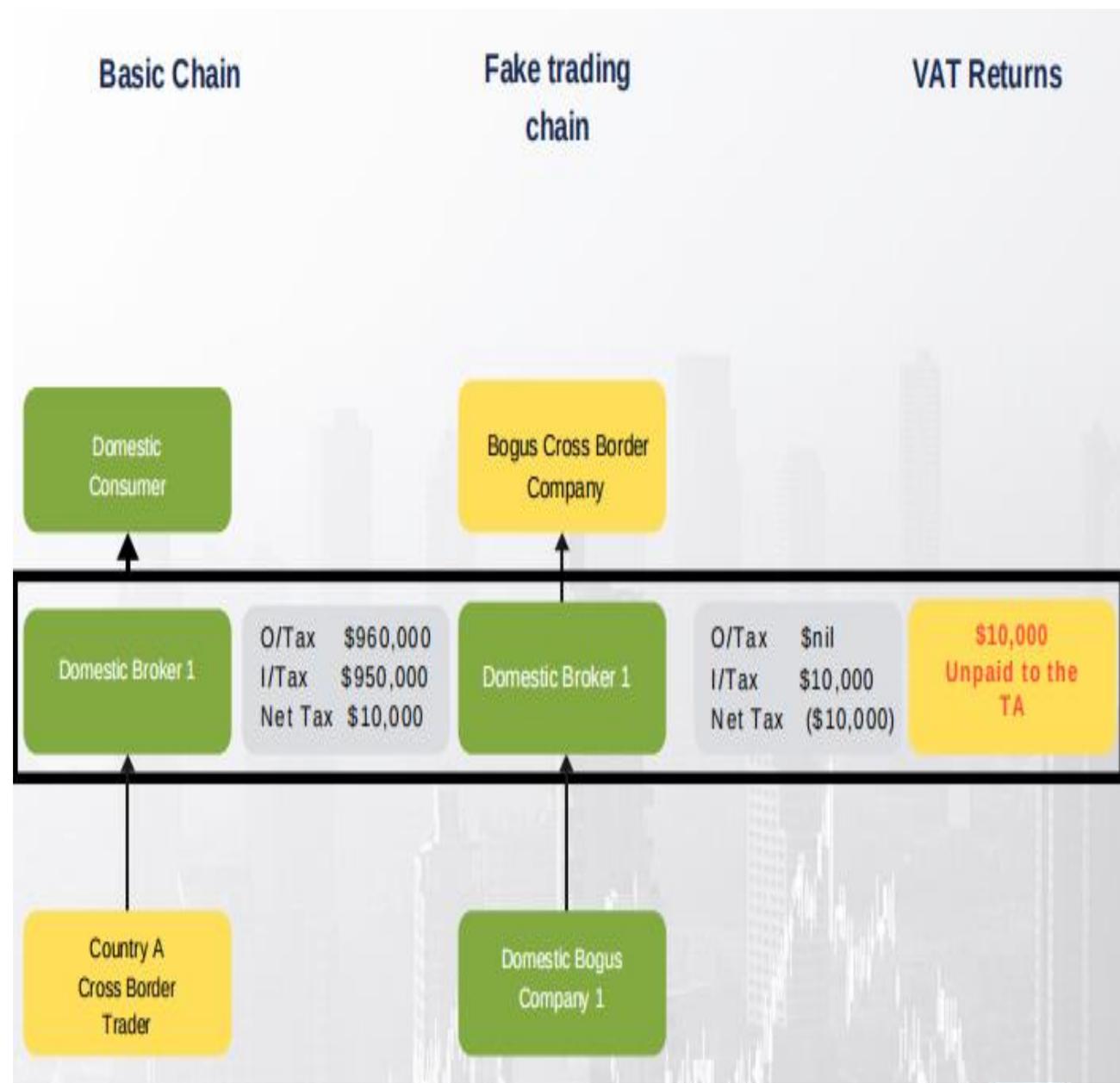
This scheme appears to delink and hide the final economic beneficiary of the purchases.



CONTRA TRADING



CROSS INVOICING



Source: ATAF VAT Technical Note on Missing Trader Fraud

MANIFESTATIONS



Defaulter

- Missing trader
- Acquirer
- Hijack trader
- Fails to remit tax

Buffer

- Conceals trail
- Pays marginal tax

Beneficiary

- Also **Broker**
- Exports goods
- Claims refund
- Benefits from increased input tax credit



Missing Trader:

The “missing trader” in the **Kenyan case** is one who in the business chain does not supply any goods or services but “payment” is made to create notional cost of goods sold.



This scheme appears to delink and hide the final economic beneficiary of the purchases.



THE SCHEME: KENYAN PRACTICE

The Beneficiaries transfer the total value of the “fake” supply to the Accounts held by the Missing Traders

- Import Undervaluation
- Kick-Backs & Corruption
- Non-Registered Taxpayers
- Profit Suppressors

1. Beneficiaries



Forex Bureaus either transfer money to the undeclared local bank accounts (for tax purposes) belonging to the beneficiary OR transfer to foreign accounts for imports

Manufactures and supply “fake” Invoices and ETR receipts for agreed value to be inflated



Beneficiaries Prepare Payments and Claim the value of the “fake” invoice as part of goods sold

2. “The Missing Trader”

The Missing trader, Through the individual with POA withdraws 100% cash received from the beneficiaries at once



- Account Opening Documents
- Huge bank Transfers
- Transactions in Cash
- Accounts under POA

3. Bank



The Missing trader, Through the individual with POA deposits 90%-95% into the account held by the beneficiary and retains 10%-5% as commission

- Holds Accounts for Beneficiaries
- Allows Huge Cash Deposits
- Used to transfer Cash to oversee Accounts
- Used to pay for Import Goods

4. Forex Bureau



CLASS DISCUSSION

Let's share some VAT fraud stories from the case files



CASE LAW

COMMISSIONER OF DOMESTIC SERVICES VS. GALAXY TOOLS LIMITED [2021]



- 17. The appellant had contended before the Tribunal that it had carried out investigations on the suspect suppliers and found out that; **they were curiously supplying to the respondent only (that the respondent was their only client), their PIN's were registered at the same time, they did not have a place of business nor were they registered to trade or import the goods they were allegedly supplying the respondent, they did not have any physical address and above all, all the payments were suspiciously made in cash.**
- 18. Further, **the appellant questioned the authenticity of the documents relied on by the respondent by querying what invoices related to what products, delivery notes did not specify the drivers who made the deliveries, the vehicles used for delivery and even the destination or place of delivery.** It is for that reason that the appellant asked for additional information from the respondent to justify the alleged transactions but none was availed.
- 30. The appellant had demonstrated that there was loss of VAT in the subject transactions. **There having been no supply of any goods, the respondent cannot be said to have been innocent in the transactions.** As a reasonable businessman, it was expected of it to keep all the transactional details of the subject transactions. It is only then it would have satisfied the appellant and the Court that it was innocent in the fraud perpetrated by the missing traders whom the appellant had concluded **were in the business of selling air and invoices to colluding traders.**



CASE STUDY 1



Nigeria:

Sales suppression fraud

- MC Kenechy Industries Ltd (MKIL) was found to have directed its sales executives to get their customers who make large purchase of goods in excess of **N50,000,000.00** conduct *electronic transfer to their suppliers' bank account and to record such sales manually in a separate book* maintained by Mr. Lukas, the managing director.
- MKIL had also directed those sales below **N50,000,000.00** be done electronically and all sales records kept in compliance with not only the Tax provisions but also the Tax Authorities' guidelines.
- It was also revealed that Mr. Lukas' personal bank account was used to receive several sales proceeds for which accruing VAT of over **N1,350,000,000.00** was unremitted and the sales records were completely omitted.
- The company and its Managing Director successfully carried out this fraudulent practice for a 14 months period which led to the monumental VAT fraud of **N7,500,000,000.00** (**\$8,300,000.00 equivalent**) recorded.



CASE STUDY 2



South Africa:

- **Manipulation of supply chain in the second-hand gold industry**
- The fraudulent scheme is premised on vendors introducing illicit gold (which does not carry VAT) into the supply chain and unlawfully claiming VAT refunds using fabricated documents.
- The illicit gold is believed to originate mainly from illegally melted Krugerrands, illegally mined gold (so-called “zama-zama” gold), and illegally imported gold.
- Fictitious businesses (shell companies) are registered for VAT and required documentation (eg, tax invoices) are fabricated. This is done to enable the purchasing vendor to claim actual (not notional) input tax deductions in respect of VAT at 15% supposedly charged by a fictitious supplier. Typically, the VAT reflected on the false documentation is never paid over to SARS.



CASE STUDY 3



Kenya:

■ Withholding VAT Refund Fraud

- Mecca Engineers made several refund claims arising from Withholding VAT. The refund claims would be supported by inflated withholding VAT certificates from an existing client. The company took advantage of the manual filing system where returns from the Withholding VAT agents (VAT32A) were not being reconciled with the suppliers Withholding VAT claims on the returns. This happened over a period of time and taxes were lost.
- Upon discovery of the scheme, and introduction of iTax system that mitigated the problem, taxpayer re-emerged with a different scheme.
- Mecca Fund, a government parastatal, supplied mechanical engineering services to various government bodies (withholding VAT agents). Tax withheld from Mecca Fund would however be credited to Mecca Engineers. The company would then enjoy the credits and even claim tax refunds on the basis of these withholding VAT. Mecca Fund was not keen to claim its credit.

CASE STUDY 4



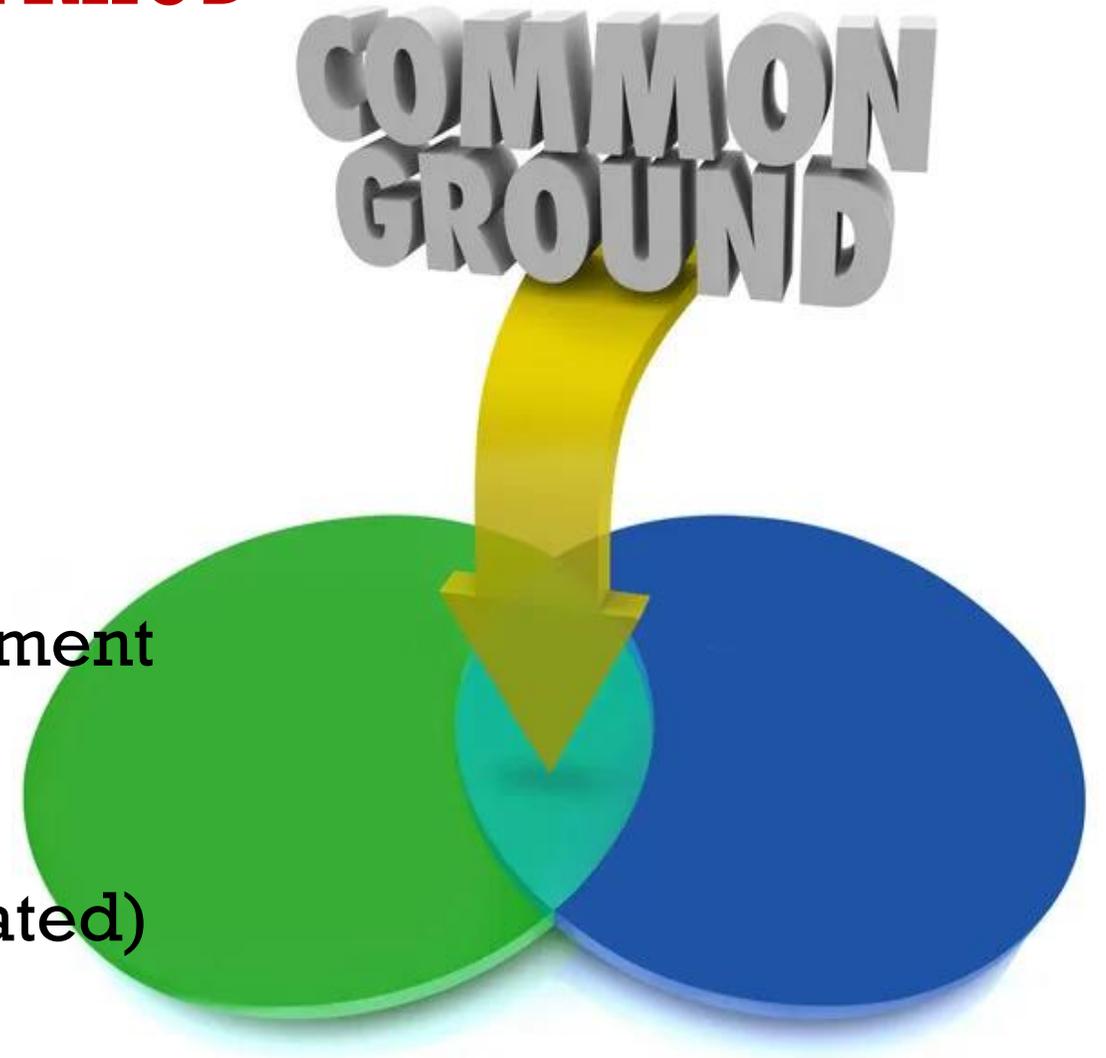
Kenya:

- **iTax account hacking – siphoning of sales from unregistered customers to registered customers category**
- Jayla Construction Ltd alleges unauthorized access into their iTax profiles, amendment of VAT returns, nor did they receive notification of amendment. Could not log into iTax profile due to incorrect password.
- Analysis of system logs showed change of email address on 25th and 28th Nov 2022 (new address closely relates to old address) taxpayers. Taxpayers original return filed on 16/11/2022 and amended on 26/11/2022.
- Return analysis showed
 - Sales for unregistered customers reduced from Kes.21,309,355/- to Kes.6,343,257/-.
 - Sales for registered customers increased from Kes.11,153,366/- to Kes.26,124,537/- (achieved by adding 103 entries in favor of GL Construction Ltd worth Kes.14,971,172/-.
 - Purchases remained unaffected.
 - Jayla's VAT payable increased by Kes.1889.28/- (negligible difference)



COMMON ASPECTS OF VAT FRAUD

- Complex Supply Chains
- Documents/invoice manipulation
- Bogus Businesses
- Identity Theft
- Cross border Transactions
- Inadequate Controls and Enforcement
- Inadequate Information Sharing
- Lack of due diligence
- High value transactions (real/inflated)
- e-commerce/online sales?



TRANSACTIONS PRONE TO MTF

Low Volume High Value

Allows for easy movement of the goods with less need for storage space while the high value increases the stakes of VAT to be stolen.

- Precious Metal and Stones
- Electronics e.g. Smartphones, Tablets,
- Laptops et cetera.
- Clothes



Luxury Goods (High Value)

High value implies higher nominal VAT

- Luxury cars,
- Jewellery,
- Equipment,
- Wine



Inelastic Demand

Provide opportunity to inflate prices

Includes essential goods or service;

- Food and Beverages
- Fuel, Petrol, Gas
- Electricity
- Telecommunication



Artificial Demand

Demand easy to inflate due to complexity or hurdles of verifying the demand.

- Digital Products
- Services and Other Intangibles
- Electricity
- Telecommunication Services
- Fuel, Petrol, Gas

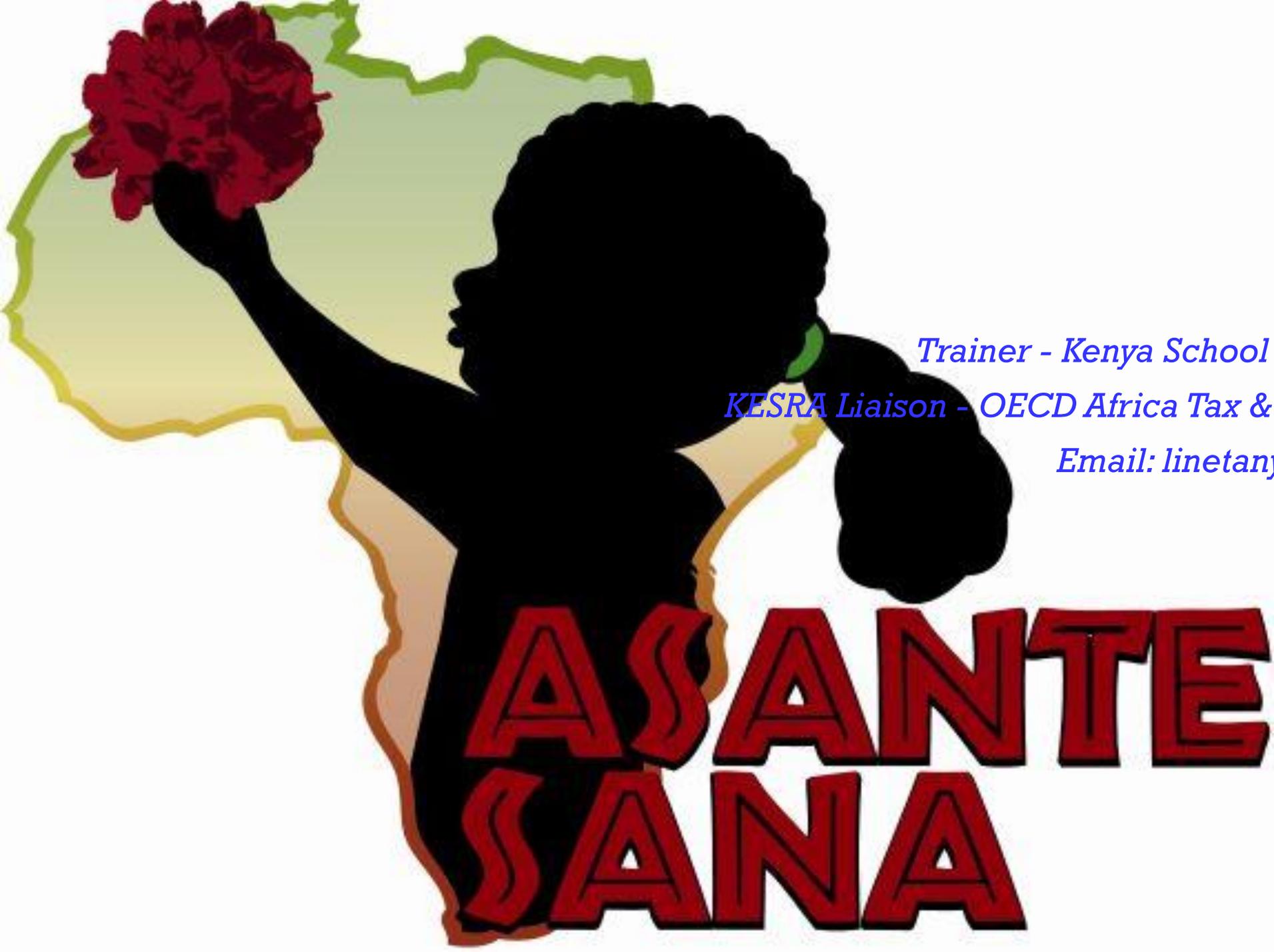


Complex or Extensive Supply Chain

These supply chains have levels of sub-contractors who can easily act as buffers or missing trader in the fraud scheme.

- Manufacturing
- Construction





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