



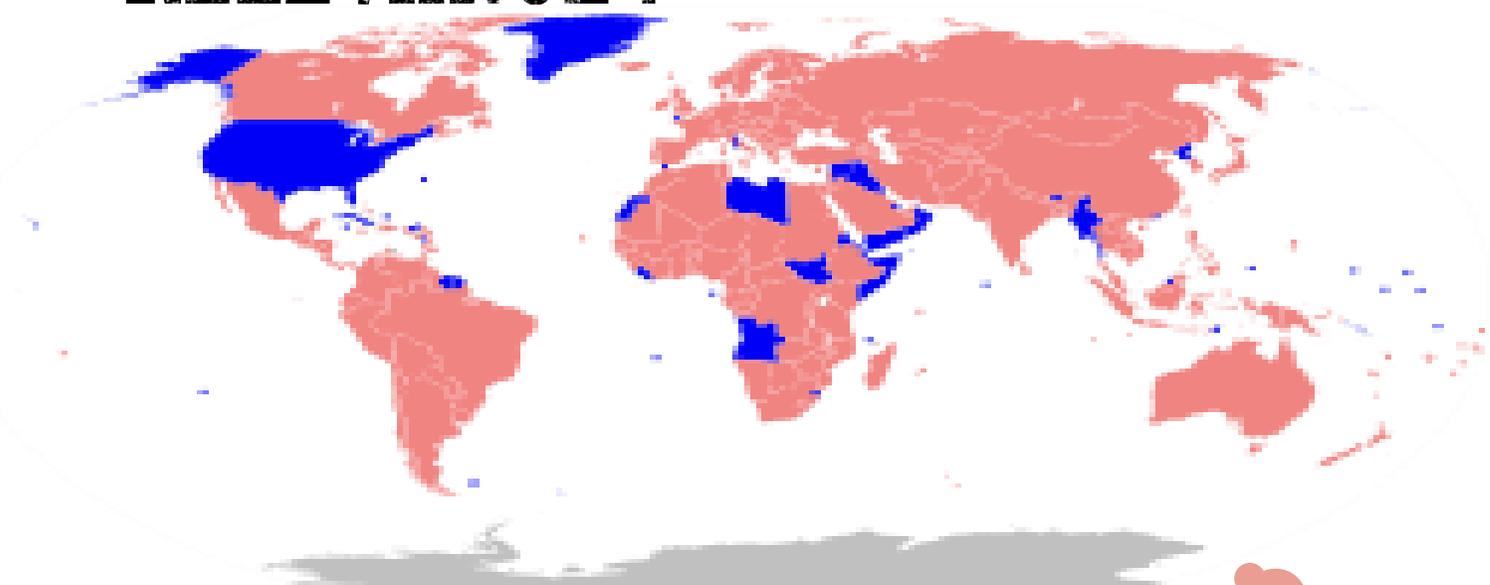
# VAT FRAUD

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**OECD Africa Tax & Financial Crime Academy**

**Managing Financial Investigations 2021**

# RELEVANCE?



[https://en.wikipedia.org/wiki/Value-added\\_tax](https://en.wikipedia.org/wiki/Value-added_tax)



VAT and MTIC Fraud ranked 1<sup>st</sup> in the Tax & Crime Perspective Survey Top Risks



# SCOPE OF COVERAGE

## Basics

- Basics of the VAT System
- Typologies of VAT fraud

## Example

- Case Example
- Transactions prone to MT Fraud

## Risk

- Risk indicators in VAT Fraud
- Mitigating measures

## AfCFTA

- Opportunity for Fraud?



# VALUE ADDED TAX

## VAT BASICS

- 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.



*Timber dealer*



*Carpenter*



*Furniture Store*



**VAT  
BASICS**

*Forest Farmer*



*Final Consumer*



*Timber dealer*



**INVOICE**

Value 1000  
16% VAT 160  
Price 1160

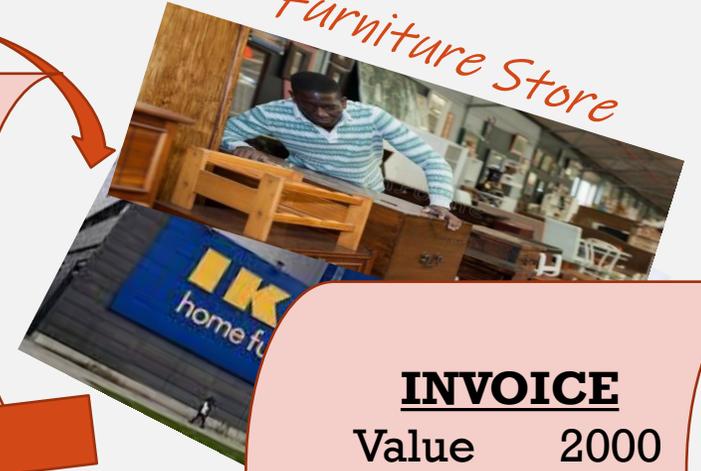
*Carpenter*



**INVOICE**

Value 1500  
16% VAT 240  
Price 1740

*Furniture Store*



**INVOICE**

Value 2000  
16% VAT 320  
Price 2320

*Forest Farmer*

**INVOICE**

Value 500  
16% VAT 80  
Price 580

Remits  
Shs.(160-80)=80

Remits  
Shs.(240-160)=80

Remits  
Shs.(320-240)=80

Remits Shs. 80



**TAX OFFICE**

Pay 2320  
**Tax**  
**Shs.320**

*Final Consumer*



# CLASS DISCUSSION

What makes the VAT system open to fraud?

- ❖ Registration
- ❖ Varied rates
- ❖ Self assessment
- ❖ Input-output system
- ❖ Refund claim



# TYPOLOGIES OF VAT FRAUD

## Registration

- Failure to Register
- Identity theft

## Filing & Payment

- Failure to file
- Failure to pay
- Misclassification of commodities
- No declaration/  
misclassification of  
imported goods

## Input-Output

- Under-reported sales
- Over-stated inputs
- Fraudulent refund claims



# MANIFESTATIONS

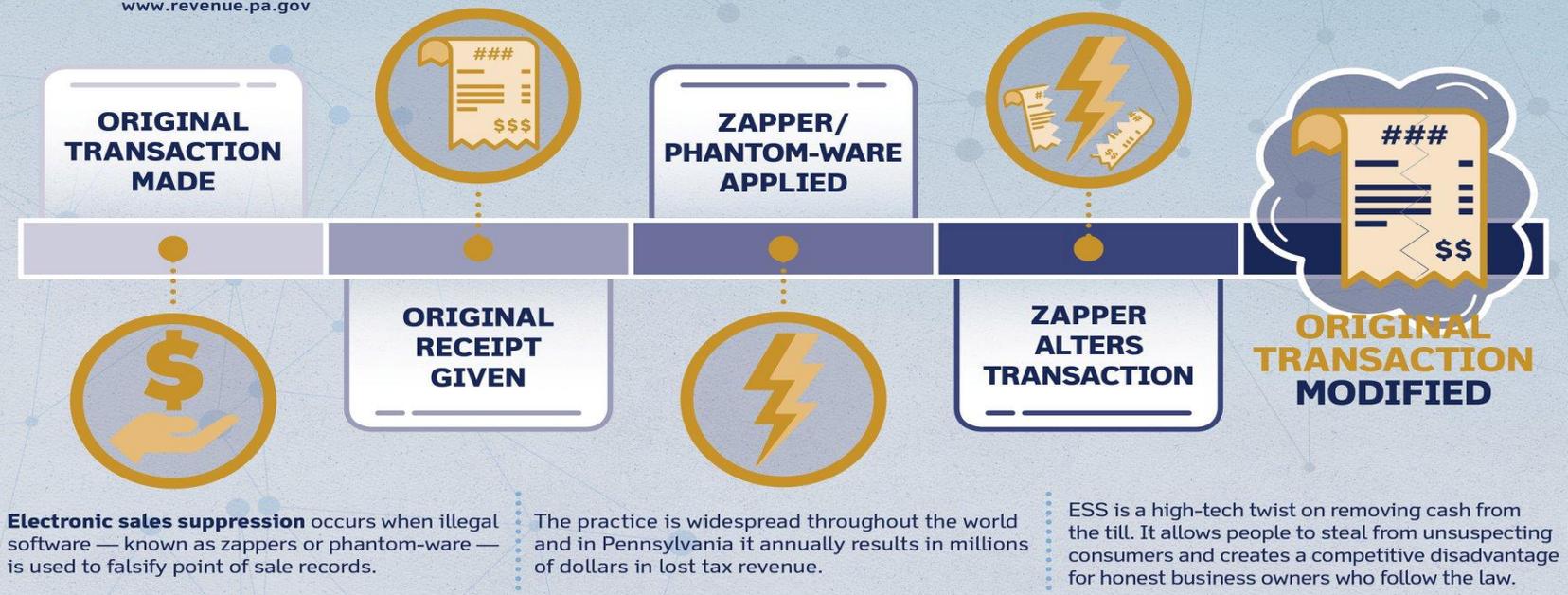


ELECTRONIC SALES SUPPRESSION:  
A THREAT TO TAX REVENUES



## Electronic Sales Suppression

a helpful timeline showing what happens from start to finish



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



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
	<b>TOTAL</b>	<b>\$70.00</b>

THANK YOU. WE APPRECIATE YOUR BUSINESS



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.

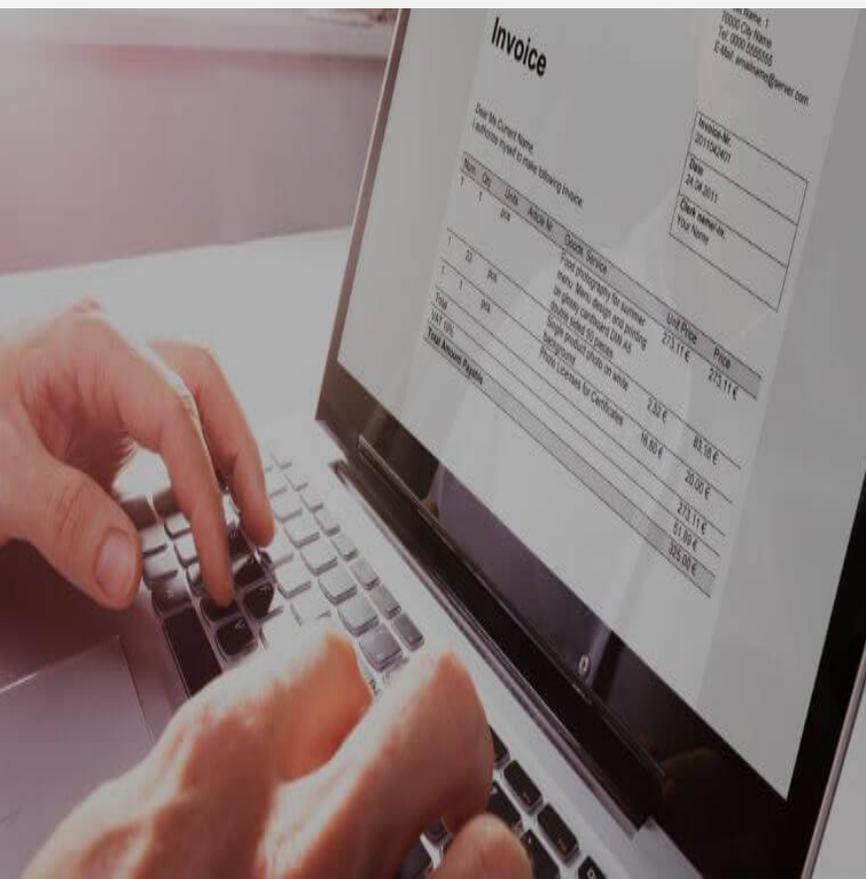
In some other cases, taxpayers will claim using non-existent or exempt imports.

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.

# 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

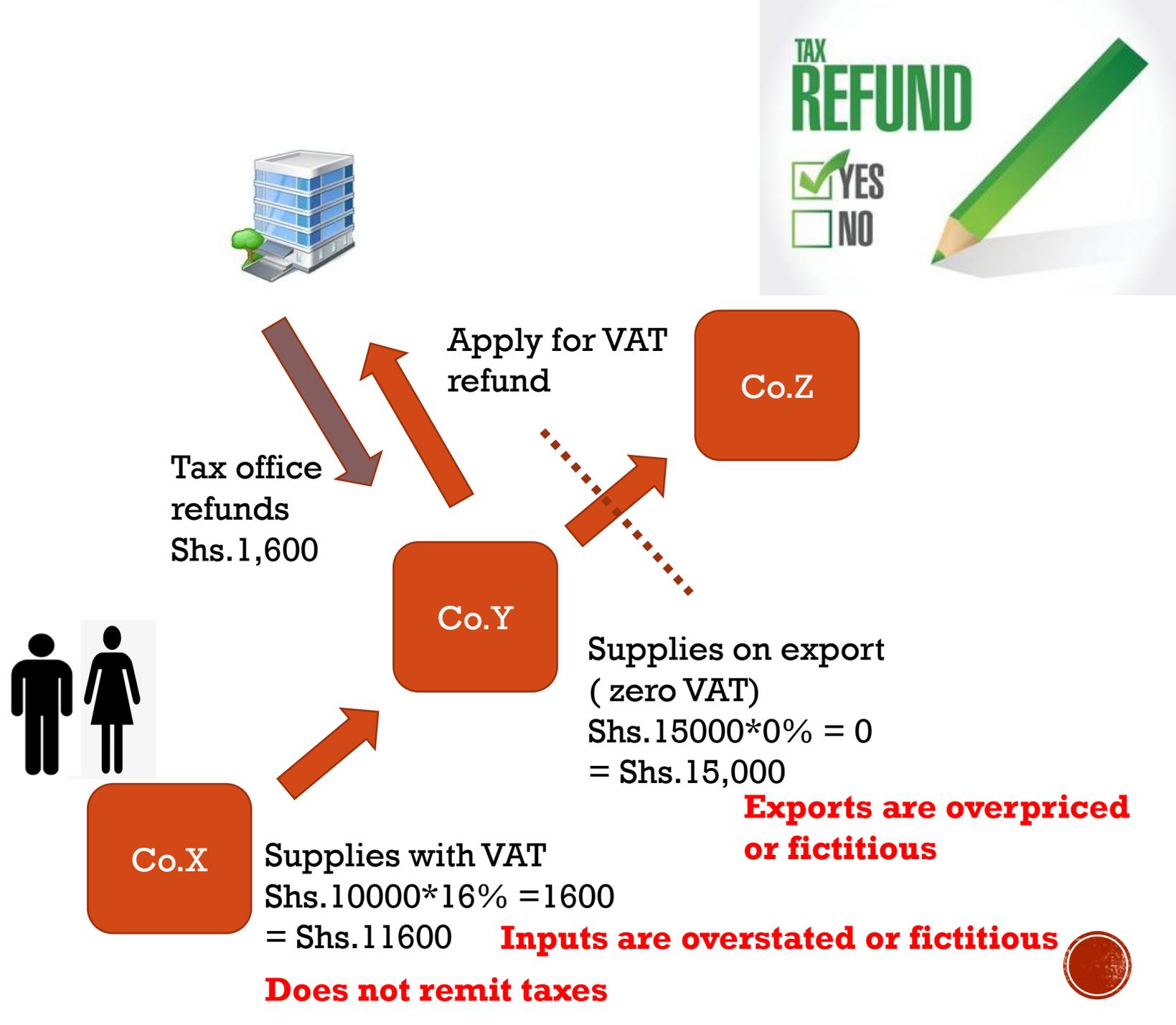
Fraudulent  
taxpayer – Bill  
Ltd

## 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
- Fails to remit tax

**Buffer**

- Conceals trail
- Pays marginal tax

**Beneficiary**

- Also **Broker**
- Exports goods
- Claims refund



## 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
- Many Accounts few individuals

**3. Bank**



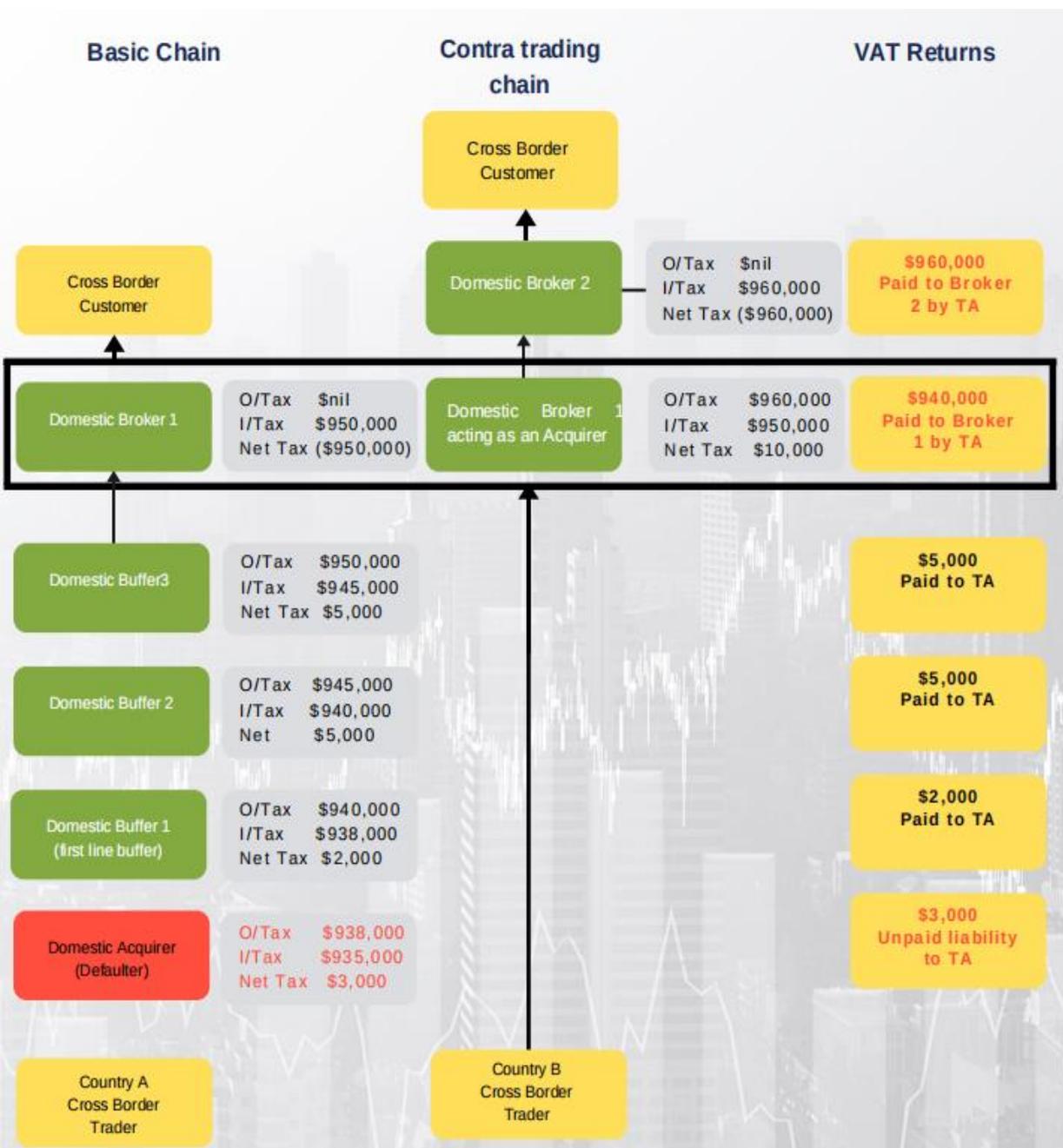
The Missing trader, Through the individual with POA deposits 90%-95% into the account held by the beneficiary and retains 10%-5% as commission

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

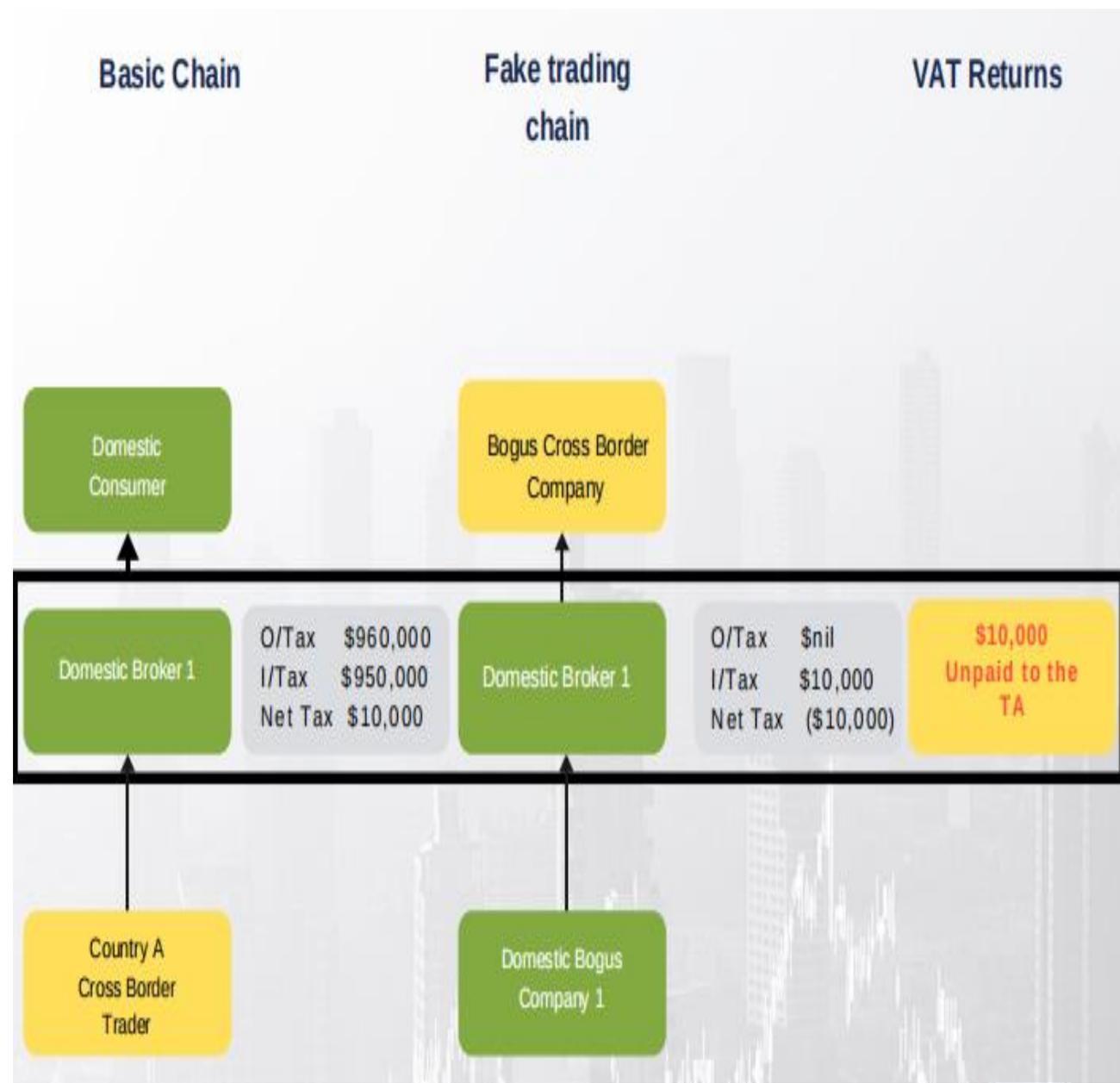
**4. Forex Bureau**



# CONTRA TRADING



# CROSS INVOICING



# CLASS DISCUSSION

Any other VAT Fraud types?



## CASE EXAMPLE: MISSING TRADER

### Informants

- Information received on 6 traders paying marginal taxes are making little or no taxes on their returns.
- Position achieved by buying and selling goods to each other.
- Traders amiss. Cannot be located physically or on phone.

### Investigation methodologie

- Database analysis of itax and Simba system
- Third party information - Registrar of Cos, Banks, Clients
- Surveillance - mobile phone tracking
- Interviews

# CASE EXAMPLE: FINDINGS

## 1. Business registration details

### Registrar of Cos.

- M1-M5 are business names while M6 is trading on own PIN
- M1 & M2 registered on same date by same M6
- M3 & M4 registered on same date by Mr. J
- M6 registered by Mr.P

### itax registration

- Proprietors as per Registration certificate different from iTax partners

## 2. Analysis of iTax returns

- Businesses duly file VAT returns
- Declared sales made to unregistered customers
- Claim input tax equal to or more than output tax
- Self invoicing observed eg. in 2 yrs M1 supplied M2 Shs.1.6Bn goods while M2 supplied M1 Shs.1.3Bn goods
- Proprietors do not file Corporation tax and PAYE returns

## 3. Analysis of bank statements

- Deposits were approx. 3-10% of declared sales
- Deposits from several registered companies
- Said registered cos. claim huge inputs from the MTs
- Depositors mainly in construction sector, importers of construction materials and hardware from China

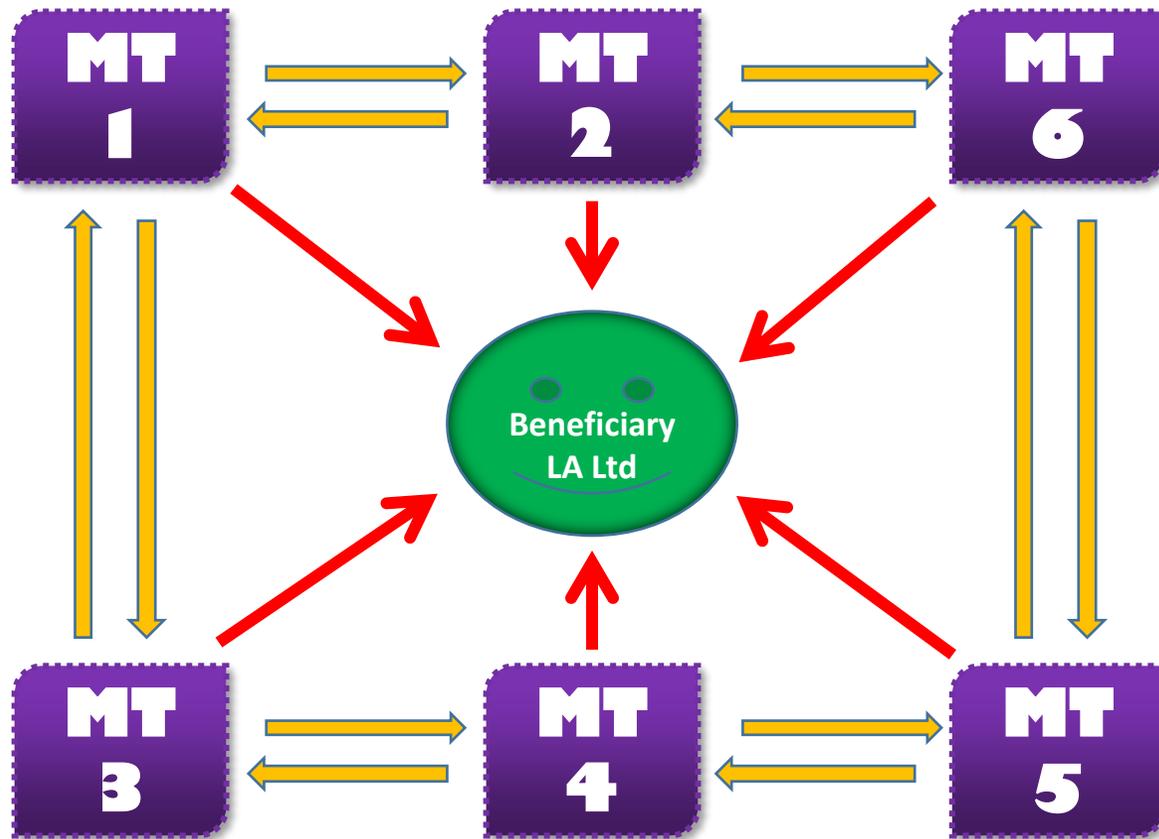
# CASE EXAMPLE: FINDINGS

## **4. Analysis of returns filed by Registered 'buyers'**

- Claim huge inputs from the MTs and expense in P&L
  - Paid little to no VAT and carried huge creditors from MTs in Balance sheet
  - Claimants mainly in construction sector, importers of construction materials and household hardware from China
- *Recall MTs reported supplies to unregistered customers*
- *Hence; either MTs are under-declaring sales or claimants are claiming fictitious inputs*

## **5. New business registrations**

- Mr. J, proprietor for M3 and M4 found to have abandoned Cos 2 yrs later and registered 3 new ones



## THE SCHEME

- Individuals register several businesses for invoicing purposes
- Businesses supply invoices to each other
- Invoices sold at a fee of 3-10% of invoice value to would be beneficiaries interested in claiming fictitious inputs



Self invoicing



Sale of invoices

# Admitted liability



3 registered buyers gave statement without prejudice owing up to scheme and purchase of invoices



# Motivation



**Importers of household goods:** Importers understate imports to pay less duty and VAT then make up with fictitious purchases to reduce VAT payable

**Construction sector:** Cos mainly source goods from unregistered suppliers hence attempt to reduce VAT payable using fictitious purchases

**Scrap metal dealers:** Source goods mainly from unregistered Juakali traders and make up for the input tax claim with fictitious purchases

## ***Notably;***

- Goods sourced locally from MTs are similar to those imported
- MTs are not importers and no Co. manufactures similar products locally

# 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



# BREAK OUT SESSIONS

- Groups 1 & 2

**Identify some risk indicators that one should look out for in profiling missing trader schemes**

- Groups 3 & 4

**Suggest some counter measures that revenue authorities can employ to mitigate VAT fraud**



# RISK INDICATORS

- Invoices with generalized descriptions
- Consolidated supplies
- Nil filer/Dormant supplier making out huge sales
- Consistent credit filers
- Company with no substantial activity
- Disparities between nature of business and supplies made
- Big contract companies with little VAT input
- Businesses with informal arrangements
- Frequent use of brokers in transaction chain
- Spikes in transaction trend
- Unusual office space or location with suspicious contact details
- Bank transactions that are mainly pay-outs
- Entity deals with a very limited number of suppliers and clients.



VALUE ADDED TAX  
TECHNICAL NOTE ON  
MISSING TRADER FRAUD



An ATAF Publication



# SUGGESTED COUNTER MEASURES



- **Enhanced preregistration checks** - particularly in high risk industry
- **Stakeholder engagement** - taxpayer education, tax professionals, business registration agencies, consider providing public registration checkers
- **Shared databases** - customs, third party, registrar of cos, regional block
- **Automation of VAT compliance processes** - Tax Invoice Management System, cross matching system (VAA), Kenya Success story
- **Capacity building** - specialized officers / task force
- **Risk profile indicators** - high value invoices, high risk entities, high risk supplies
- **In depth verification checks** - include detailed checks into the veracity of supply chains and due diligence carried out by a trader to ensure that the proposed transaction is not connected to fraud (eg. [Galaxy Tools](#))
- **Criminal/Civil investigation** - have clear strategy and punitive measures of deterrence. Convictions communicate consequences
- **Legal measures** - Reverse charge, Joint & several liability, Cannot claim input before sale is declared

VALUE ADDED TAX  
TECHNICAL NOTE ON  
MISSING TRADER FRAUD



An ATAF Publication



# COMMISSIONER OF DOMESTIC SERVICES V 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 EXAMPLE: ACTIONS TAKEN**

**Deregister all MTs**

**Disallow input tax claim from all MTs**

**Publication done in newspapers requiring all cited MTs to report to commissioner of investigation**

**CSD to conduct 100% verification of major importers of household goods and construction materials**

**Prosecution of all parties involved in scheme**

**Proposal to have scrap metal dealers appointed as Withholding VAT agents / Exempted**

**Renewed vigilance to check on such cases**

# AFCFTA – OPPORTUNITY FOR FRAUD?



Creating One African Market

## Africa Continental Free Trade Agreement (AfCFTA)

- Liberalize trade and facilitate easy movement of goods and services on the continent,
- Removing tariff barriers to trade
- Provide free access to foreign markets and free movement of people

### Enabling environment?

Relaxation of fiscal rules and checks at the physical borders creates fertile ground for

- MTIC fraud
- smuggled or misrepresented imports
- unregistered entities, hijacked VAT identities or fake entities to be used in the importation of goods/services
- obscure value chains

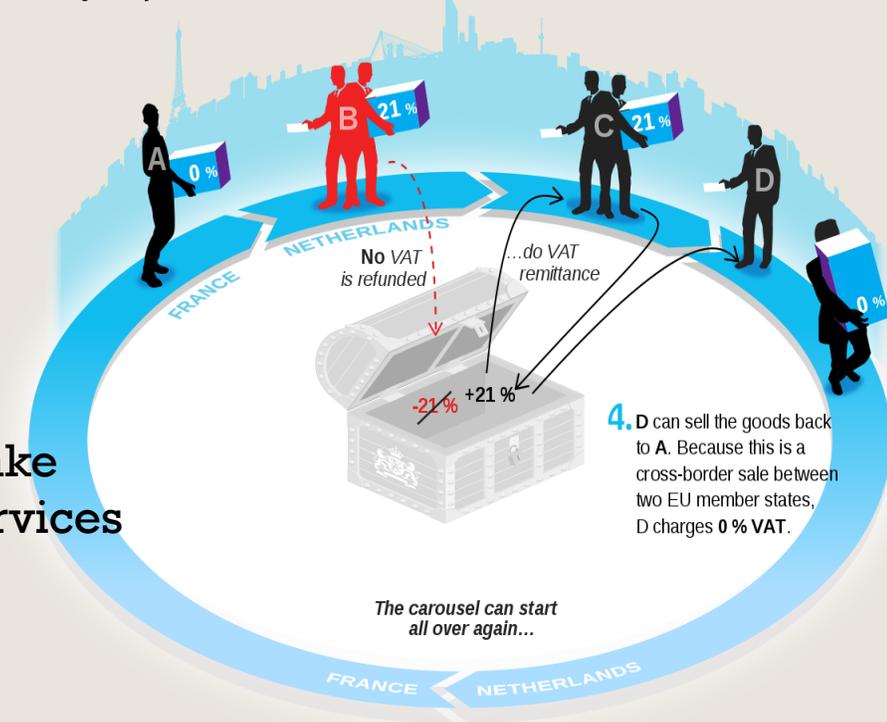
### Counter Measures?

- Shared database - of entities flagged as high risk for MTF / Cross border tax audits / EOI - ATAF Agreement on Mutual Assistance in Tax Matters (AMATM)
- Harmonization of VAT – Registration no. & Rate

## Missing trader fraud

In carousel VAT frauds, a merchant fails to remit VAT to the taxing authority, despite charging his buyers the price of the sold goods plus VAT.

1. Business A delivers goods to B in the Netherlands. Because this is a cross-border sale within the EU, A does not charge B any VAT.
2. B sells the goods to C and charges him 21% VAT. He has to remit this to the taxing authority, but fails to do so. He commits **fraud**.
3. C has paid 21% worth of VAT to B, which he can deduct on his VAT return. C delivers the goods to D and charging VAT.





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