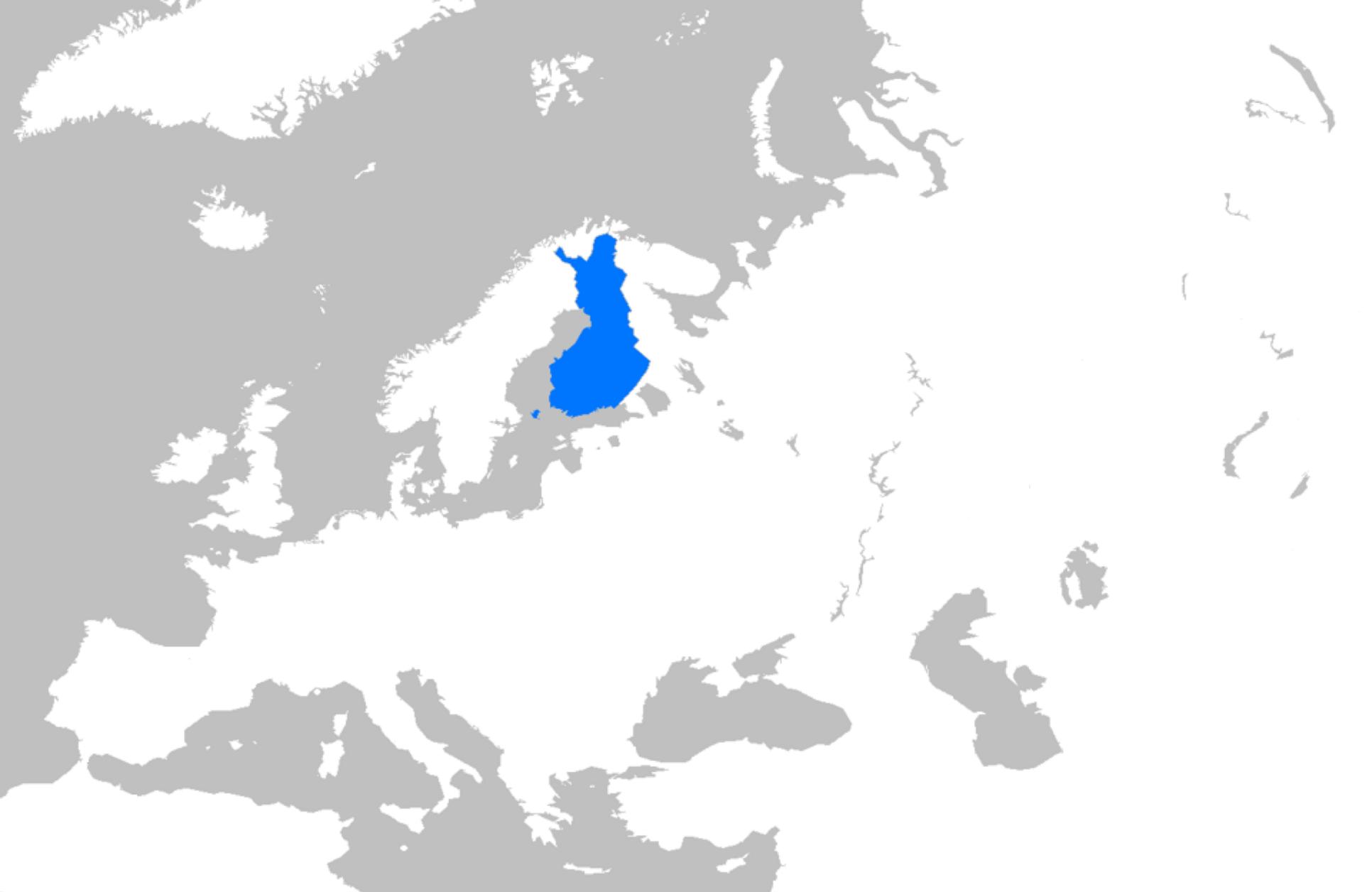




VAT/GST refund frauds

Markus Forstén





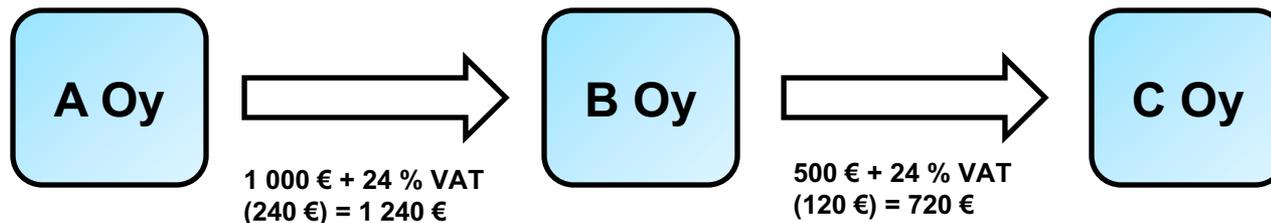
Overview

- **The refund mechanism**
 - The "Achilles heel" of the VAT/GST system
 - Refunds are an integral part of the system
- **Refund frauds**
 - Significant variations between complexity
 - Requires very little recourses to set up
 - Does not require a lot of knowledge to commit
 - Relatively easy to do internationally
 - Digitalization = easier to stay anonymous
 - Low risk, high reward

How are VAT refunds generated?

Example 1

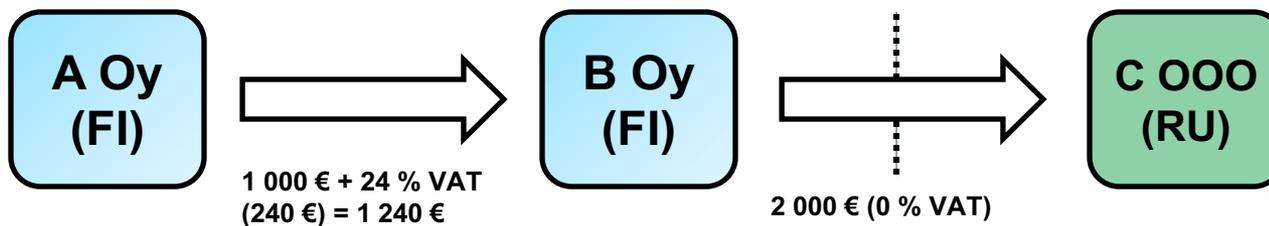
- **Input VAT exceeds the output VAT**
 - Output VAT - Input VAT = Payable/-Refundable VAT
 - Usual in new businesses due to investments
 - B Oy would claim a 120 e VAT refund (240 - 120)



Example 2

- **International trade - Exports**

- Responsibility for the reporting of VAT on the buyer
- B Oy would claim a 240 € VAT refund
- How does C OOO report the VAT?
 - Pay first and claim it back?



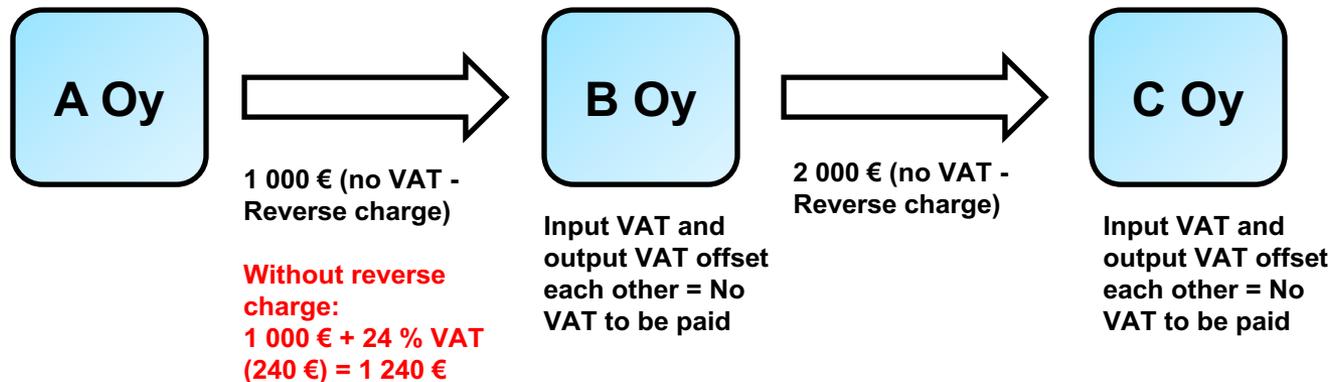
- **European union (EU)**

- Reverse charge if the buyer in EU → no effect on B Oy refund
- No customs duties in trade between member states!

Example 3 - 1/3

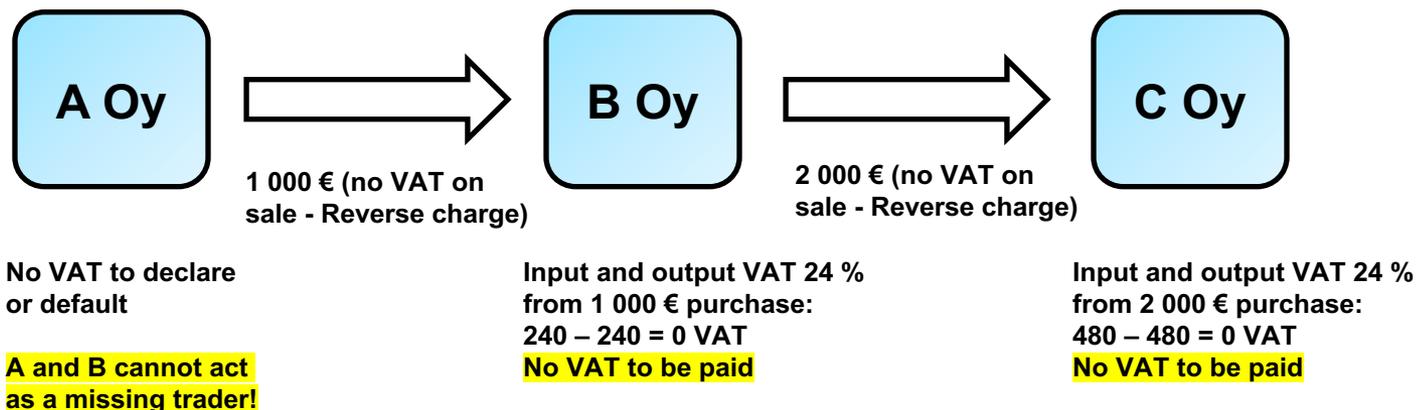
- **Domestic reverse charge**

- Reverse charge moves VAT liability (output) from the seller to the buyer (from A to B and from B to C)
 - B and C report both output and input VAT from the purchases → no VAT to be paid!
- Goods/services under reverse charge can differ from country to country (construction services, phones etc)
- **If acquisitions from A are not under reverse charge → A would pay 240 € VAT and B would claim a 240 € VAT refund**



Example 3 - 2/3

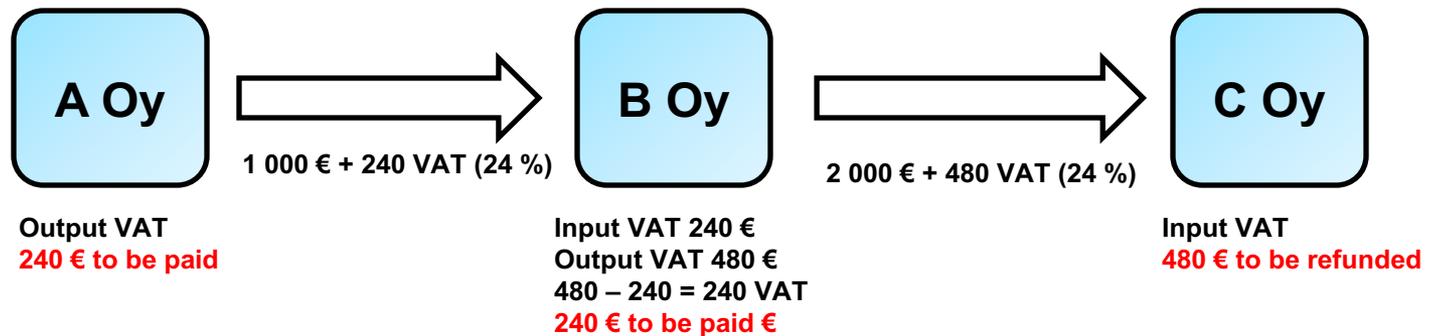
- Goal of the reverse charge mechanism is to fight MT frauds



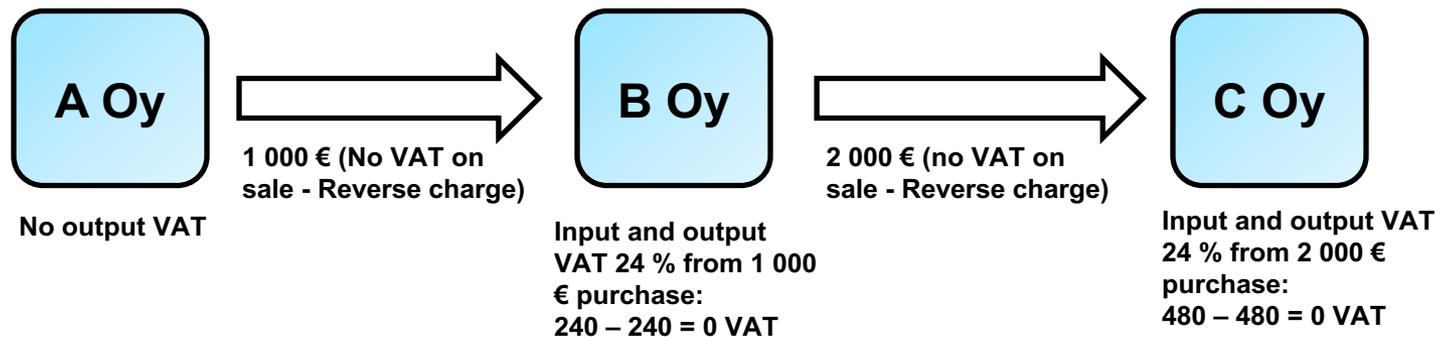
- If all the sales of company A, B and C are reverse charge, all normal purchases that include VAT will lead to a refund
 - Transformation from a missing trader fraud to a refund fraud by reporting normal sales (with VAT) as reverse charge (no VAT)?

Example 3 - 3/3

No reverse charge



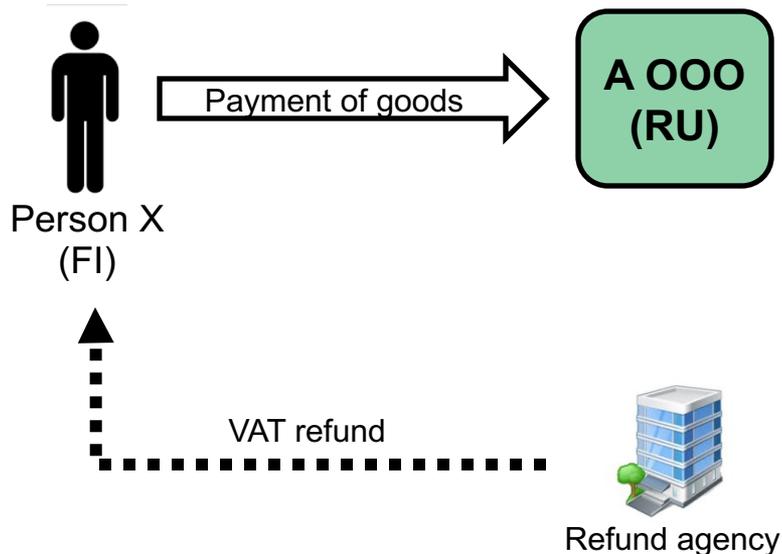
Reverse charge



Example 4

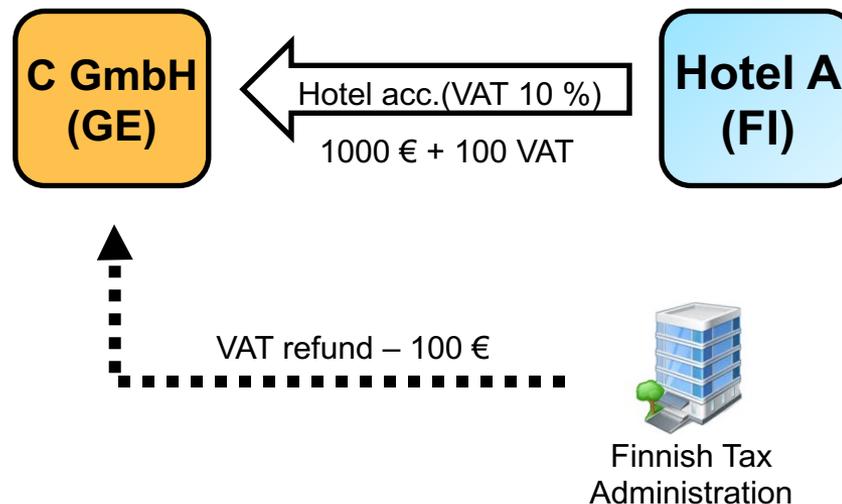
- **VAT refund for tourists/travellers**

- Finnish person X travels to Russia and buys goods from a store A located in Moscow (RU)
- Person X pays the price of the goods with VAT included and claims it back from a VAT refund agency



Example 5

- **Refund of VAT to foreign businesses (non established)**
 - In many countries foreign businesses have the right to receive refunds of the VAT included in the price of goods and services purchased there (for example hotel accommodation, travel in Finland)



Things to consider...

- For the VAT system to be neutral, it has to have a refund/credit mechanism of some kind
 - VAT system should therefore not affect B2B transactions
- Special VAT schemes and specialty areas can create new opportunities for VAT frauds
- VAT rates, exemptions, reverse charge mechanisms, languages, reporting requirements and deadlines tend to differ from country to country
 - Different systems can be susceptible to different kinds of VAT frauds
 - Important to learn from others!
- Nature of the VAT problematic for anti-fraud efforts
 - Refunds every month?



What steps does the fraudster need to take to get the refund?

Fraudster needs to get through...



- Enough to participate in a fraud
 - Minimum requirement
 - Is possible but not the goal
-
- How well do these processes work together?
 - Important to understand the minimum steps necessary

VAT (refund) control

- **The target of the fraudsters**
 - Whoever handles the VAT refunds
 - Level of anti-fraud knowledge?
- **How complex does the fraud have to be?**
 - Depends on the available anti-fraud tools
 - Refund control vs tax audit proof?
- **Supporting the VAT control**
 - Adequate recourses to combat VAT frauds
 - How capable is the VAT control?
 - Proactive vs reactive
 - Continuous effort

How it should work

Registry control

- Detects new trends / schemes relating to frauds
- Flag risky businesses

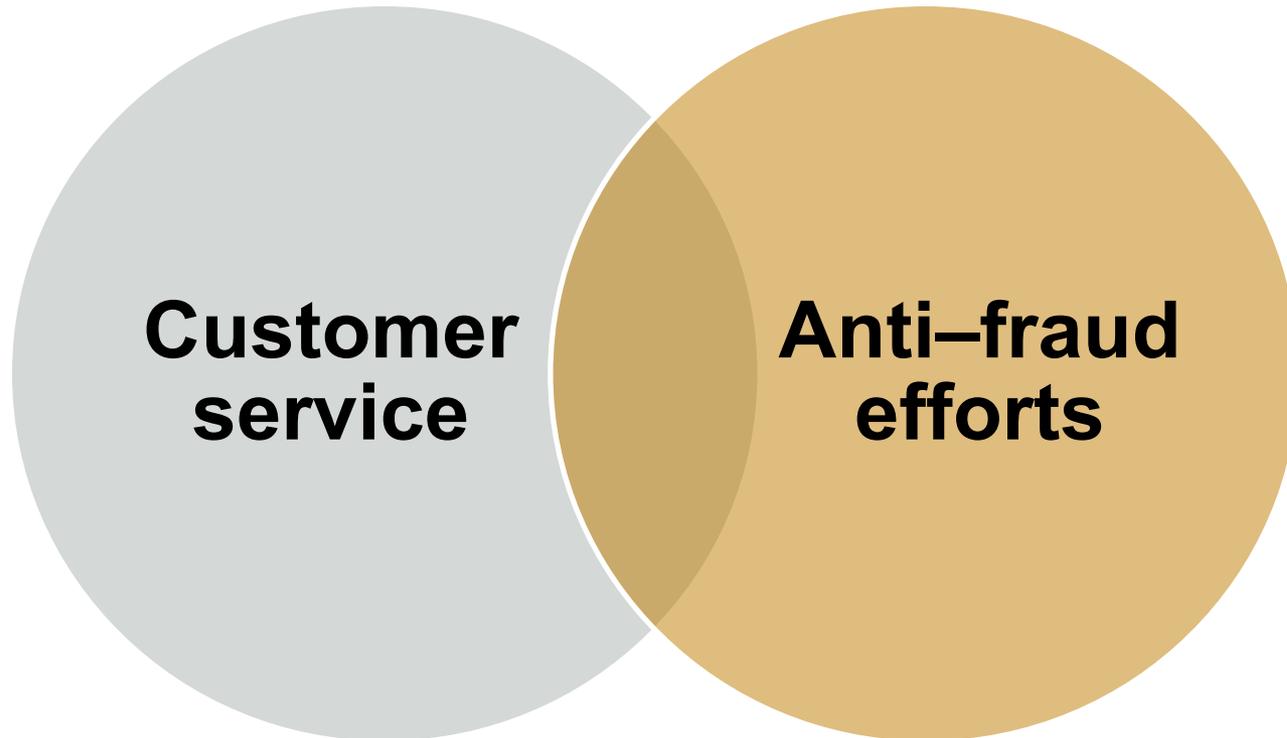
VAT control

- Acts independently with limited support to combat non-complex refund frauds
- Prevents / limits frauds

Tax audits

- Cases requiring an actual audit
 - Cooperation with other agencies
 - International cooperation
- Supports registry and VAT control

Conflicting interests?



When we improve customer service / experience, we need to take into account how it affects anti-fraud efforts and our ability to detect risks

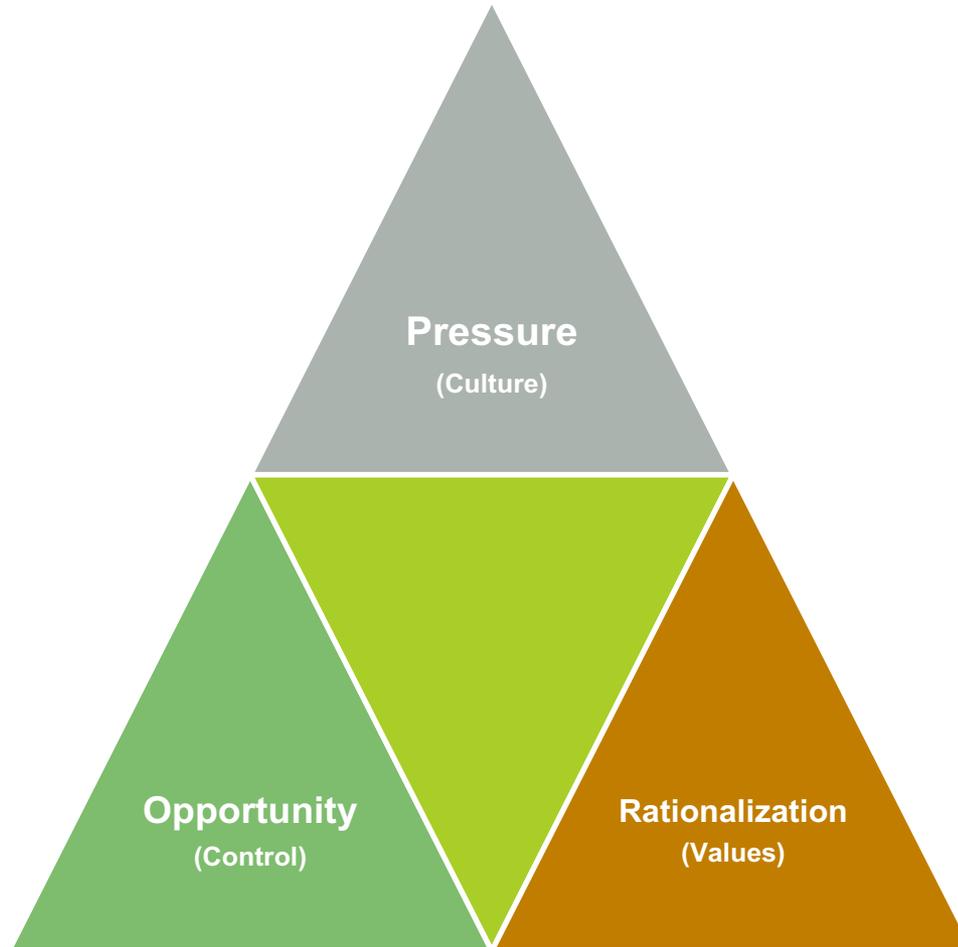
What does the fraudster need?

- **Company**
 - Setting up or buying a new company
 - No tax compliance history
 - No history of VAT refunds
 - Not investigated/audited before
 - History of the seller can raise red flags
 - Buying an existing and operating company
 - Buy a company that generates refunds!
 - Staying completely anonymous is a problem
 - Can be expensive
 - Hijack/steal a company?
 - Usually linked to defrauding the company in various ways

What does the fraudster need?

- **Shadow persons**
 - Domestic or foreign?
 - Risk assessment?
 - Active or passive?
 - What role does the shadow person have?
 - Is more than the identity needed?
 - Willing or unwilling?
 - Compensation, payment of debt, role in the criminal organisation (prospective members)
 - Extortion, identity theft

The Fraud Triangle



VAT Refund fraud examples

Simple refund frauds

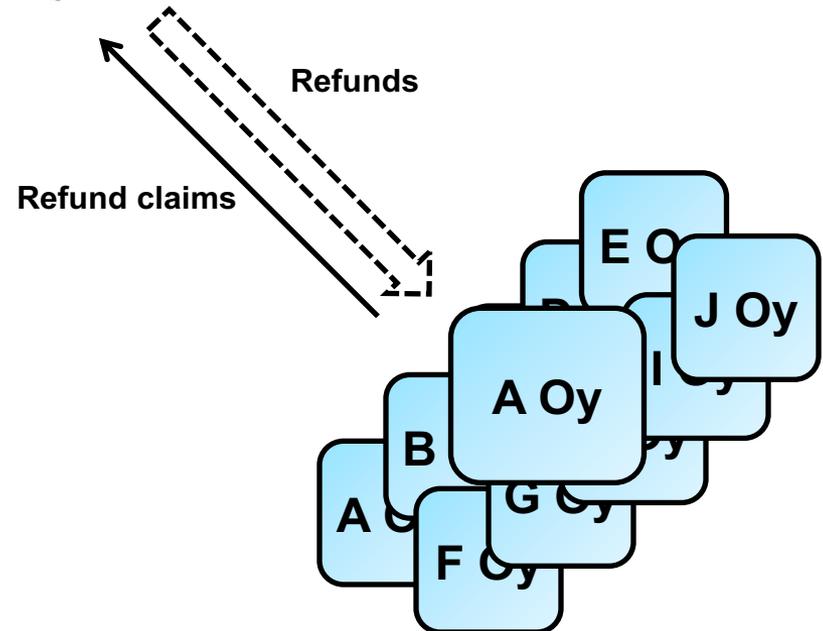
In general...

- Need only one company
- Everything else is made up
- Fake goods or services
- Refunds withdrawn as cash or moved forward
- Weak shadow persons
- No response to detailed inquiries
- No bookkeeping, assets, employees etc.
- Company easily abandoned by the fraudsters

Dividing refund claims to multiple companies?

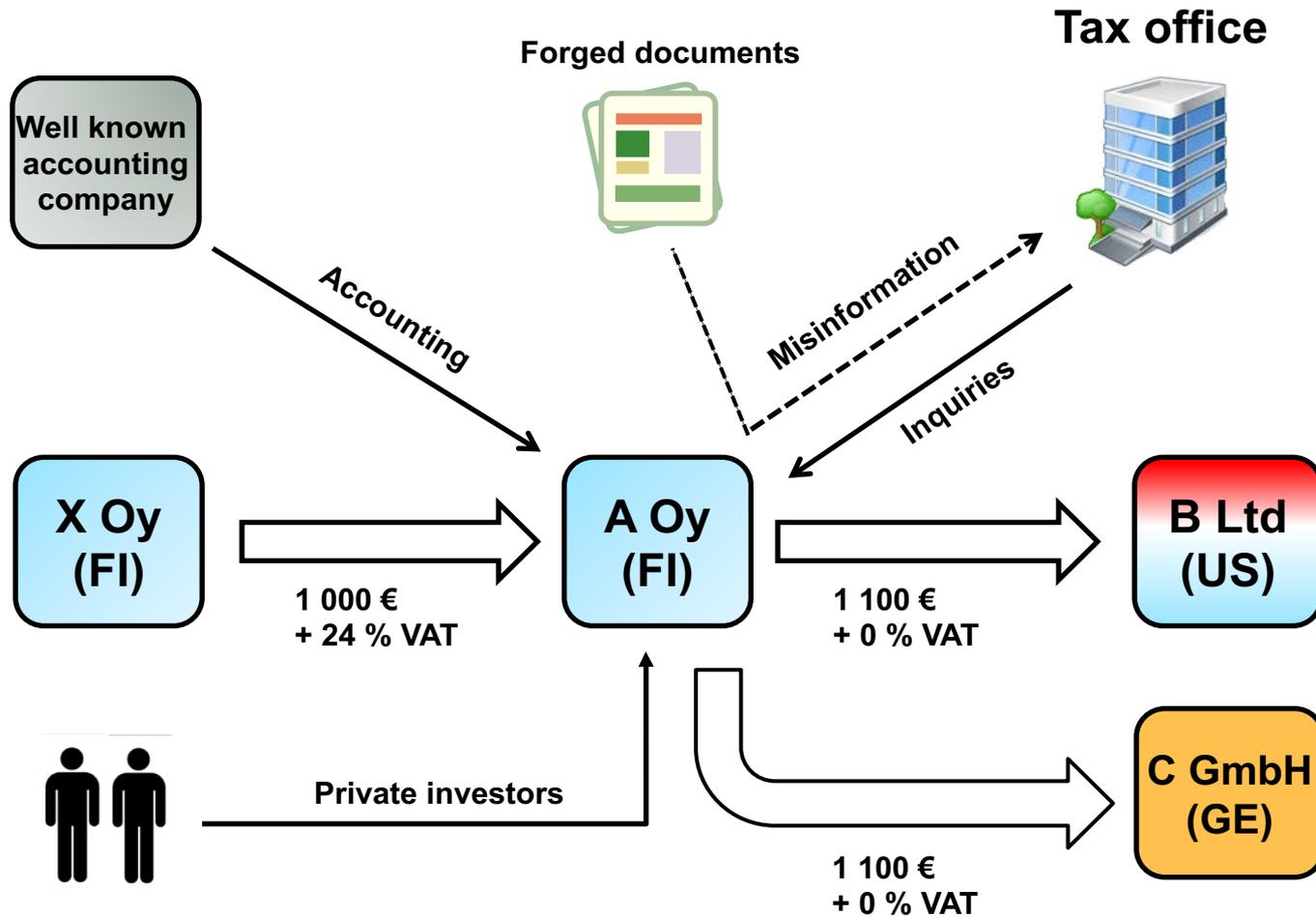
- + Easier than one big refund claim
- + Hard to link all the companies to the same fraudster
- + Repercussions can be lower
- Requires multiple shadow persons
- More companies to manage

Tax office

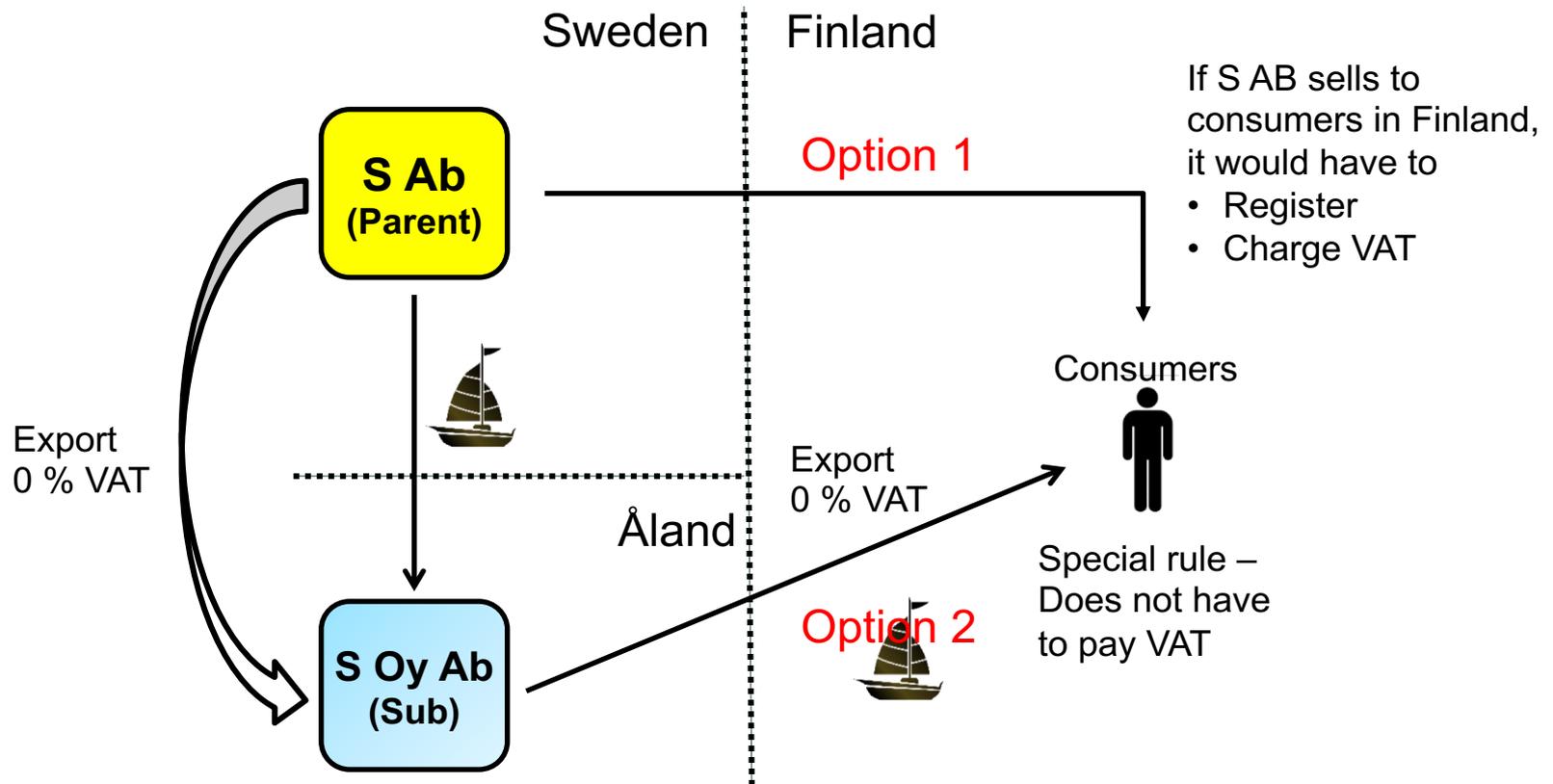


Fraudsters are not limited by facts

(Simple refund fraud example)



Example from a case



What is happening in Åland? Is company S (sub) actually conducting business activities there?

Explanations

- **Work done by S (sub) according to explanations**
 - Securing the integrity of the shipping
 - Security management
 - Logistical coordination
 - Final postage to the end customer
 - Harbor services
 - Necessary postage adjustments
 - Other services related to the shipping
- **What really happened?**

The need for audits...

- Written communication vs phone calls
 - Reliability of the documents?
 - Person we are communicating with?
- Verify what is said
 - On site checks
 - Cross-reference
- Few case examples
 - Event organiser
 - Estonian carousel
 - Specialty area related audits

MT refund fraud

In general...

- Fake goods or services
- Idea is to shift the blame to A
- Behavior harder to predict
- B claims to be innocent
- More convincing shadow persons
- Responds to inquiries
- Bookkeeping done by an accountant

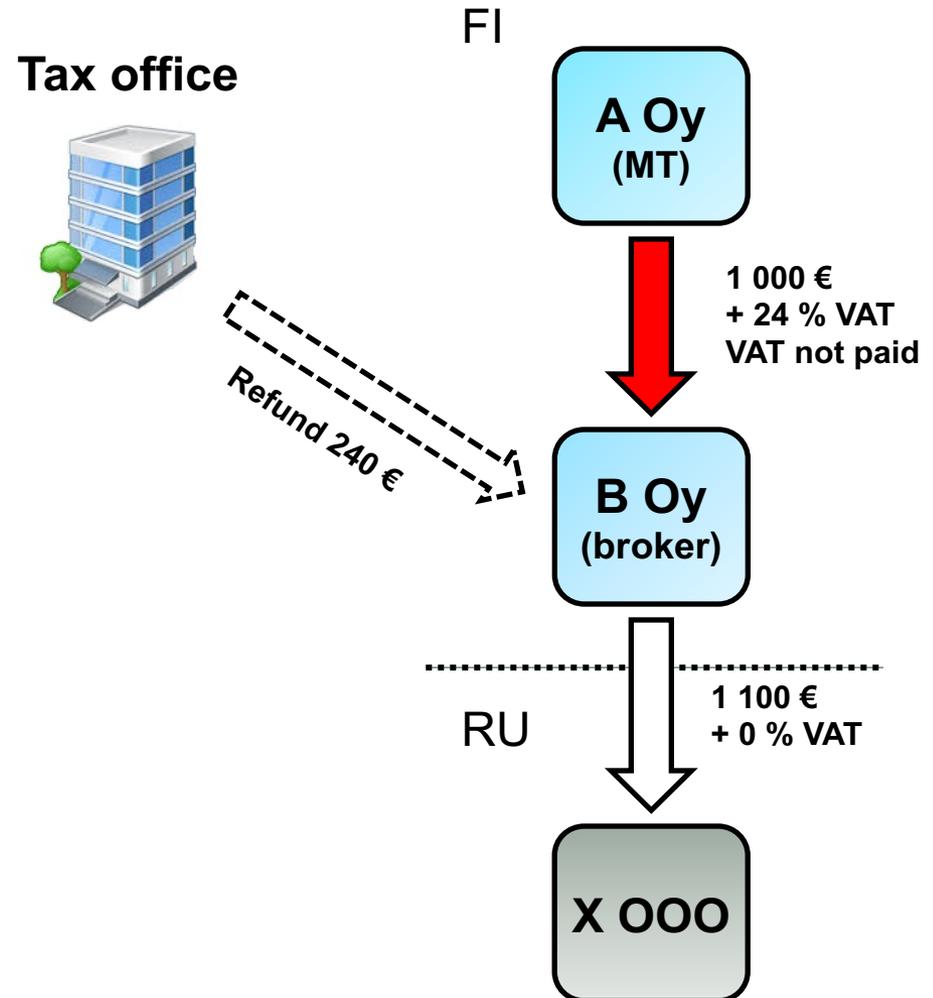
Pros

- Harder to detect
- Plausible deniability

Cons

- More companies involved in the fraud → more points of interest

How would you make it harder to detect?



MT refund fraud - Reporting period

In general...

- Same core principle
- A Oy reports and pays the VAT yearly → yearly reporting period
- B Oy is on monthly reporting period → claims refunds every month
- Where is the missing trader?

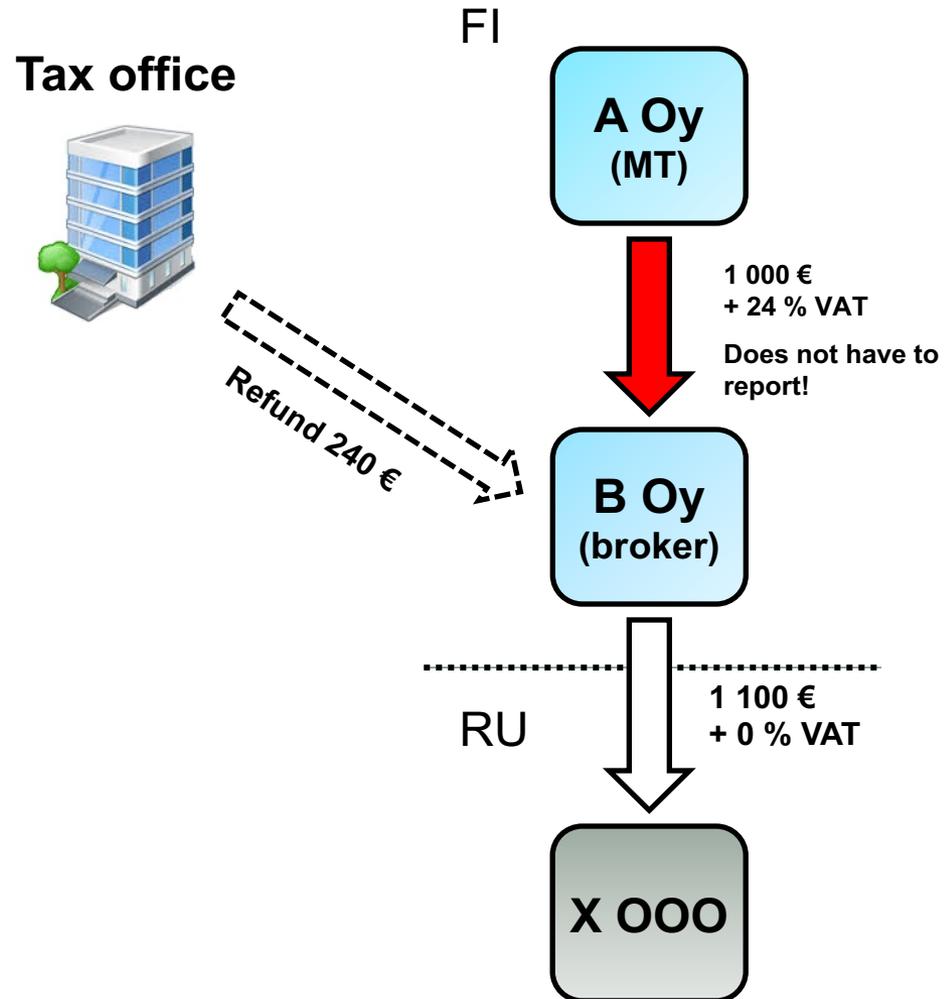
Pros

- Missing trader becomes visible only later

Cons

- Reporting periods such as quarterly and yearly usually require the total turnover to be low

Can we use different accounting methods for VAT for the benefit of a fraud?



MT Refund - Chain fraud

In general...

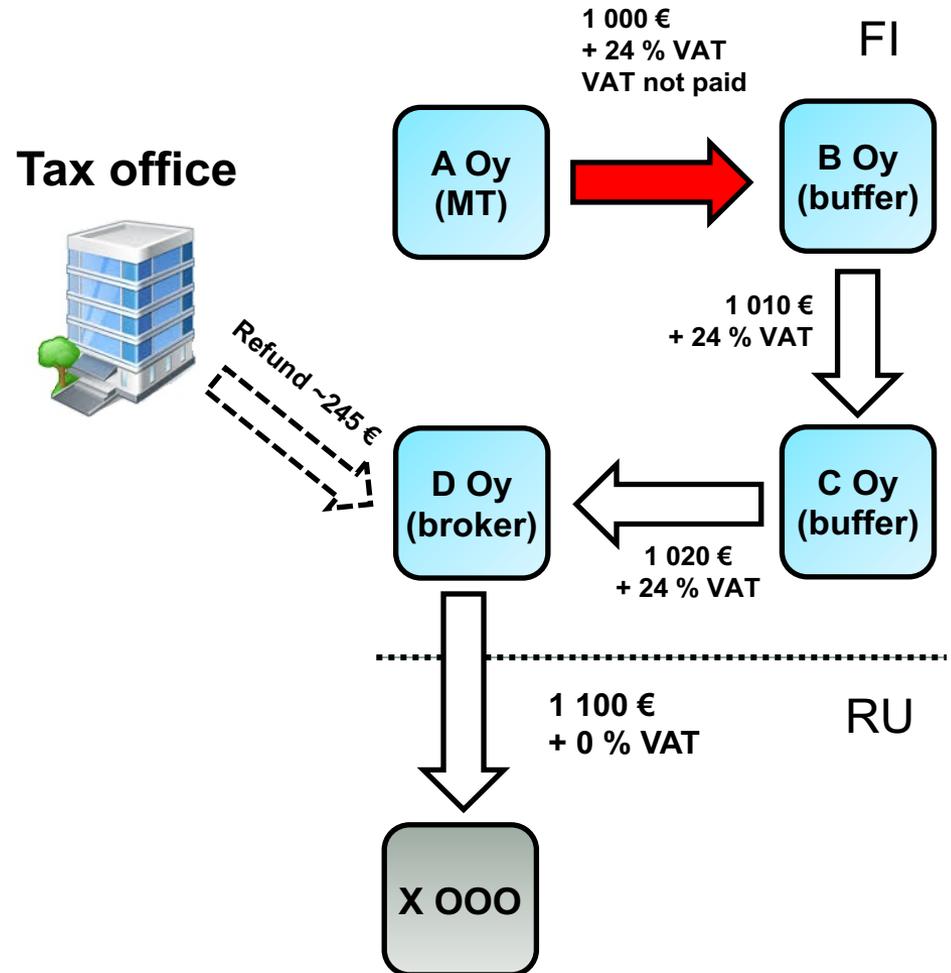
- Principle is the same as in MT refund fraud
- More complex with buffers

Pros

- Harder to detect
- More distance between MT and broker

Cons

- More companies involved in the fraud → more points of interest
- Where do the goods go from X 000?



Refund fraud - Diversion

In general...

1. Initial purchase of real goods from the supplier
2. Goods transported to Russia by B Oy, and then brought back (there is no real sale of goods)
3. Forge additional invoices based on the initial purchase and repeat by transporting the same goods

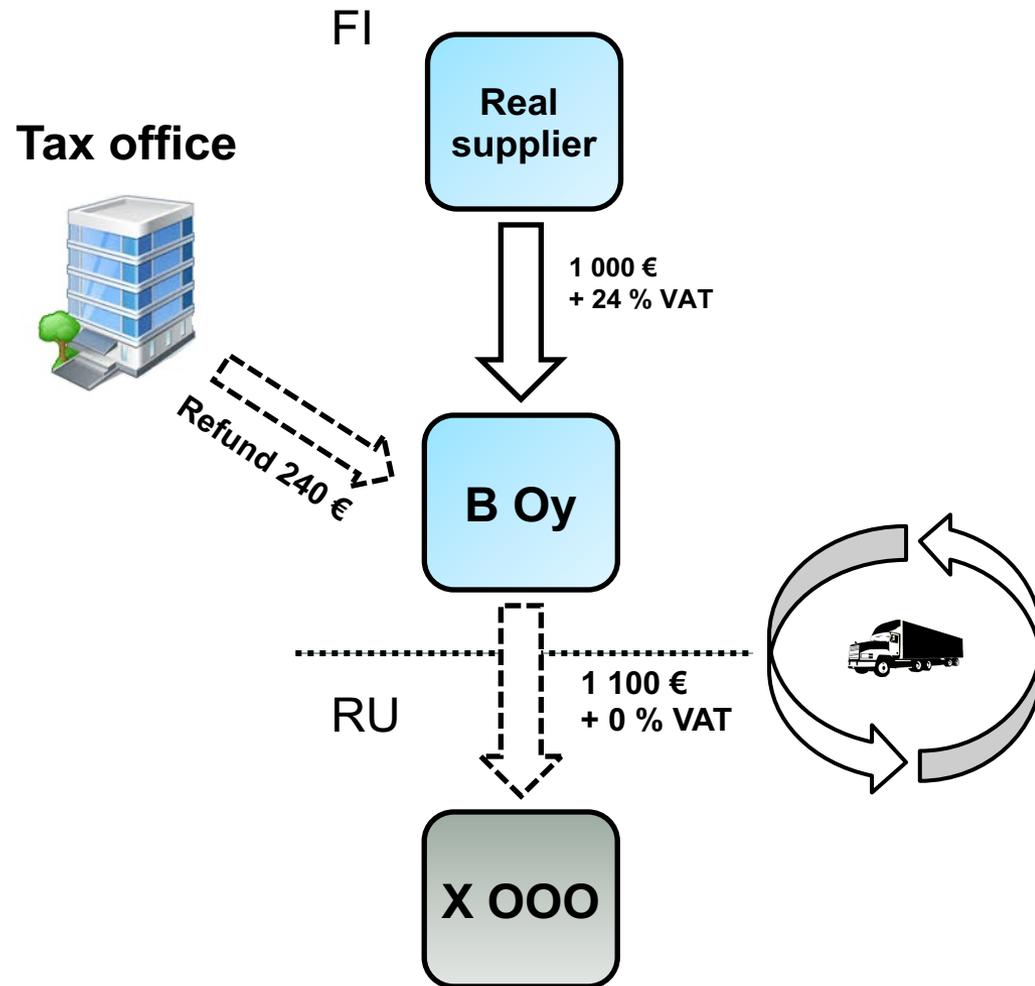
Pros

- Ability to show the transportation of goods

Cons

- Requires more resources such as logistics

How would you make it harder to detect?



Cross-invoicing scheme

Cross invoicing

- Refunds used in the business
- No shadow persons
- Practises real business

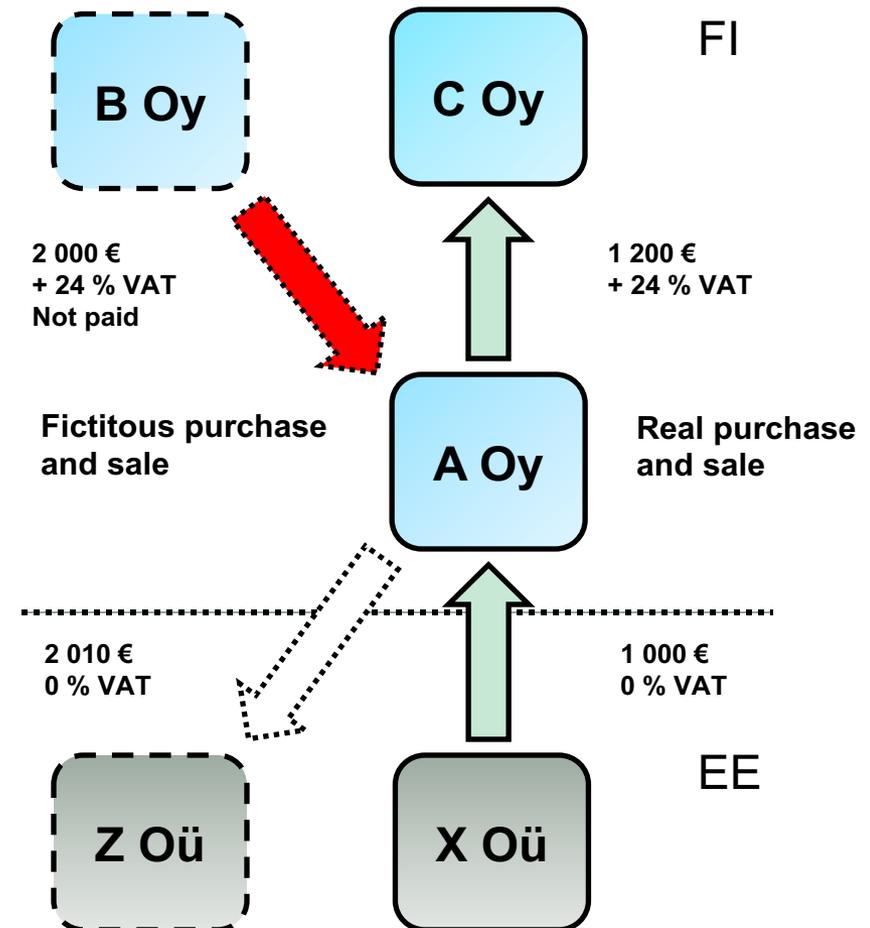
Pros

- Real business acts as cover
- Hard to detect

Cons

- More companies → more points of interest
- Companies B and Z can draw attention to company A

How would you make it harder to detect?



Refund for foreign business

In general...

- Foreign non established businesses can generally claim a refund from purchases in another country
- Claim a fraudulent VAT refund with forged invoices from a well known business (company A)

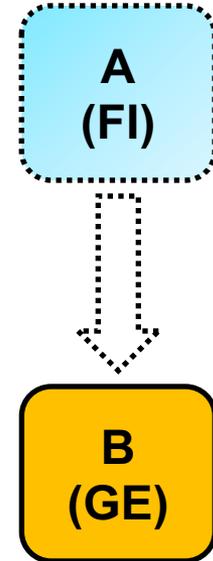
Pros

- Risk detection of foreign businesses is harder because of no prior history or availability of information

Cons

- Harder to claim larger refunds

Tax office (FI)



Identity theft

Hijack

- Change banking details and claim refunds in the name of another company
- How are banking details changed in your countries?

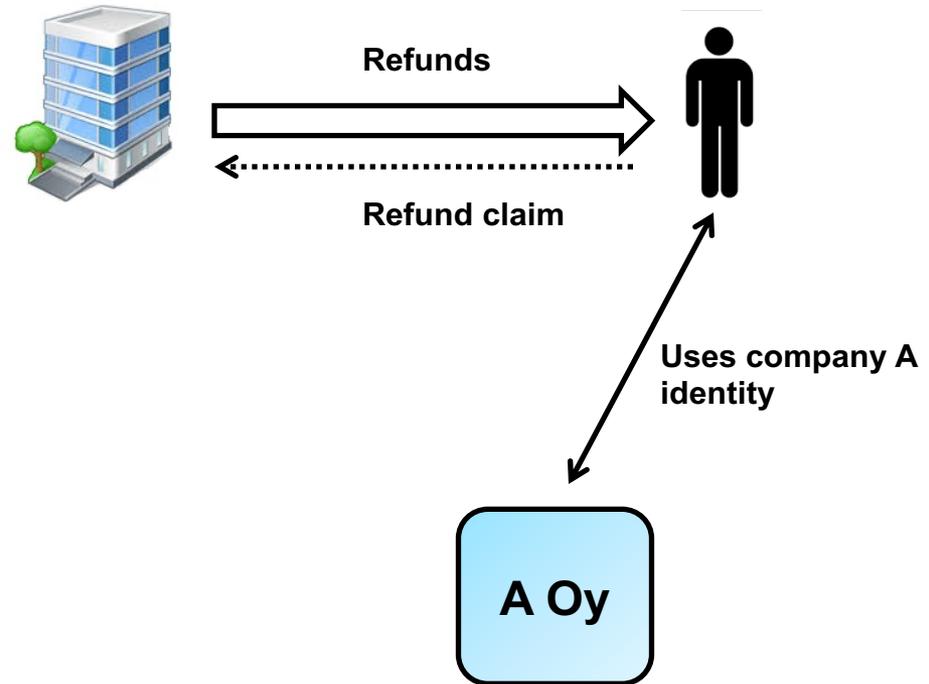
Pros

- Very little to conceal → bank account on shadow persons name

Cons

- Short term
- Success rate?

Tax office



Misunderstanding

Misunderstanding

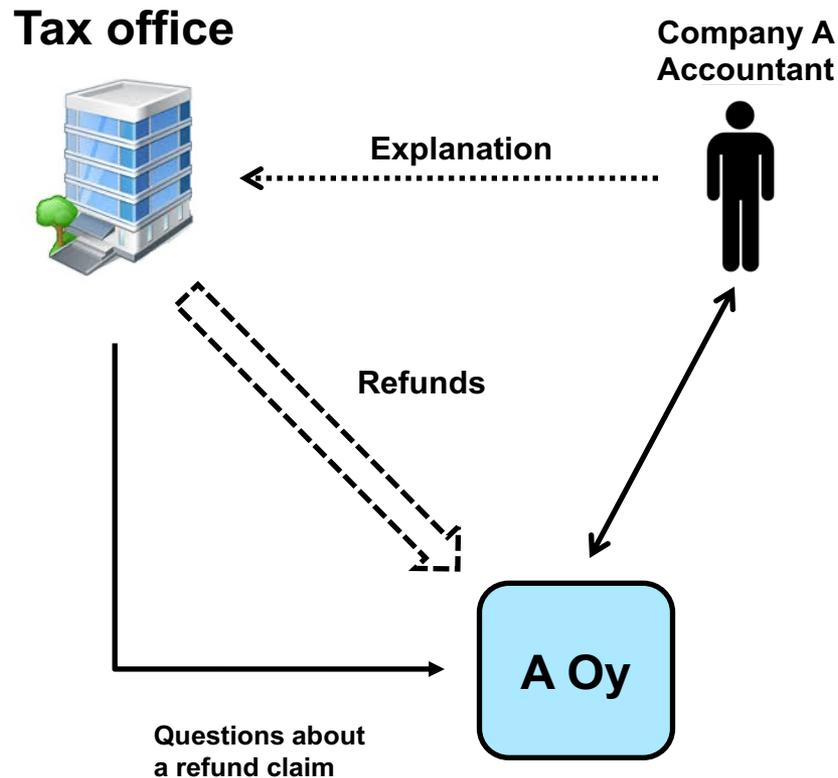
- How does it work?
- Plausible explanation

Pros

- Hard to prove criminal intent
- Mistakes happen all the time...

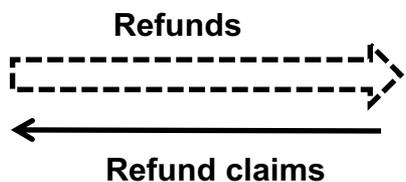
Cons

- Short term → cant keep repeating the same mistake

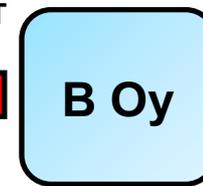
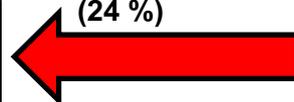


Is it a refund fraud?

Tax office

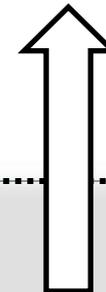


1 000 + 240 VAT
(24 %)



Declared but does not pay VAT

1 400
0 % VAT

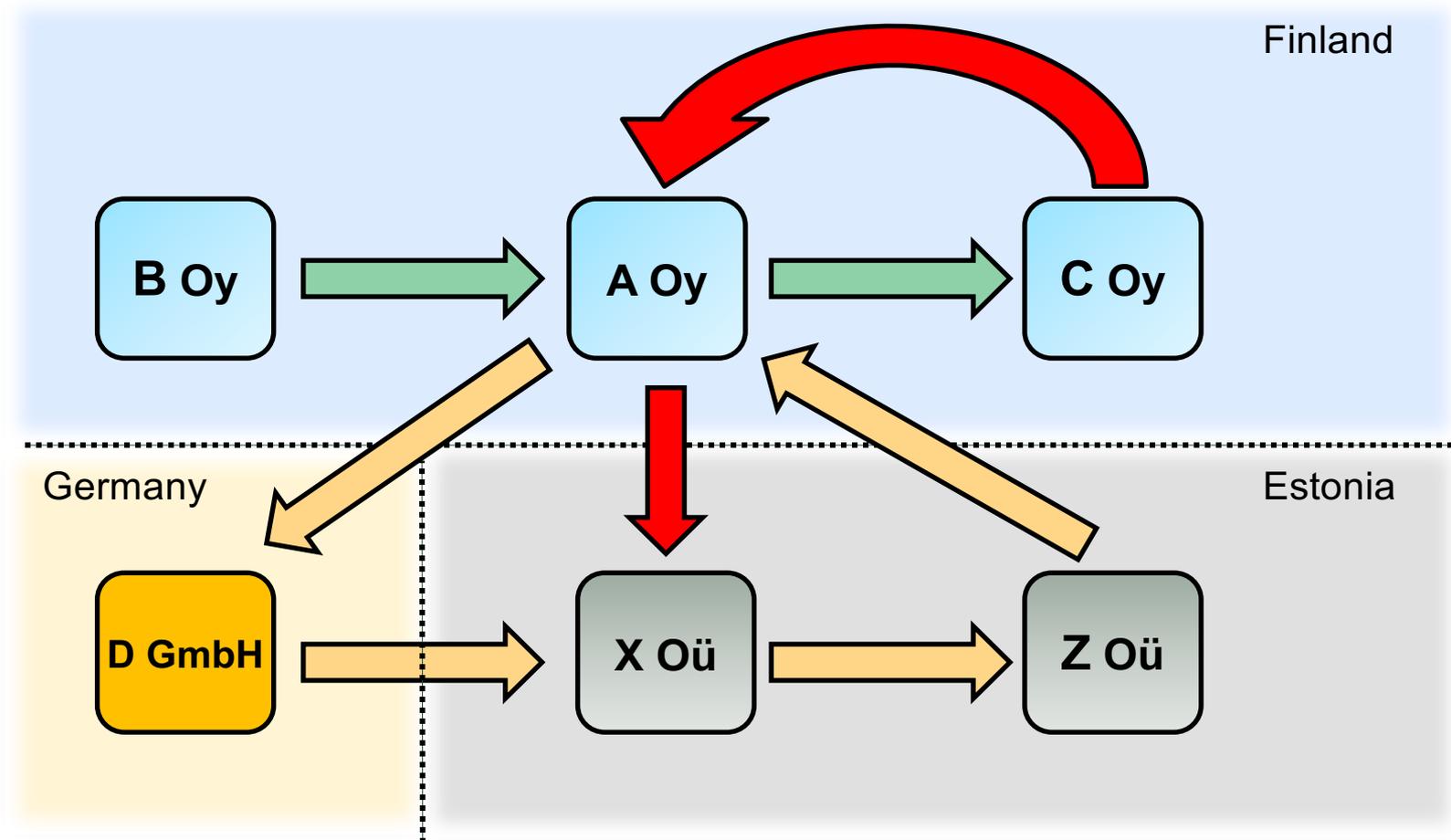


Practical exercise

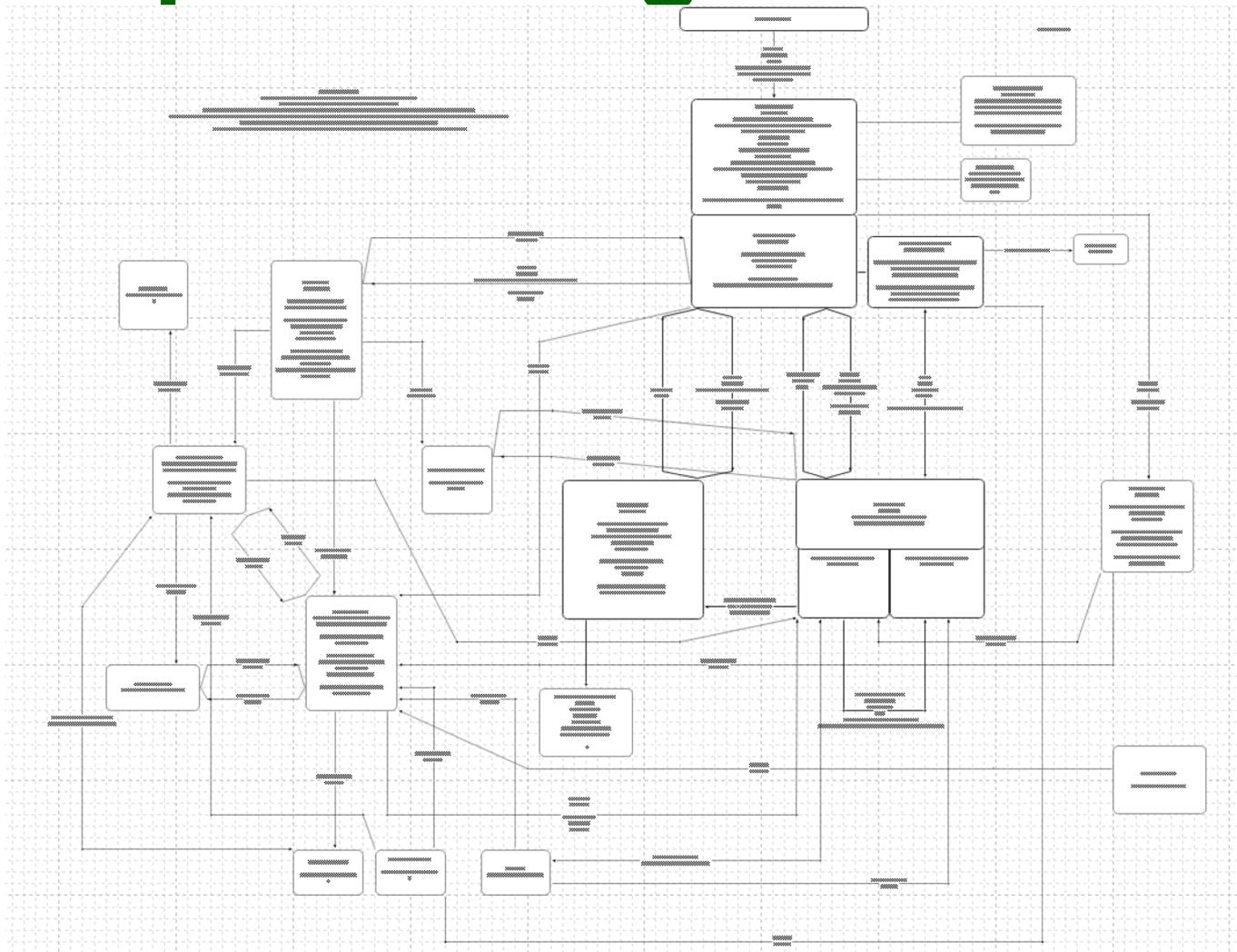
1. What type of the previously mentioned VAT refund frauds have you personally investigated?
2. What type of VAT refund fraud is the most common in your groups opinion?
3. What type of VAT refund fraud would you do as a group?

Just a refund fraud?

Company A role in the fraud?



When presenting a case...

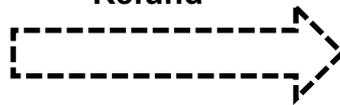


Keep it simple!

Tax office



Refund



A Oy
(Broker)

1 000 € + 24 % VAT

Declares the VAT but
does not pay (defaulter)



B Oy
(MT)



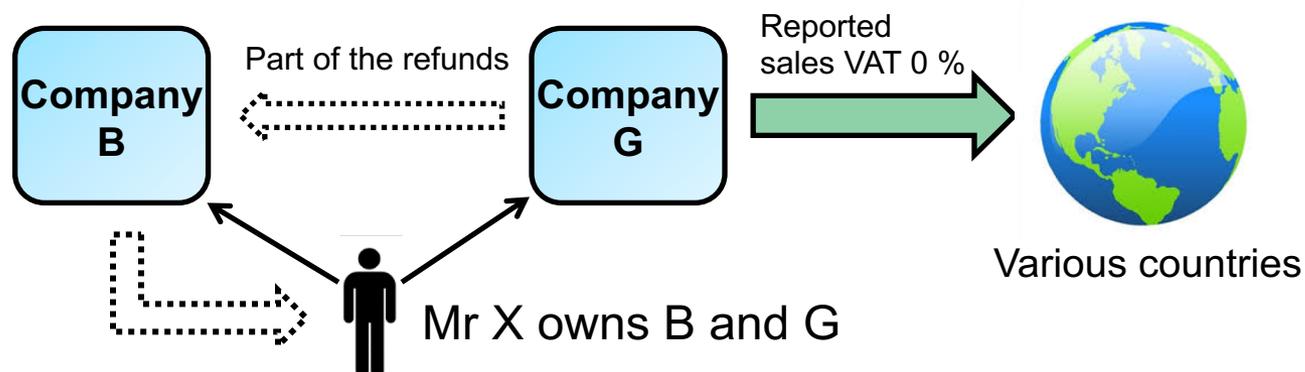
Case studies

Glass fabrication – Case study 1/3

- Company G produced various glass products to consumers
 - Had production facilities, warehouse, machinery, employees etc.
 - In-house accountant
- Person in charge Mr. X
 - Mr X owns 99/100 shares. Mr Y owns 1/100
- VAT registered from 2007. Refunds claimed from 1/2010 – 4/2017
- Refunds paid = 4 million €
 - Reported zero rated sales (0 % VAT)
 - High input VAT due to large investments (input VAT 24%)
- How did we detect the company?

Glass fabrication – Case study 2/3

- Company G is informed of the audit in april 2017
 - Files for bankruptcy in may 2017
- Accountant gets mysteriously ill
- Bank account information reveals...
 - Refunds used to operate the business (salaries, materials, rent etc.)
 - VAT returns and bank account information do not match
 - Flow of money:



Glass fabrication – Case study 3/3

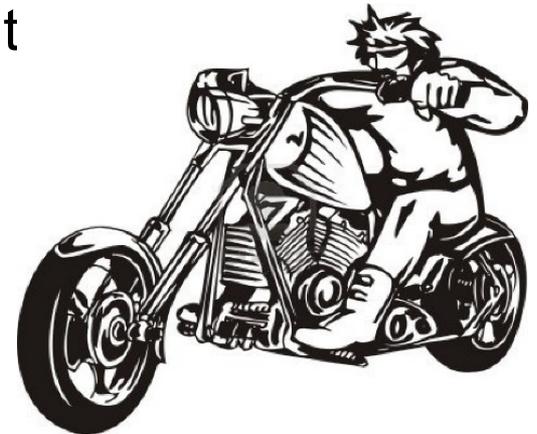
- Information from the bookkeeping
 - Entries in the bookkeeping?
 - Separate accounts for fraudulent transactions!
 - No invoices for the fake goods.
- Fraudulent VAT refunds paid ~4 million €
- Why was it hard to detect?
 - No missing traders, buffers, conduits etc.
 - No shadow persons
 - The real business generated VAT refunds before the fraud
 - Company G was not originally set up for the purpose of conducting a VAT refund fraud

Biker gang– Case study 1/7

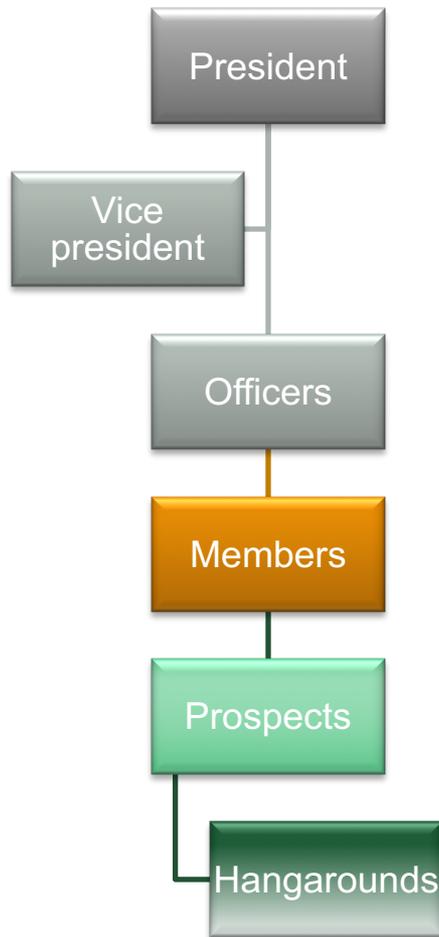
- Money laundering reports received
 - Report consists of two companies
 - VAT refunds paid to the companies
 - No signs of business activity
 - Cash withdrawals
- Two auditors start comparing notes
 - 20 connected companies found
 - All claiming refunds
- Police is already investigating
 - Investigation is not VAT related
 - Bank fraud
 - Business fraud
- Cooperation started

Biker gang– Case study 2/7

- Further investigation reveals a total of ~40 companies claiming refunds
 - Weak shadow persons
 - No business activity
- Companies linked to an outlaw motorcycle club
- Audits start with ~8 auditors put on t
 - Support staff
- VAT refunds paid = 1 million €



Organisation 3/7



General information on outlaw motorcycle clubs

- What does the 1 % label mean?



- How do they operate?
 - Hierarchy
 - Regional chapters
- Is the fraud done as a group or as individuals?
 - Has a direct impact on the possible sentencing in multiple countries

Biker gang– Case study 4/7

- Pattern is seen on bank accounts
 - Money in / Money out
 - No indications of real business activity
- Multiple logins to "tax accounts" on refund days
- Nature of VAT problematic for the investigation
 - Damages every month
 - Stopping refunds can raise alarm for the fraudsters
 - Should we keep paying the refunds?
 - How much can you pay?
 - How long can we keep paying?

Biker gang– Case study 5/7

- Surveillance
 - Cash machines take pictures and can be identified from bank account statements
 - Same cash machines used to withdraw the money
 - Part of the cash taken to the clubs tattoo shop
 - Cash used to purchase bars of gold etc.
- Companies also used to conduct 1 million € worth of business frauds
 - Purchased goods that were never going to get paid
 - Sold the goods (charge VAT) and keep the money

Biker gang– Case study 6/7

- Audits
 - No bookkeeping to audit
 - Challenge for the auditors?
 - Quantity and consistency
- Assets recovered?
- Aftermath
 - Awaiting criminal trial...
 - Internal conflicts in the motorcycle club
 - The "leaders" of the fraud kicked out
 - The mastermind?
- The case led to increased anti-fraud efforts (VAT)

Biker gang– Case study 7/7

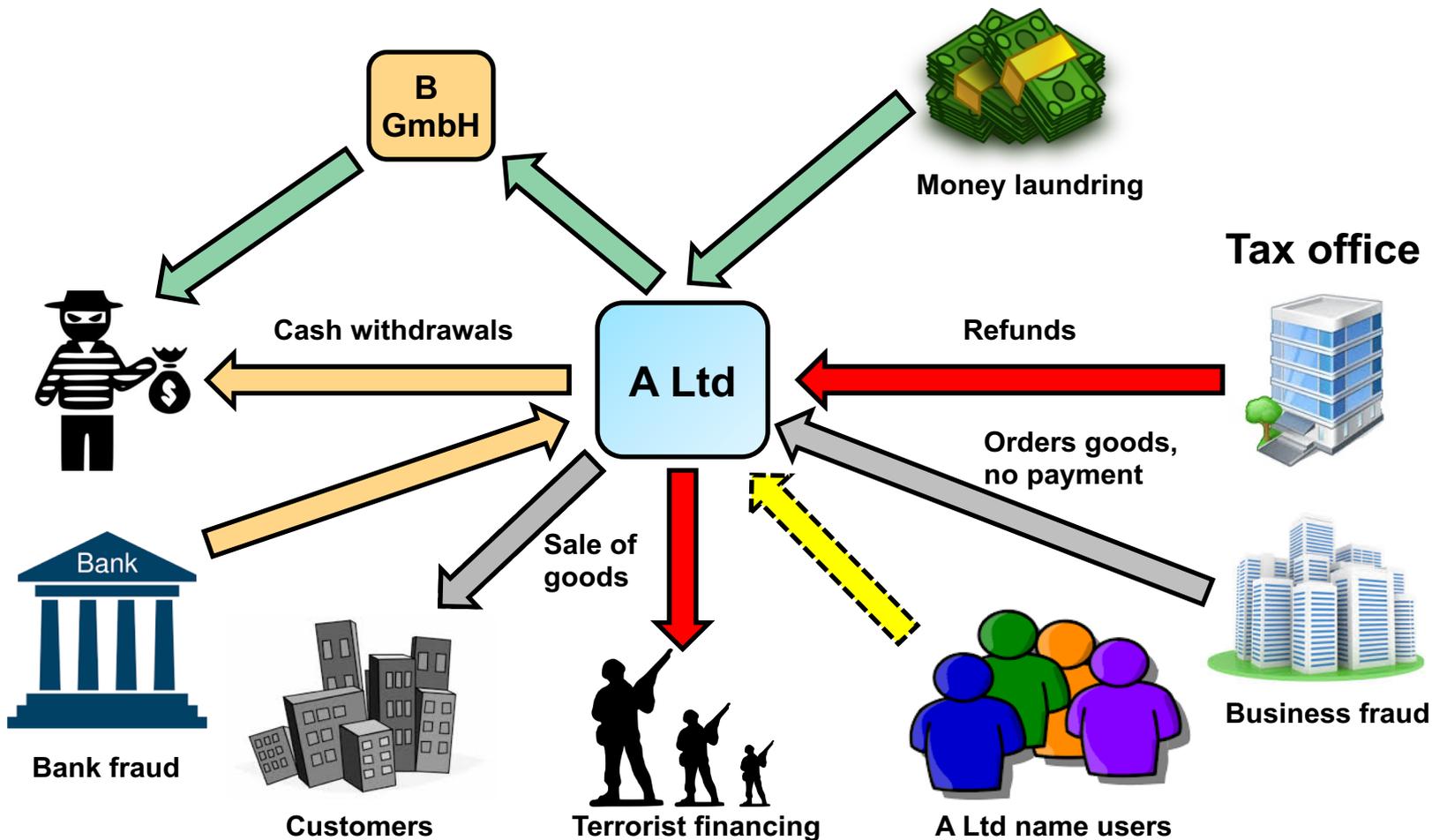
- Where are we now?
 - One of the main organisers of the fraud fled the country
 - Prosecution demands a penalty of...

- What did he do while in hiding?

Hijack and harass – Case study

- Requests to change the company bank account number
- Registry control started to suspect a fraud
- Further investigation...
 - ~ 200 requests received on paper
 - Companies requesting the change to the banking information had also sent a new refund claim
 - Companies had clean background
- What was happening?
 - Companies unaware
 - Aim was to overburden the Tax administration

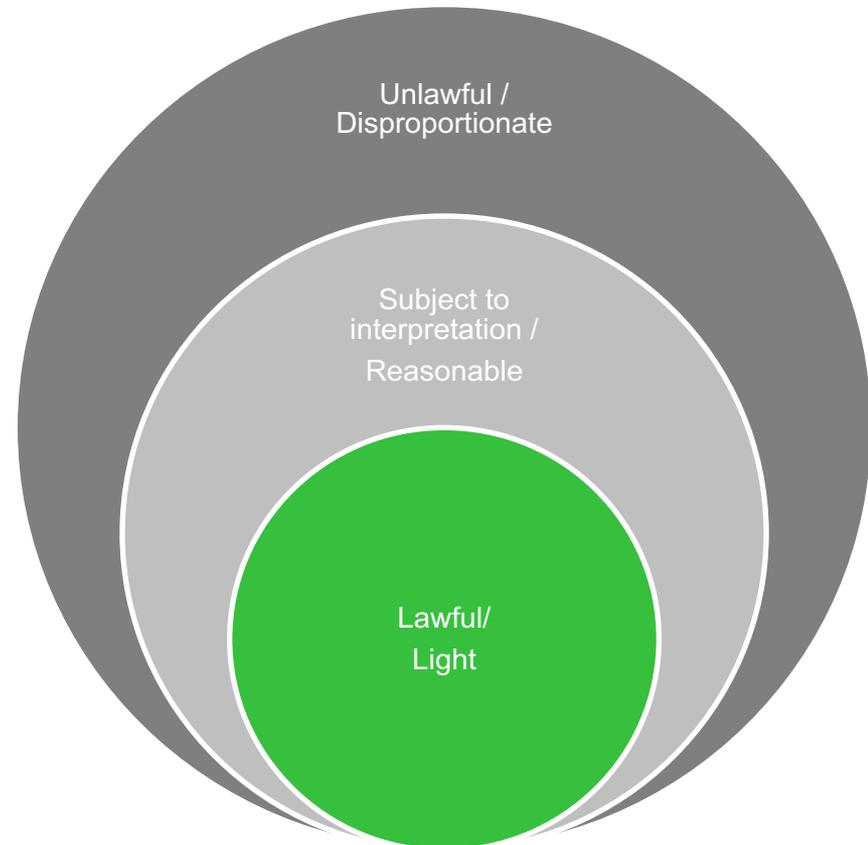
More than a VAT fraud...



Few words on control measures/actions

- Must be lawful and appropriate considering the end goal
 - Information needed vs burden to the taxpayer
- The big picture
 - Anti-fraud is not the main tax collector
 - Anti-fraud measures promote healthy competition and builds trust
- The risk factors on a taxpayer decide the actions we take
 - Identifying the fraudsters and risky taxpayers is the key (risk analysis)
 - Low risk → light actions
- Fraudster do not respond to:
 - Written instructions
 - General advice
 - Preliminary discussions

Legality of actions / Burden of actions



In conclusion...

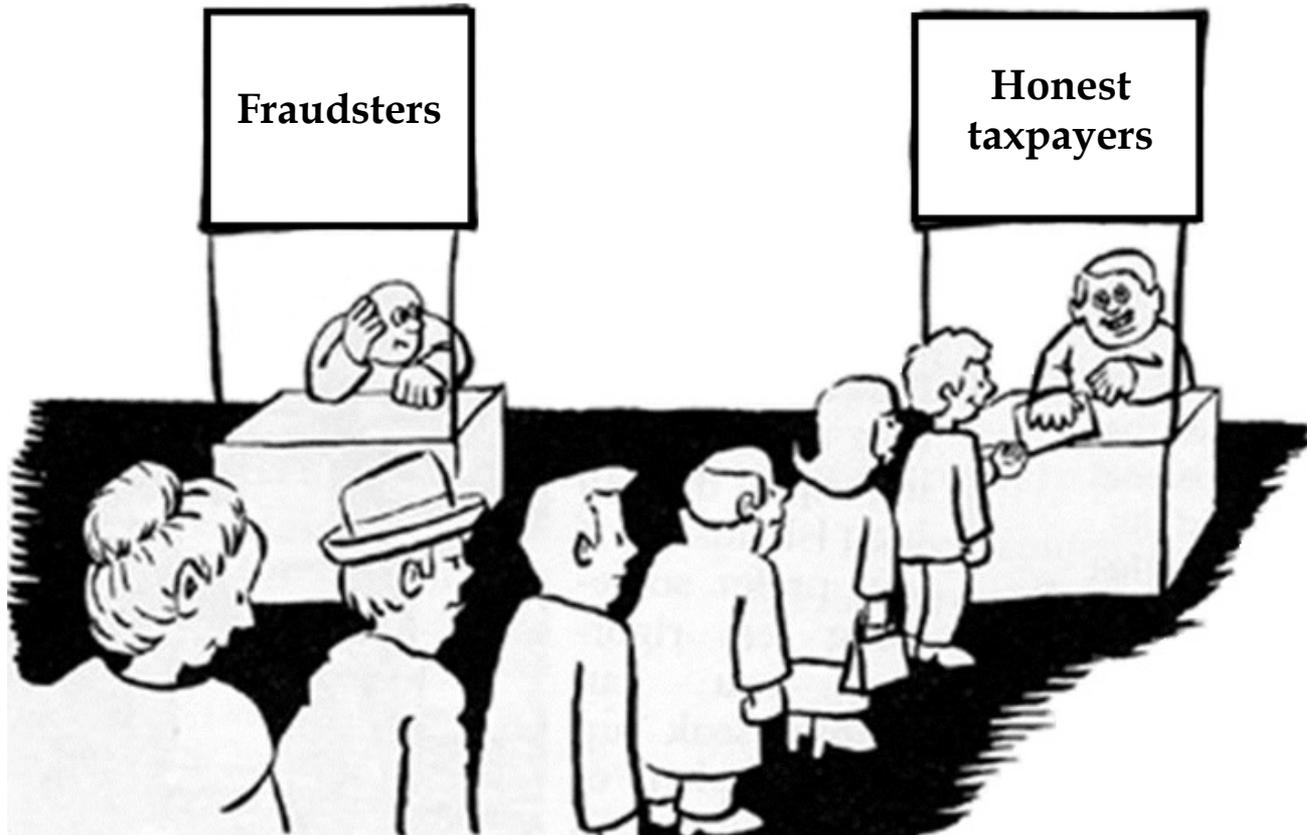
- Refund mechanism is problematic
- Operating internationally gets easier
- Virtually any refund mechanism can be exploited, not just VAT!
- Support for the Registry and VAT control!
 - Not everything requires an audit
- The big picture...

Think outside the box



"...and this is where we train our employees to think out of the box."

The anti-fraud mentality



Make sure the investigators have enough time and resources



Tax positive atmosphere



Questions?