Beware the GST Carousel Fraud

E-Tax Guide On Due Diligence Checks To Avoid MTF

8 April 2021, Thursday

Facilitated by:
Mr Koh Soo How

Missing trader fraud (MTF) is a growing concern for tax authorities in jurisdictions with value-added tax systems. This fraud scheme, commonly used by crime syndicates to defraud tax authorities, has caused annual tax losses of around €60 billion to the European Union[1], and has put some S$450 million of public revenue at stake in Singapore[2].

Understanding Missing Trader Fraud

MTF often operates under the guise of a series of legitimate business transactions across a supply chain. In a typical MTF arrangement, the seller (the "missing trader") does not account for or pay Goods and Services Tax (GST) (that is, the output tax) charged on goods sold to the intermediary or "buffer" business. There is an immediate loss of public revenue while the buffer businesses continue to make input tax claims on their purchases.

The goods are ultimately exported to an overseas customer, with no GST charged as the supply is zero-rated.

The exporter then claims the input tax which it paid on the purchase of the goods. The fraud may be repeated by re-importing and re-exporting the same goods which gives rise to the term "carousel fraud".

Sometimes, the missing trader inflates the value of counterfeit or lower quality goods and absconds with the GST charged on the inflated value without accounting the output tax to the tax authorities.

Amendments to the GST Act

Prior to the enactment of the GST (Amendment) Bill 2020, customer accounting was the primary measure to deter MTF. Under customer accounting, the responsibility to account for output GST on the sale of prescribed goods (such as mobile phones, memory cards and off-the-shelf software) made to a GST-registered customer shifts from the supplier to the customer, akin to a domestic "reverse charge".

"While customer accounting continues to act as a counter measure to MTF in Singapore, it is not without its limitations, shared Accredited Tax Advisor (GST) Koh Soo How, Executive Director, Koh SH & Associates Pte Ltd, at a webinar organised by the Singapore Chartered Tax Professionals. "For customer accounting to be effective, the authorities would have to pro-actively identify the types of goods that would be the subject of MTF schemes. In reality, the law will always be 'playing catch-up' with the fraudsters."

[1] Europol (n.d.) "MTIC (Missing Trader Intra Community) Fraud" (n.d.), Europol; https://www.europol.europa.eu/
[2] Tang See Kit (2020) "More power for taxman to seize goods for investigations among changes to GST Act" (3 November 2020), Channel News Asia; https://www.channelnewsasia.com

Parliament has since passed amendments to the GST Act to introduce new measures to better counteract MTF in Singapore.

The Knowledge Principle

Since 1 January 2021, a taxable person is not entitled to claim input tax on supplies made to him which he "knew or should have known" to be part of any arrangement to cause loss of public revenue, regardless of whether the loss was indeed caused. This rule is referred to as the "Knowledge Principle".

Under the Knowledge Principle, businesses are to conduct proper due diligence of business deals and scrutinise the legitimacy of their purchases more carefully.

Businesses are expected to take reasonable steps to ascertain and conclude that the goods or services were not part of an MTF arrangement, this conclusion being one that a reasonable person would have made. Otherwise, the Comptroller of GST can withhold or deny the input tax claims and impose a 10% surcharge on the input tax denied if the taxpayer "knew or should have known" that the arrangement was fraudulent.

IRAS' Guidance on MTF

In line with these legislative amendments, the Inland Revenue Authority of Singapore (IRAS) published an e-Tax guide titled "Guide on Due Diligence Checks to Avoid Being Involved in MTF" on 10 February 2021. Emphasising the importance of businesses' role in instituting proper controls to prevent perpetuation of MTF, the guide proposes a three-pillar approach to applying the Knowledge Principle. More importantly, it provides insights into IRAS' thinking as to the reasonable steps that businesses should take to avoid being caught up in MTF arrangements.

PILLAR 1: IDENTIFY AND ASSESS RISK INDICATORS

Before entering into a business transaction, businesses should understand the circumstances surrounding the transaction, look out for risk indicators, and assess whether there is a reasonable risk that the supply made to or by them might be part of an MTF arrangement. Some tell-tale signs and risk indicators that may distinguish MTF transactions from normal commercial practices are:

(a) **Legitimacy of customers and suppliers**
- Is it reasonable for a newly established supplier to offer high-value deals?
- Is the supply within the nature of business ordinarily carried on by the supplier/customer?
- Do the transacting parties share the same address?

(b) **Commercial viability of the business arrangement**
- Are the deals "too good to be true"?
- Is the value of goods transacted unusually high relative to the market demand and price?
- Is the profit margin abnormally high for the relatively low level of commercial risks involved?

(c) **Commercial viability of the payment arrangement**
- Are they cash-only transactions?
- Does the supplier require payments to be made to a third-party or offshore bank account?
- Does the customer make payments through a local paying agent or third-party account?

(d) **Authenticity of the goods/services transacted**

- Are the source and authenticity of the goods unclear?
- Is there assurance on the quality and condition of the goods which are backed by documented warranties?

Pillar 2: Perform Due Diligence Checks

After the risk indicators have been identified and assessed, businesses are expected to conduct the appropriate due diligence checks and enquiries. The due diligence efforts should take a risk-based approach that commensurate with the type and level of risks identified.

Essentially, businesses are to verify the legitimacy of the immediate customers and suppliers, ascertain the commerciality of the business arrangement and payment arrangement, and verify the authenticity of the goods and services transacted, based on the risk indicators identified. With a discerning mind, they can avoid being used as buffer companies for MTF arrangements.

Pillar 3: Respond to the Risks and Results of Checks

For each transaction entered into, businesses should maintain proper records to demonstrate that reasonable steps have been taken and that they can reasonably conclude that the supply was not part of an MTF arrangement. The documentation should include the risks assessed, the due diligence checks performed, and the actions and precautions taken by the business in response to the results from the checks.

Ultimately, businesses must maintain records of the measures taken to mitigate the risks and issues identified, and avoid participating in a transaction if it is suspected to be part of an MTF arrangement.

What Businesses Can Do to Protect Themselves

To avoid getting involved in MTF or being taken for a ride on the carousel fraud, businesses should also consider the following to drive the integration of an MTF risk management approach:

(a) **Integrate MTF risk management into existing governance framework**
The business should identify a risk/process owner to be accountable for MTF risk management and mitigate the risks by implementing a process to identify, assess and understand MTF risks.

(b) **Conduct risk assessment**
The business is expected to take reasonable steps to identify any exposure to MTF risks. Current supplier/customer onboarding processes should be reassessed and continuously monitored to mitigate such risks. If the risk assessment suggests potential MTF exposure, more detailed checks must be carried out to determine the appropriate counter measures.

On the question of whether businesses need to perform due diligence checks on existing relationships, Mr Koh suggested that pragmatically, a prospective rather than retrospective approach is due.

"If you have already done your proper onboarding as far as your existing vendors are concerned, you should not need to do much more due diligence than what you have already done with them, unless there are red flags signalling a possible connection with MTF arrangements or if there are material changes in the transactions with the vendors. For the most part, it is only when you are onboarding new suppliers that you should consider whether there is a need to expand the scope of your due diligence checks to address potential MTF risks."

(c) **Document GST policies and periodic GST reviews**

It is good practice for businesses to document their GST policies and procedures. Specifically, they should maintain proper records of the GST treatment of business transactions; procedures for preparing, reviewing, and filing of GST returns, as well as process for escalating errors.

To ensure that GST policies and controls remain robust, businesses should also consider conducting periodic GST reviews on the organisation's risks and controls.

(d) **Awareness and training**

While MTF seeks to exploit the mechanisms of the value-added tax system, it would take more than just the tax and finance departments' efforts to avoid being caught in such arrangements. Regular training should be provided to employees on MTF arrangements, its risk indicators and common errors involved. The awareness training can focus on employees performing governance and compliance functions, as well as those whose roles put them in close proximity to potential MTF transactions (including personnel from procurement, sales, logistics and accounts departments). The goal is to teach employees to be wary of transactions that seem "too good to be true" and identify the red flags of potential MTF arrangements.

While the new GST rules have augmented the standards of compliance for GST-registered businesses, the incorporation of an MTF risk management approach need not necessarily be onerous for businesses with proper frameworks and strong existing controls in place. For other businesses lacking proper frameworks and controls, the latest amendments to the GST legislation are additional reasons why they should finally review their GST compliance – or risk losing their input tax claims.

Please click here to rate this article.

Facilitator

Mr Koh Soo How
Executive Director
Koh SH & Associates Pte Ltd
Accredited Tax Advisor (GST)
E: soohow@kohsh.sg

Felix Wong is Head of Tax, Singapore Chartered Tax Professionals (formerly Singapore Institute of Accredited Tax Professionals).

For more tax insights, please visit www.sctp.org.sg

This article is intended for general guidance only. It does not constitute professional advice and may not represent the views Koh SH & Associates Pte Ltd, the facilitator or the SCTP. While every effort has been made to ensure the information in this article is correct at time of publication, no responsibility for loss to any person acting or refraining from action as a result of reading this article or using any information in it can be accepted by Koh SH & Associates Pte Ltd, the facilitator or the SCTP.

SCTP reserves the right to amend or replace this article at any time and undertake no obligation to update any of the information contained in this article or to correct any inaccuracies that may become apparent. Material in this document may be reproduced on the condition that it is reproduced accurately and not used in a misleading context or for the principal purpose of advertising or promoting a particular product or service or in any way that could imply that it is endorsed by Koh SH & Associates Pte Ltd, the facilitator or the SCTP; and the copyright of SCTP is acknowledged.

© 2021 Singapore Chartered Tax Professionals. All Rights Reserved.