



STATISTICS DIRECTORATE

STD/NAES/TASS/ITS(2006)21
For Official Use

National Accounts and Economic Statistics - International Trade Statistics

Item 8 b): VAT fraud and the trade supply chain: the "missing trader" or carousel fraud and its impact on trade statistics

**7TH OECD INTERNATIONAL TRADE STATISTICS EXPERT MEETING ITS
and OECD-EUROSTAT MEETING OF EXPERTS IN TRADE-IN-SERVICES STATISTICS (TIS)**

Tour Europe - Paris La Défense, Salle des Nations, 11-14 September 2006

This document has been prepared by Caroline Lakin, ONS, and Sandra Tudor, HM Customs & Excise, for information and comments under item 8 b) of the draft agenda.

For further information, please contact:
caroline.lakin@ons.gsi.gov.uk
sandra.tudor@hmrc.gsi.gov.uk

JT03213199

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

**UK TRADE STATISTICS AND THE IMPACT OF MISSING TRADER
INTRA-COMMUNITY FRAUD**

Caroline Lakin
Trade in Goods Branch
Balance Of Payments Division
Drummond Gate
London
UK
caroline.lakin@ons.gsi.gov.uk

Sandra Tudor
Statistics and Analysis of Trade Unit
Knowledge, Analysis and Intelligence
Alexander House
Southend
UK
sandra.tudor@hmrc.gsi.gov.uk

OECD asked for a brief on the current situation affecting UK trade statistics and trade associated with Missing Trader Intra-Community VAT fraud (MTIC fraud).

Interest in the UK is very high because the impact on the trade statistics is currently growing again – estimated at over **£8 billion in Q1 2006** (13 billion euros or 14 billion US dollars) - and the link to crime appeals to the press. In particular, monetary analysts supporting the Monetary Policy Committee at the Bank of England are very keen to understand how they should interpret UK trade figures.

This note describes changes to the pattern of trading associated with MTIC fraud, the way in which the public have been kept informed about the impact of the fraud on the trade statistics and how we have sought to maintain confidence in the estimates themselves.

What is MTIC trade? - background and history

Missing Trader Intra-Community fraud is a systematic criminal attack on the VAT system, which has been detected in many EU Member States. It relies on the VAT-free movement of goods between Member States. In essence, fraudsters obtain VAT registration to acquire goods VAT-free from other Member States. They then make a domestic sale of the goods at VAT inclusive prices and disappear without paying over to the tax authorities the VAT paid by their customers. The trade tends to be in high value, low volume goods such as mobile phones and computer components. The fraud is usually carried out very quickly, with the fraudsters disappearing by the time the tax authorities follow up the registration with their regular assurance activities.

The estimated value of the fraud can be seen in table 1.

Table 1: Estimated MTIC Fraud (£ billion)

Financial Year	Upper estimate	Lower estimate
2000–01	2.47	1.31
2001–02	2.53	1.72
2002–03	2.34	1.54
2003–04	1.73	1.06
2004–05	1.90	1.12

Source: HM Revenue & Customs 'Measuring Indirect Tax Losses', 2005

There are two types of fraud:

Acquisition fraud is where the goods are imported from another EU state into the UK by a trader who then goes missing without completing a VAT return or Intrastat declaration. The 'missing trader' therefore has a VAT free supply of goods, as they make no payment of the VAT monies due on the goods. They sell the goods to a buyer in the UK and the goods are available on the home market for consumption.

Carousel fraud is similar to acquisition fraud in the early stages, but the goods are not sold for consumption on the home market. Rather, they are sold through a series of companies in the UK and then re-exported to another EU State, hence the goods moving in a circular pattern or 'carousel'.

Because the recording of EU trade data is based on Intrastat declarations from VAT registered traders, the way in which the fraudulent transactions are reported means that any exports relating to the fraud are

reported but imports relating to the fraud are not. As a consequence, UK import statistics would be under reported. (There is some debate, discussed later, about whether the exports should in fact be excluded.)

Adjustments have been made to import data since July 2003, following an extensive review process and consultation with the UK and internationally. This was accompanied by an article¹, and reported on to OECD members in September 2003.

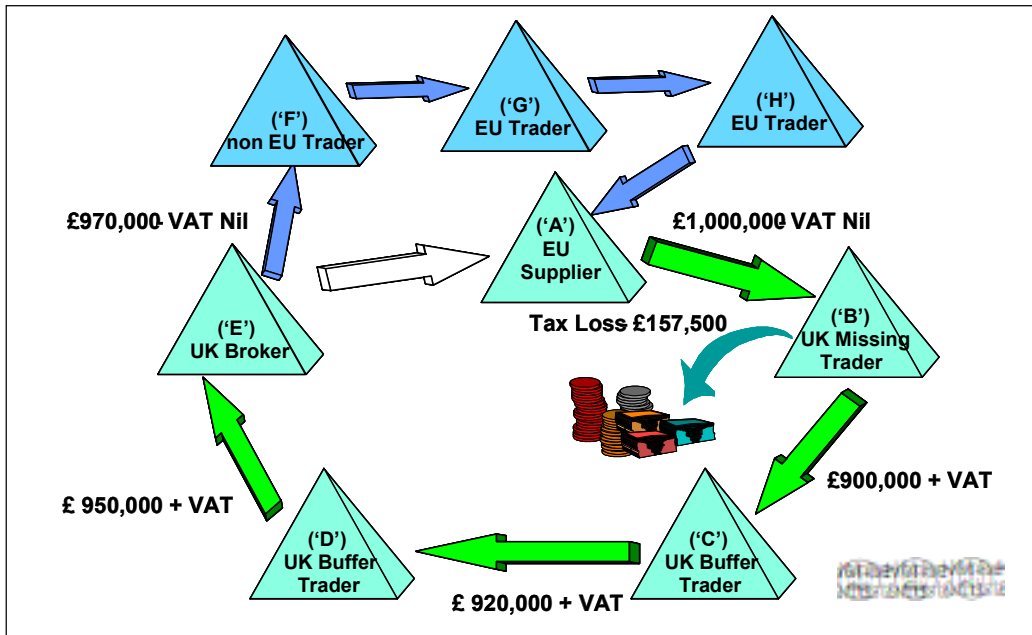
The method used relies on information uncovered during Customs' operational activity. As such, it cannot be detailed for risk of prejudicing current activity and undermining the UK's ability to tackle the fraud effectively.

Originally, most carousel chains only involved EU member states and were relatively simple. More recently, some carousel chains include non-EU countries, for example, Dubai and Switzerland. The goods are exported outside of the EU and return via another EU member state, or more usually through more than one other EU Member State. The MTIC-related trade adjustments are added to the EU import estimates derived from Intrastat returns as it is still this part of the trading chain that is not recorded.

Changes to the pattern of trading associated with MTIC fraud can therefore make it difficult to analyse trade by commodity group and by country as changes in the impact of activity associated with this fraud affect both imports and exports.

¹ VAT Missing Trader Intra-Community Fraud: The effect on Balance of Payments Statistics & UK National Accounts can be found at <http://www.statistics.gov.uk/cci/article.asp?id=402> or <http://www.uktradeinfo.com/ttarticles/MTIC.pdf#search=%22ruffles%20tudor%20mtic%22>

Simple model of carousel chain with non-EU country



This extension to non-EU trade was identified in early 2005 and estimates were incorporated almost immediately

y (from August of that year). The extension was identified by operational activity. However, in retrospect, the statistical departments concerned might have spotted the unusual increases in exports to destinations that were not usually major export markets e.g. Dubai. The delay was due to the fact that the monthly trade data contains about two million consolidated lines of trade, and that that monitoring systems used in the UK tend to focus on commodities OR countries, not on commodities by country because the latter gives too much detail. This is being addressed by the current review of the underlying methodology of the adjustments.

International convention for both the Balance of Payments and the Overseas Trade Statistics (Merchandise trade) determines that the treatment of the impact is to adjust imports upwards by the relevant amounts. However, some users wish to interpret short-term movements in exports and imports excluding completely this fraudulent activity, and for this purpose an analysis of the export and import figures with the VAT MTIC adjustments excluded is made available for both datasets.

National Accounts are constructed according to the European System of Accounts (ESA) 1995. The purpose of this is to give a standard so that all countries' figures are comparable against each other. At the most basic level the ESA specifies whether transactions / activities should or should not be included in the

National Accounts. The ESA took explicit account of illegal activity when considering the definition of a transaction:

"1.42. The definition of a transaction stipulates that an interaction between institutional units be by mutual agreement Illegal economic actions are transactions only when all units involved enter the actions voluntarily. Thus, purchases, sales or barter of illegal drugs or stolen property are transactions, while theft is not."

Recognising these guidelines, the UK had already taken steps towards the incorporation of illegal activity in the UK National Accounts. In the 2001 National Accounts ONS introduced estimates for the smuggling of tobacco and alcohol into the UK involving adjustment of consumer demand, imports of goods and compensation of employees. Incorporating an adjustment for the impact of MTIC fraud into the National Accounts involves a judgement over whether the activity should be in the accounts at all. The relevant consideration is that all involved in transactions forming part of a MTIC carousel are participating by mutual agreement (even if some may not be involved in the fraud), and so complies with section 1.42 of the ESA above. In this way, the transactions should be recorded in both import and export flows.

For the Overseas Trade Statistics, Member States are required by EC legislation to include all movements of goods from traders who fall within the scope of Intrastat and Extrastat legislation. The UK was initially advised not to add in the estimates, as we could not provide the level of detail required. However, as we assume the goods actually move around the carousel, the correct procedure is to add in the missing trade data to the EU arrivals (imports) and we agreed to investigate how this could be achieved.

A second project was set up after publication in mid 2003 to consider the way forward. It concluded that, while the additional analyses confirmed that the method produced the best estimates possible from existing sources, it was not possible to improve or extend the estimates for the impact of fraud on the statistics². It agreed however that work would continue in a number of areas:

- Introducing adjustments for the impact of MTIC fraud into the Overseas Trade Statistics
- Liaising with other Member States, to monitor any progress with development of their estimates and methodology
- Balance of Payments asymmetries analyses
- Overseas Trade Statistics asymmetry studies

² Report on further research into the impact of Missing Trader Fraud on UK Trade Statistics, Balance of Payments and National Accounts can be found at: <http://www.statistics.gov.uk/cci/article.asp?ID=1066> or http://www.uktradeinfo.com/downloads/Further_Missing_Trader_Fraud_Research.pdf

- Monitoring changes to commodities used in MTIC fraud
- Input-Output supply balance analyses
- Monitoring changes/developments in the Pre-Budget Report (PBR) estimates of VAT Revenue Loss

We are currently conducting our third review relating to the impact of MTIC fraud on the trade statistics. This is looking at several issues, for example whether some MTIC imports are actually recorded in the trade statistics. Changes in the last few months have led to the scope of the project increasing to 10 from 6 work packages. Additional work includes estimating the effect of "reverse charging" (see below). The sources that are being examined in the review include VAT, Intrastat, (EU trade) and European Sales List (ESL). The ESL is a mandatory document that all VAT registered traders are required by VAT legislation to complete.

The UK government has applied to the EU for derogation on the VAT regulation, in order to implement reverse charging on specific goods associated with the fraud. When this measure is implemented, changes are expected in the pattern of MTIC activity and the pattern of trade. (The purpose of the measure is to stop the fraud rather than to get import forms completed.)

Under the Reverse Charge procedure, the suppliers of goods still declare sales to other VAT-registered firms, but the end (VAT) purchaser assumes responsibility for paying VAT, and recovering any rebate. It is difficult to predict the impact on illegitimate trade. Reverse charging is a deterrent to Carousel Fraud. However, fraudsters may switch to trading in goods for which the reverse charge doesn't apply. The ability for traders to do so will be limited by a number of factors. These include:

- the availability of such goods in large enough volumes
- the ability to 'credibly' build up carousel trade so it appears to be legitimate

Impact on users

Substantial adjustments (now up to £8 billion in a quarter) are being made to the trade figures to account for missing trade declarations associated with MTIC fraud but the underlying pattern and key economic messages are still being obscured both in terms of the country and the commodity breakdown. Changes affect both imports and exports, increasing the level of trade across the EU and giving high growth rates.

When the additional problem with non-EU exports arose in the summer of 2005, we reacted more quickly than in 2003 even though it meant that we could not consult as widely. This was welcomed by the Press and other Government Departments. Apart from the additional problem with the EU/non-EU breakdown in the Balance of Payments analysis, difficulties in analysing changes in trade in commodities became even more apparent. We have always briefed the Press and other Government departments as fully as possible, via our websites and on a face to face basis. All the publications, such as the Overseas Trade Statistics books and ONS' First Release, include a contact point and we have talked to a number of contacts from the financial sector in particular. We have spent a considerable amount of time briefing journalists from the media, for example, the Guardian, the Economist and the BBC who have written articles on MTIC fraud, and the result has been coverage that has been generally well informed and positive.

We have improved the information in the publications as far as we can do so. In particular, there is a table showing the effect of the adjustment in the Overseas Trade Statistics publications and tables for values and volumes without MTIC related trade in the supplementary notes of the ONS' UK Trade Release. It is essential that it is made clear that the estimates are of missing trade declarations associated with carousel fraud, NOT of the fraud itself. The level of tax at risk is substantially lower. On a simplistic basis the level of tax at risk is 17.5% of the trade (the UK VAT rate). However, this will overestimate the level of VAT loss and we have explained to the Press that the estimate of the impact of MTIC fraud on trade should not be used in this way.

We always make the point that the adjustments to data should have a zero effect for trade balances at the aggregate and product level. This is not true for country balances because the adjustment for non-EU trade is spread over imports from all member states as a proxy adjustment. . The background briefing for the ONS' UK Trade Release shows commodity breakdowns for EU and non-EU trade for capital and intermediate goods so that the Press can be helped to appreciate the way in which the trade moved towards non-EU countries and is now moving back towards the EU. Up until this year's National Accounts, the net effect on the balance of trade and GDP in volume terms was not neutral because of the use of different deflators for imports and for exports. This has been changed so that the part of exports thought to be related to MTIC fraud is now deflated by the relevant import deflators so the overall effect is neutral. This has affected estimates of the volumes and prices of exports with volumes being revised upwards and prices downwards in recent periods.

In order to avoid criticism of data reliability, since the estimates are relatively likely to be revised, we make the point regularly that the UK is the only member state making such adjustments despite it being a

widespread problem throughout the Community. Other countries' data may be misleading as they will show unnaturally buoyant exports and a more favourable trade balance. The UK can estimate adjustments because of the relatively close relationship between Statistical, Customs and Enforcement areas within HM Revenue & Customs.

User reaction

Users generally have been sympathetic to the current difficulties in interpreting trade data. Many users would prefer the main Balance of Payments analyses to be published excluding such trade but that would contradict international guidance. The Bank of England has major concerns about the impact on GDP and exports, and greater uncertainty about their accuracy. They want more information, including commodity detail, which cannot be provided for operational reasons. They are tending to focus on "economic" trade, i.e. excluding MTIC fraud related trade. There are supplementary tables in the release showing trade excluding MTIC related trade but they are only aggregates and only for quarterly data as otherwise users could derive confidential monthly data by differencing.

Quality assurance

These adjustments have been assessed for coherence with other data. In particular, both the Overseas Trade Statistics asymmetry analyses and the Supply and Use balances, used for the construction of GDP estimates, have been used to validate and inform the relevant sizes of adjustments. It is clear that MTIC fraud has made a major contribution to increased asymmetries between EU Member States trade figures. The revisions for the impact of MTIC fraud on the trade statistics are, however, just one of a number of factors influencing the asymmetry discrepancies.

Asymmetry analyses are undertaken because trade can be looked at from the perspective of either of the countries involved. For example, the UK's estimate of its exports to country X should be the same as country X's estimates of its imports from the UK, and the UK's estimates of its imports from country X should be the same as country X's estimates of its exports to the UK. These types of checks are known as mirror statistics and the divergences between the mirror statistics, as asymmetries. In practice, there are a number of technical and methodological reasons that means these theoretical identities will not hold. However, comparisons of this type have long been recognised as helpful cross-checks on trade data. In

2003 and in 2006, this analysis had a significant impact on the finalised estimates in the UK National Accounts.

Conclusion

The measurement of illegal activity is difficult. However, taking advantage of the close working relationship between statisticians and customs colleagues in the UK has enabled us to analyse a range of data and information to produce reasonable quality estimates of the impact of MTIC on the trade statistics.

Recent changes in the pattern of fraud have made the measurement of the impact more difficult, but we are reviewing the impact of these changes. More information will be published later this year.

The UK will continue to monitor the impact on our trade data. We have also provided information and advice to other EU Member States who may need to consider making similar adjustments to their trade data. Meanwhile, it should be noted that the development of carousel chains that involve non-EU countries means that the fraud now affects the levels of imports and exports in a larger group of countries across the world.