



Case & Project Experience

NERA Assists Taxpayer in Successful Appeal of HMRC Claim of Carousel Fraud: *JDI Trading Limited v. The Commissioners for Her Majesty's Revenue and Customs*

Background

In April 2008, Her Majesty's Revenue and Customs (HMRC) denied JDI Trading Limited (JDI) the right to deduct input tax in the sum of £688,421 relating to value added tax (VAT) that it had paid to its suppliers during 2006. The case concerned nine transactions involving consignment sales of mobile phones, which JDI purchased in the UK and subsequently exported to an Italian company, Navigo SPA IT ("Navigo"). HMRC determined that these transactions were connected to a type of missing trader intra-community (MTIC) fraud, commonly referred to as "carousel fraud."

In a carousel fraud, goods are imported, sold from one domestic trader to another (possibly through several traders), and then exported back out of the jurisdiction. The initial importer of the goods (properly) pays no VAT on its purchase of the goods and charges and collects VAT from its domestic customer. Each of the subsequent sellers of the goods charges and collects VAT from its own domestic customer and claims an input tax deduction in respect of the VAT amounts paid to its supplier. No VAT is charged or collected on the export of the goods to customers in the EU. The first trader, which imported the goods and owes the majority of the VAT payable to the tax authority, then absconds without remitting the VAT collected (i.e., it is the "missing trader" in the missing trader fraud). The fraud is successful if the tax authority permits the claimed input tax deductions from the other traders but is unable to recover the VAT owed by the missing trader. In this way, money and goods are circulated (like a carousel) and profits are earned by the traders at the expense of the tax authority.

HMRC alleged that JDI knew, or should have known, that the impugned transactions in which it engaged were part of a carousel fraud. HMRC relied on the results of an investigation of various bank account statements and transaction records conducted by one of its officers. In an expert report, that officer opined that each of these deals must have been "contrived and predetermined with the full knowledge and participation of each trader in the transaction chain." JDI appealed HMRC's denial of the input tax deductions and challenged the assertions of the tax authority and the conclusions of its officer that it was a knowing participant in a carousel fraud. JDI asserted that the facts on which HMRC based its decision did not support the allegations that JDI was a party to the fraud and that JDI in fact took robust and reasonable steps to ensure that the transactions it entered into were free from any attempt to defraud the revenue.

NERA's Role

NERA was retained by counsel for JDI to review the conclusions of the HMRC officer and conduct a detailed financial investigation of the information on which his conclusions were based to determine whether those conclusions (that JDI was a knowledgeable participant in a fraudulent scheme) were supported. NERA's investigation found that the evidence did not support HMRC's claims, and in particular that it need not have been the case that JDI knew or was involved in perpetrating the alleged fraud. NERA's analysis demonstrated that the conclusions drawn by the HMRC officer regarding JDI's knowledge of and role in the alleged fraud were not supported by the information on which he relied.

NERA provided a detailed examination of the structure of the transactions, the timing of the cash flows between parties, and the net cash flows earned by each of the parties to the impugned transactions. This analysis demonstrated that not only was it the case that JDI need not have known about the fraud, but also that it was the only party involved in the transactions that suffered net cash outflows. In other words, JDI would only benefit from these transactions if it were entitled to deduct the input tax. Given these facts, and that JDI would have recognized that recovery for its input taxes paid would be jeopardized had it known about the alleged fraudulent scheme, it was unlikely that JDI would have knowingly participated in the alleged scheme.

The Result

In July 2012, the UK Tax Tribunal allowed JDI's appeal and permitted it to deduct the full amount of the claimed input tax. The Tribunal found that HMRC had not proven that JDI had to have known or been a participant in the alleged carousel fraud. As the decision notes:

Having carefully considered the transactions and the surrounding circumstances and having heard the cross-examination of JDI's witnesses, we find that... this is not enough for JDI to be regarded as a participant and denied its input tax.

The Tribunal therefore ruled that JDI had a valid claim to repayment of VAT of £688,421 incurred on its supplies. Notably, this case is one of just a handful of victories on appeal at Tribunal for the taxpayer in where HMRC has alleged MTIC fraud.

Experts Involved

Mark L. Berenblut, Senior Vice President

Mr. Berenblut provides expertise in economics, finance, securities valuation, accounting, financial investigations, and dispute resolution to the legal and business communities, as well as to government. He has over 25 years of experience in securities and business valuation for complex litigation, complex claims including economic damage quantification, mass torts, product liability, insolvency and restructuring, major securities and antitrust class actions, financial investigation, and intellectual property. Mr. Berenblut has provided expert reports and testimony for matters in the US, Canada, the Middle East, and Europe at trial and arbitration. A graduate of The London School of Economics, Mr. Berenblut is a Fellow Chartered Accountant, Investigative Forensic Accountant, Certified Fraud

Examiner, Accredited Senior Appraiser, Fellow Chartered Business Valuator, and Certified Mediator. He is recognized by the Academy of Experts.

Bradley A. Heys, Vice President

Mr. Heys' expertise is in the fields of business and securities valuation, financial investigations, finance, and economics. He conducts financial investigations of public companies for commercial litigation, class actions, and criminal matters, and performs valuations of business and securities for commercial litigation and tax purposes. Mr. Heys has advised clients and provided testimony for cases in both Canada and the US on issues relating to market efficiency, economic materiality, loss causation, and damages in the context of shareholder class actions, and has provided economic analysis for broker-dealer disputes. He has also conducted business and securities valuations and financial investigations for tax purposes and tax litigations in Canada. Mr. Heys is a CFA charterholder and a Certified Fraud Examiner.

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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