



Case & Project Experience

Carousel Fraud and Emissions Trading: Assistance in a dispute over VAT on emissions allowances

The Situation

In the first half of 2009, the European Union's Emissions Trading System for greenhouse gases was hit by allegations of large-scale "carousel fraud" relating to VAT payments for emissions allowances traded on the spot market.

In carousel fraud – also known in the EU as "Missing Trader Intercommunity Fraud", or MTIC – a fraudulent trader can exploit the way the EU VAT regime works by acquiring goods from another EU jurisdiction (in circumstances where they do not have to pay VAT to the Seller). In its simplest form, the trader then sells the goods on to a third party in the same jurisdiction and charges the third party an amount in respect of VAT. However, the trader then disappears without accounting for that VAT to the government (thus the "missing trader", who disappears without completing a VAT return).¹

NERA's client, along with many other active participants in the carbon emissions trading market, acquired emissions trading allowances in supply chains which were alleged to be tainted with fraud (broadly where the chain had commenced with importation of the allowances by a missing trader). Even though not party to the fraud themselves, they would have been denied their right to deduct the input VAT they paid their suppliers if it could be shown that they knew, or should have known, that the supply chain was vitiated by VAT fraud. As evidence that NERA's client should have known of the alleged fraud, Her Majesty's Revenue and Customs (HMRC) cited the high volumes of trade in the market as well as a spike in trade that HMRC claimed had no other explanation in a market that

they asserted ought not to be "volatile" – although HMRC provided no justification for this claim.

Based on these allegations, HMRC sought to refuse to allow NERA's client to deduct the input VAT paid on the purchase of certain emission rights from its overall VAT liability, demanding additional payments totalling tens of millions of pounds.

NERA's Role

NERA was retained by Counsel to provide background on the EU emissions markets and to analyse the trading activity at the centre of HMRC's claim.

By providing a comprehensive overview of the relevant markets, a summary of what participants knew at the time, and by a detailed analysis of the trading activity in question, NERA provided valuable support in negotiation with HMRC.

NERA's analysis helped to establish a common understanding of the economics of the market and the way it developed, allowing our client to improve HMRC's appreciation of the market context, and thereby providing a more favourable result for our client.

Following NERA's analysis, HMRC dramatically reduced its claim for unpaid tax. The client reported that NERA's report was "extremely helpful in setting out a clear position about the state of the market and the knowledge and understanding of market participants at the time".

¹ Transactions typically follow a circular route between companies in two or more countries, hence "carousel fraud".

Experts Involved

Daniel Radov, Associate Director

Mr Radov is an Associate Director in NERA's Global Energy, Environment, and Network Industries Practice and leads NERA's environment-related work in Europe. He has more than 13 years of experience in environmental economics and policy, focusing on renewable energy, emissions trading, energy efficiency, and climate change. He has worked for clients across a wide range of industries, including aviation, cement and lime, electric power generation and retail supply, automobile and engine manufacturing, iron and steel, petroleum refineries and petrochemicals, and the public sector. He has provided reports, advice, and testimony in matters before the High Court of England and Wales and in international arbitration.

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. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. 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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