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Taxpayers should take all reasonable steps and scrutinise their transactions, to be sure they aren't party to any tax fraud along their supply chain. **BY LIU HERN KUAN AND VINCENT OOI**

MISSING Trader Fraud (MTF) is a problem that has plagued tax authorities around the world. It is a form of fraud by which syndicates make use of the Goods and Services Tax (GST) regime to defraud tax authorities.

There are essentially two broad aspects of the GST regime that should be noted when one seeks to understand how MTF takes place.

The first is that a GST-registered supplier has to charge GST on its supplies to the purchaser. This is known as output tax. Under the law, the output tax paid by and collected from the purchaser has to be paid by the supplier to the tax authorities.

Second, in the course of making supplies, the supplier may have itself paid GST to its own suppliers. These GST payments paid by the supplier (known as input tax) may be used as a credit against its output tax payment to the tax authorities. The supplier has to make a claim for input tax paid to its own suppliers that may be set off against its output tax payment to the tax authorities.

To illustrate how the GST regime operates across a supply chain, consider the case of a manufacturer of computer notebooks. Generally, the manufacturer will need to buy notebook components from various suppliers and assemble the notebooks for sale. As the manufacturer is GST- registered, it will need to charge GST (output tax) on its sales to purchasers. The output tax collected from various purchasers will need to be paid to the tax authorities.

However, the output tax payment to the tax authorities may be reduced by input tax the manufacturer has paid to its own suppliers.

Suppose then that one of the purchasers from the manufacturer is a notebook distributor; similarly it will charge output tax on supplies it makes to its own purchasers, who may be retailers of the notebooks.

The distributor is entitled to credit for GST paid (its input tax) to its supplier (the manufacturer) when it pays the output tax collected to the tax authorities. The final consumer who uses the notebook for personal purposes will have to pay the GST to the retailer but will not be able to make an input tax claim because it is not a GST-registered person.

Generally, MTF seeks to exploit the legal obligation of the GST-registered supplier when it makes supplies, collects the GST paid by the purchaser and pays the GST to the tax authorities.

HOW SYNDICATES OPERATE

A syndicate involved in MTF will generally defraud the tax authorities in one or both of the following ways:

- By fraudulently obtaining from the tax authorities an input tax credit claim on purported supplies which it never received (and then absconding), or,
- By charging a purchaser output tax and absconding without handing over such tax to the tax authorities.

Syndicates rely on the technical difficulties that the tax authorities face in tracing the supplies of goods and services down the supply chain and often make this more difficult by interposing many businesses along this chain. MTF is a serious problem for tax authorities; in the UK alone, it has been estimated that up to £5.5 billion (S$9.71 billion) of tax revenue were lost in financial years 2005-2006 and up to £2.2 billion in 2008-2009.

Syndicates involved in MTF may be prosecuted for a variety of criminal offences. In Singapore, the Inland Revenue Authority of Singapore announced in 2019 that it arrested members of criminal syndicates suspected to have been involved in such fraud.

The Draft Goods and Services Tax (Amendment) Bill 2020 promises to tighten the noose around cases of missing trader fraud. It kicks in on Jan 1. BT FILE PHOTO

However, it is often difficult for the tax authorities to go after the syndicates involved, given that they would have long absconded by the time investigations bring their fraud to light. The parties left holding the pieces are the other suppliers along the supply chain that may be innocent, as they may not have been involved in the fraud. To protect public revenue, tax authorities often seek to withhold or deny input tax claims of these suppliers along the chain once a fraud along the line has been discovered.

The recent Draft Goods and Services Tax (Amendment) Bill 2020 proposes a new framework to deal with the problem of MTF. It is expected to come into effect on Jan 1, 2021.

Under the proposed framework, a taxpayer's input tax claims will be denied in cases where it knew or "should have known" that the supply made to the taxpayer was part of an arrangement to cause loss of public revenue.

The Draft Bill defines the circumstances under which a taxpayer "should have known" that a supply made to it is part of a fraudulent arrangement to cause loss of public revenue. In essence, it provides for a test with three requirements.

The first question is whether the circumstances of the supply are such that there was a reasonable risk of the supply being part of a fraudulent arrangement that is intended to cause loss of public revenue.

If there is such a reasonable risk, then secondly, the taxpayer must show that it took every reasonable step to determine if the supply made to the taxpayer was part of the fraudulent arrangement.

Thirdly, having taken reasonable steps, the taxpayer must come to a reasonable conclusion that the supply was not part of such a fraudulent arrangement. Whether there is a reasonable risk of the supply being part of a fraudulent arrangement, whether every reasonable step is taken to assess the arrangement and whether a reasonable conclusion is reached by a taxpayer is very much a question of fact based on background circumstances.

Therefore, where there is a fraudulent arrangement, if a taxpayer did not take every reasonable step to assess the arrangement, it would be taken to "should have known" that there was a fraudulent arrangement. Even if the taxpayer had taken every reasonable step, but did not arrive at any, or any reasonable conclusion, the taxpayer would still be taken to "should have known" that the arrangement was fraudulent.

DENIAL OF INPUT TAX CLAIM

So the only scenario where the taxpayer can successfully make its input tax claim where there is a fraudulent arrangement is if the taxpayer had taken every reasonable step to ascertain the propriety of the arrangement; and arrived at a reasonable conclusion that the arrangement was a proper arrangement (even when it was fraudulent).

Not arriving at any conclusion or arriving at a wrong conclusion after every reasonable step is taken to assess the arrangement will not exonerate the taxpayer; the input tax claim can be denied.

The Draft Bill goes further: Where the taxpayer knew or "should have known" of the fraudulent arrangement, the taxpayer's input tax claim will not only be denied, but the Comptroller of Goods and Services Tax may impose a surcharge of 10 per cent on the input tax claimed. It is also noteworthy that the Comptroller need not demonstrate any loss suffered: he may deny the input tax claim regardless of whether there was a loss of public revenue.

Pursuant to these proposed amendments, taxpayers would generally have to ensure that they are not in any way connected to a fraudulent arrangement leading to loss of public revenue. They would be well-advised to take all reasonable steps and scrutinise their transactions.

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