Insights on recent cases involving missing trader fraud arrangements

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In brief

From August 2023 to April 2024, there have been three reported decisions by the Goods and Services Tax Board of Review (the *Board*) and High Court (*HC*) involving tax controversies in relation to business arrangements exhibiting typical traits of a missing trader fraud arrangement.

While these cases took place prior to the introduction of section 20(2A) of the Goods and Services Tax Act (*GSTA*) to combat missing trader fraud, the decisions remain relevant as an alternative basis for the Comptroller of Goods and Services Tax (the *Comptroller*) to deny an input tax claim.

This Note summarises the key takeaways that businesses should be aware of to safeguard their business transactions.

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Key takeaways

- The taxpayer bears the burden of proof of proving that there were actual supplies of goods made in the furtherance of a business.
- It is sufficient for the Comptroller to simply rebut the taxpayer's evidence by taking into account certain red flags typical of missing trader fraud in challenging the veracity of the transactions, without having to prove actual missing trader fraud.
- Businesses should understand their obligations and undertake due diligence checks to avoid being involved in a fraudulent arrangement.

Extent of the taxpayer's duty to provide evidence of supply for input tax claiming purposes

In *GHY v Comptroller of Goods and Services Tax* [2023] SGGST 1 (*GHY*), the taxpayer was involved in the wholesale trade business. It claimed to have acquired certain "Osperia"-branded SD cards and flash drives (the *Osperia Goods*) from a supplier [K] and to have exported them to two Malaysian customers in a series of transactions between the period of 1 April 2016 and 31 August 2016 (the *Relevant Period*).

In relation to these trades, the taxpayer claimed S$1,341,557 in input tax credit refunds. An IRAS audit was triggered due to the sudden spike in the value of its zero-rated supplies and input tax claim within a single quarter.

Based on the GST returns filed by [K] and evidence provided by the taxpayer during the audit, [K] had obtained the Osperia Goods from an upstream supplier [S], who had in turn sourced the Osperia Goods from the purported manufacturer [O]. However, the Comptroller's investigations revealed that the directors of both [S]

and [O] were unaware of these transactions. There were also significant red flags which cast doubt on [O]'s existence as a manufacturer of the Osperia Goods.

The Comptroller denied the taxpayer's input tax claims on the basis that there was no conclusive evidence of supply and that these were not genuine business transactions. The taxpayer appealed.

The key issues before the Board were whether there were actual supplies of the Osperia Goods from [K] to the taxpayer and whether there were actual supplies of said goods which the taxpayer claimed to have sold to its customers.

A. Burden of proof in appeals against the decision of the Comptroller

Under section 52(3) of the GSTA, the onus is on the taxpayer to prove that the Comptroller's decision to disallow its input tax claim is wrong. The Board noted that this is readily justified as the GST collection system operates on a self-assessment basis – the taxpayer is presumably acquainted with his own affairs and the Comptroller is not privy to the contemporaneous circumstances or details behind the purported transactions. Accordingly, the burden should not be on the Comptroller to prove that goods as described in the tax invoices were not supplied, or to prove what goods were actually traded, or whether they were non-existent, non-functional, or of a counterfeit or different brand.

B. The taxpayer failed to make out its burden of proof

As a starting point, the Board found that the taxpayer had provided *prima facie* documentary and witness evidence to show that the transactions between itself and [K] and its customers were genuine, including emails, invoices, and other documentation evidencing export. Having done so, the evidential burden shifted to the Comptroller to convince the Board why it should reject the evidence.

In this regard, the Board agreed with the Comptroller that there were multiple red flags which casted serious doubt on the veracity of the transactions, including:

a. The sudden and anomalous surge in volume of transactions and value of tax claims over the Relevant Period;

b. The inability to trace the goods to the purported manufacturing source [O] or the supplier which sold the products to [K];

c. The inexplicable reason why Osperia products were not known or traded in the market despite the high transaction volumes involved in the present case;

d. The lack of business rationale behind the transactions – the supplier and customers were pre-sourced without any effort required by the taxpayer. The taxpayer would only place orders with its supplier *after* it had received confirmed orders from its customers, and collected payment from its customers *first* before the taxpayer had to pay its supplier for delivery of the goods. This was a “truly bizarre and incredulous” risk-free arrangement as the taxpayer was earning a marked-up profit of about 1-2% per transaction as a mere middleman despite not bearing any commercial risk; and

e. The elusive nature of the customers (e.g. doubts on the customer's financial ability to make such purchases from the taxpayer) and the commercially irrational arrangements made.

Since the Comptroller had cast sufficient doubt on the taxpayer's account, the evidential burden shifted back to the taxpayer to provide further proof to address the red flags raised. Had the transactions been genuine, the Board noted the taxpayer could have adduced evidence from the missing personalities in its case (e.g. controlling minds of [O]), or provided further evidence of communications between the parties apart from purchase and export, such as aftersales support or warranty issues, which should have arisen given the volume of transactions involved.

Ultimately, the Board found that the taxpayer failed to discharge its burden of proof under section 52(3), and the appeal was dismissed. In concluding this, the Board made certain notable remarks:

a. Payment of any purported GST output tax as shown on a tax invoice does not in and of itself give rise to an entitlement to claim input tax if there had been in fact been no supply.

b. The taxpayer has to show actual supply of the goods as described in the tax invoice. As the taxpayer had claimed in its GST returns that the goods transacted were Osperia-branded goods, if there are serious doubts as to their origin, the taxpayer would be put to strict proof that the goods indeed matched such description. In other words, it was not sufficient to show that *generic* SD cards and flash drives had been transacted.

c. Since the legal burden rests on the taxpayer to prove the transactions were genuine, it is sufficient for the Comptroller to rebut any evidence submitted by the taxpayer, and there was no need for the Comptroller to prove that the taxpayer was complicit in or had knowledge of any kind of fraud to deny an input tax claim. The Comptroller was entitled to *take into account* certain red flags that are the hallmark of missing trader fraud in challenging the veracity of the transactions, but did not have to go further to prove actual missing trader fraud.

d. Even if the taxpayer was an innocent victim who was duped by a dishonest trader further upstream, the taxpayer's legal recourse lies against that party alone, and not the Comptroller.

Observations

This decision impresses the importance of conducting proper due diligence checks and maintaining sufficient evidence of actual supplies. In particular, where there are red flags surrounding the circumstances of the transaction, taxpayers are expected to make more detailed checks to ensure the authenticity and commerciality of the business arrangement. It is clear from the Board's decision that even if the taxpayer was an innocent victim of fraud, this would not give rise to a claim for input tax against the Comptroller and the taxpayer's only recourse lies against its supplier.

Proving that the transactions were genuine business transactions for input tax claiming purposes

A similar decision to *GHY* was reached in *GIG v the Comptroller of Goods and Services Tax* [2023] SGGST 2 (*GIG*). In this case, the taxpayer purported to engage in the wholesale trade of computer processors and claimed input tax amounting to S$102,288.20 on the purchase of certain Intel processors for the accounting period of 1 July 2018 to 30 September 2018.

The Comptroller's investigations revealed the following supply chain for the transactions in question: the Intel processors were traced to the supplier [DDD] (the *Upstream Supplier)*, who on sold the processors to the supplier [ZZZ] (the *Intermediate Supplier*), who supplied the taxpayer with the processors, which the taxpayer on sold to a Singapore company and a Hong Kong company. Notably, all of the companies involved in this supply chain appeared to be under the control of a common party, who was known as Mr [E]. In essence, the transactions involved Mr [E] arranging the sale and purchase of Intel processors from companies controlled by him to other companies controlled by him, through the taxpayer as an intermediary. For each transaction, the taxpayer applied a mark-up of 1%.

The orders would be completed within a few hours and payment would be made within the same day. Despite the high value of the transactions, the Intermediate Supplier did not have any written contracts with either its suppliers or customers. Neither was its director required to conduct any checks to ensure that the processors were working, and the serial numbers of the processors were not recorded down.

The Comptroller denied the taxpayer's input tax claims on the basis that the taxpayer was not conducting a genuine business and that there was no supply of the goods as described in the tax invoices. The taxpayer appealed on the basis that the Comptroller had incorrectly asserted that there were no genuine goods and that there was missing trader fraud.

As with *GHY*, the issue before the Board was whether the taxpayer has met the statutory requirements for input tax relief.

A. Burden of proof in appeals against the decision of the Comptroller

The Board affirmed the decision in *GHY* that the burden of proof lay on the taxpayer to show that the Comptroller's decision to disallow the taxpayer's input tax claim is wrong. The Board reiterated that the Comptroller does not have to prove missing trader fraud to disallow a taxpayer's claim for input tax – it was for the taxpayer to show on the balance of probabilities that the statutory requirements for input tax relief had been met and that there were indeed supplies of the goods as stated in its invoices.

B. For the purposes of claiming input tax, there must be a legitimate business with economic substance

As compared with *GHY*, the Board approached the case in *GIG* slightly differently by considering whether there were supplies made in the course or furtherance of a business carried on by the taxpayer. The Board agreed with the Comptroller's submission that a "business" must be a legitimate business with economic substance. Accordingly, where the business entities in the supply chain are not involved in a legitimate business activity, there is no basis for them to claim an input tax refund.

On the facts, the Board found that the taxpayer had failed to prove that the transactions were genuine business transactions. In particular, the speed at which the transactions took place (over the course of 11 days, each involving back-to-back trades that were all contemplated from start to end on the same day) cast serious doubt on the taxpayer's claim that it was involved in a genuine business transaction. Further, there was a lack of commercial rationale in having the taxpayer act as a middleman, when the Intermediate Supplier was acquainted with the Customer.

C. Failure to prove actual supply

The Board further noted in *obiter* that it was unconvinced that the taxpayer had made actual supplies. In particular, the fact that (i) the taxpayer failed to track stock, track serial numbers, or perform hardware testing, (ii) the Intel processors were all second hand, and (iii) the models stated on the suppliers' invoices were not consistent with the models found on the Intel website, all cast further doubt on whether the Intel processors even existed to begin with.

Observations

Taxpayers should be vigilant of business arrangements which are "too good to be true". As illustrated in this case, business arrangements which lack commercial rationality will be subject to the scrutiny of tax authorities. *GIG* shows that even if there are actual supplies made, where the supplies made are not genuine business transactions, this can be an alternative basis for the Comptroller to deny the taxpayer's input tax claims.

Distinguishing fact, law, and mixed law and fact for the purposes of appealing against a Board of Review decision

The taxpayer in *GHY* subsequently appealed to the HC against the Board's decision. In the case of *THM International Import & Export Pte Ltd v Comptroller of Goods and Services Tax* [2024] SGHC 97, the taxpayer raised the following arguments:

a. The Board had erred by taking into consideration events higher up the supply chain in determining whether there was a supply of the Osperia Goods in relation to the taxpayer. The Board had in substance prospectively applied provisions that were subsequently introduced into the GSTA (long *after* the alleged supplies had occurred) to disallow input tax claims by taxable persons with actual or constructive knowledge that the supply was part of a fraudulent scheme to cause loss of public revenue.

b. The Board erred in its assessment of evidence by failing to prefer the taxpayer's direct evidence on the existence and supply of the Osperia Goods over the circumstantial evidence led by the Comptroller on the various red flags surrounding their supply.

c. The Board had imposed an insurmountable burden of proof on the taxpayer by requiring the taxpayer to give evidence pertaining to facts over and beyond what it had actual knowledge of, including the identities of the missing personalities and information on the origin of the Osperia Goods.

A. Scope of right of appeal against Board decisions

The HC found that the GSTA makes it clear that the permissible scope of appeal to the HC against decisions of the Board is a narrow one. Under section 54(2), an appeal may only be made in respect of "any question of law or of mixed law and fact". The High Court found that the legislature had clearly determined that the Board is the sole decision-maker in issues of fact, and that appeals on questions of fact alone are not permitted. Only a limited exception has been recognised in *Comptroller of Goods and Services Tax v Dynamac Enterprise* [2022] 5 SLR 442 (*Dynamac*), which allows curial intervention on a finding of fact by the Board if it is one that no reasonable body of members constituting a board of review could have reached. There is thus a high threshold that must be crossed before the HC can review a finding of fact by the Board.

B. Distinguishing fact, law, and mixed law and fact

The HC adopted the following distinction drawn by the Supreme Court of Canada in *Canada (Director of Investigation and Research, Competition Act) v Southam Inc* [1997] 1 SCR 748:

a. Questions of law are questions about what the correct legal test is.

b. Questions of fact are questions about what actually took place between the parties.

c. Questions of mixed law and fact are questions about whether the facts satisfy the legal tests.

C. The taxpayer's appeal only raised questions of fact

On the foregoing basis, the HC found that the taxpayer had mischaracterised the Board's reasoning. The Board did not deny the taxpayer's input tax claim on the basis of its constructive knowledge of fraudulent activity conducted upstream. The Board simply drew a factual inference on the non-existence of the Osperia Goods from the dubious surrounding circumstances. This was an entirely logical inference that the Board was entitled to draw and more importantly, was clearly a finding of fact which did not implicate the law at all.

The HC disagreed with the taxpayer's argument that the Board had imposed an insurmountable burden on the taxpayer. The HC held that the source of the Osperia Goods supplied to the taxpayer and the evidence of the parties' communications apart from purchase and export were clearly something within the knowledge of the taxpayer rather than the Comptroller.

In this case, even though the taxpayer had discharged its initial evidential burden of showing that the judgment were *prima facie* genuine, sufficient doubt was cast by the Comptroller to shift the evidential burden back to the taxpayer. As such, the taxpayer ultimately failed to discharge its legal burden of proof under section 52(3) of the GSTA.

On a whole, the HC found that the taxpayer's appeal, in substance, had only raised questions of fact – i.e., whether the Osperia Goods claimed to have been supplied existed. As a pure question of fact, there was nothing in the judgement to suggest that the Board's assessment of the evidence was so outrageously in defiance of logic that no reasonable body of members constituting a GST Board of Review could have arrived at the same conclusion. Therefore, the taxpayer did not come within the limited exception for appeals on fact as recognised in *Dynamac,* and its appeal was dismissed.

Observations

This decision is significant as it clarifies the distinction between fact, law, and mixed law and fact in the context of the taxpayer's right to appeal under the GSTA. As noted by the HC, there might have been an issue of law or mixed law and fact if there was a dispute as to the legal definition of "supply", or as to whether a particular form of supply could constitute a "supply" under the GSTA.

While this decision was in the context of the GSTA, the HC decision would apply similarly in the context of the Income Tax Act (*ITA*), where the right of appeal under section 81(2) of the ITA only applies upon "any question of law or of mixed law and fact". Taxpayers may only appeal against findings of fact where it can show no reasonable tribunal could have reached that decision of fact.

Concluding remarks

The above cases underscore the importance of conducting due diligence checks in new business arrangements and maintaining sufficient evidence of the commerciality of transaction, since it is the taxpayer who bears the legal burden of proving that actual supplies are made in the furtherance of a business.

Businesses should be aware of amendments introduced to the GSTA to combat missing trader fraud. With effect from 1 January 2021, a GST-registered business that claims input tax on any supply made to it which it knew or should have known to be part of an arrangement to cause loss of public revenue (whether or not the loss was in fact caused) will be denied input tax pursuant to section 20(2A) of the GSTA. A surcharge of 10% will be applied on the amount of input tax denied pursuant to section 45A of the GSTA. Criminal prosecution actions may also be brought against the business and directors involved.

Most recently, stiffer criminal sanctions based on a two-tiered approach have been introduced from 1 January 2023 through the new section 62C of the GSTA. Tier 1 offences apply to missing trader fraud masterminds, co-conspirators and syndicate members who participate in such fraud schemes. These persons need not know the entire plan or that it involves goods and services tax fraud; they will be found liable if they know that the plan is carried out for a fraudulent purpose. Tier 1 offences carry a maximum imprisonment term of 10 years and/or maximum fine of S$500,000. Tier 2 offences apply to current or former sole-proprietors, partners or directors of business entities who allow their entities to be used in missing trader fraud schemes, and carry a maximum imprisonment term of 1 year and/or maximum fine of S$50,000.

There is no doubt that Singapore is sending a strong signal on combatting such fraud schemes. It is therefore crucial that businesses take particular heed of their obligations and be alert to transactions and arrangements that deviate from normal commercial practices and expectations within their industry.