VOIP MTIC – THE ITALIAN JOB
(OPERAZIONE “PHUNCARDS-BROKER”)

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On February 8, 2010 a speculative paper on the likelihood that fraudsters proficient in missing trader intra-community (MTIC) fraud might move into voice over internet protocol (VoIP) was submitted to the Boston University School of Law Working Paper Series. Prior to that paper there was very little (if any) public discussion of VoIP MTIC. There were no assessments, no arrests, and not a hint of litigation. Fifteen days later, and before final publication in this journal the financial press exploded with coverage of a massive VoIP MTIC fraud (the Operazione “phuncards-broker” investigation):

An [Italian] judge … ordered the arrest of 56 people, including one of Italy’s richest men as part of an international probe into an alleged $2.7 billion money-laundering and tax-evasion scheme involving two major Italian telecommunications providers. Prosecutors allege billionaire Silvio Scaglia was part of a ring with mafia ties … between 2003 and 2006, according to a copy of the arrest warrant seen by The Wall Street Journal.

VoIP MTIC is no longer a topic for academic speculation. It is real. It poses a very serious threat to the workability of the VAT.

Traditional formulations of MTIC or carousel fraud were goods-based – a fraud involving the intra-community sale of cell phones, computer chips, perfumes or precious metals. There is a measure of comfort when MTIC is seen this way. Goods-based MTIC frauds are moderately responsive to traditional audit techniques. Tangible property can be followed, and fraudsters can be apprehended with the goods. All the funds may not be recovered but the fraud can be confronted. Everything is much more difficult when the property is digital.

Europe became very concerned on June 8, 2009 when it appeared that the first mutation of MTIC into services was unfolding. This was CO2 MTIC. June 8 was the day when MTIC closed the BlueNext exchange in Paris.
Emissions certificates trade primarily on well regulated markets. Mechanisms within these exchanges can be leveraged for prevention. Tightening up oversight on the exchanges and adjusting VAT rules (exempting, zero-rating and reverse charging transactions in CO2 permits) offer some assurance that CO2 mutation can be handled. After all, the European Commission must also examine questions raised by the chairman on his own initiative or at the request of the representative of a Member State, concerning the application of VAT. The Committee is merely an advisory body, although originally it was the intention to apply the procedure of a regulatory nature (i.e. a procedure based on which the Committee can prescribe binding rules as is common in customs matters). Nevertheless its “decisions”, which are not published, have a big influence on the day-to-day practice of VAT. The results of that advisory meeting can be found in: VALUE ADDED TAX COMMITTEE, WORKING PAPER 443 REV 1, Question Concerning the Application of Community VAT Provisions: Greenhouse Gas Emission Allowances, TAXUD/1625/04 REV 1 (May 27 2004). An analysis of the VAT Committee’s reasoning can be found at Richard T. Ainsworth, CO2 MTIC Fraud – Technologically Exploiting the EU VAT (Again), 57 TAX NOTES INTL. 357 (Jan. 25, 2010).

Union Emissions Trading System (EU ETS) is the world’s largest multi-national emissions trading scheme.\(^{13}\) The same is not true with VoIP which is bought and sold globally outside any regulated market.

Administrative comfort with MTIC enforcement is an illusion.\(^{14}\) Patchwork efforts will never stem the tide of MTIC. The cause is a structural flaw in the EU VAT.\(^{15}\) MTIC is a known and active fraud in over forty discrete commercial markets.\(^{16}\) MTIC only requires (1) a reverse charge followed by (2) an onward sale with VAT. MTIC is not goods-centric.\(^{17}\) MTIC is not service-specific. MTIC frauds will arise wherever this structural flaw is set into law, and in most VATs around the world this is the main rule for cross-border trade in services.

Eliminating either of the two MTIC elements will solve the fraud. Either the reverse charge or the forward sale must be targeted. Solutions that focus on the reverse charge either eliminate it (which has the effect of converting the VAT into an origin-based tax) or extend it throughout the entire supply chain (which has the effect of converting the VAT into a retail sales tax). Solutions that focus on the onward sale administratively assure that whenever VAT is paid

\(^{13}\) Each EU Member State must grant emission rights (called EUAs or European Unit Allowances) to domestic emitting facilities. There are roughly 12,000 energy and industrial plants across the 27 EU Member States that have been granted EUAs. European Climate Exchange Home Page, available at: http://www.ecx.eu/What-is-the-EU-ETS. There must be a National Emissions Plan. See: National Allocation Plans for 2008 through 2012 with Commission Decisions, available at: http://ec.europa.eu/environment/climat/emission/2nd_phase_ep.htm Parties that take physical delivery of a EUA (from the government or from a trader) must be registered with a Member State. However, parties who simply trade in EUAs do not need to be registered, and it is through this avenue that fraudsters may enter the market and trade through brokers and behind buffers.


\(^{15}\) The same flaw is replicated in almost every VAT/ GST around the globe. The Japanese Consumption Tax (CT) may be one of the few exceptions. Because the CT is an accounts-based tax that relies on income tax filings, it is not susceptible to missing trader frauds.

\(^{16}\) See list at: Richard T. Ainsworth, \textit{VoIP MTIC – VAT Fraud in Voice over Internet Protocol 57 TAX NOTES INTL. 1079, at 1094 (Mar. 22, 2010).}

\(^{17}\) For example, HMRC recently uncovered MTIC fraud in construction equipment and concrete crushing machines. Simon Halewood, \textit{Man Arrested in Sandbach Dawn Raid over £2m VAT Fraud}, CREWE CHRONICLE (Mar. 31, 2010). The largest GST frauds in Canada were similar. \textit{See:} Richard T. Ainsworth, \textit{Tackling VAT Fraud: Car-flipping and Computer Chips on a Carousel, 46 TAX NOTES INT’L 267 (April 16, 2007).}
there is a guarantee of accuracy – accurate determination, recordation, collection, reporting and remission of VAT. This is a certified digital solution. It is in place in the US retail sales tax.\(^{18}\)

To date, neither a reverse charge nor an assurance approach has been taken in the VAT. This is due in large part to a government belief that they have a handle on MTIC. After the Italian Job, this belief must surely be questioned.

All peace of mind should have vanished on February 23, 2010. On this day Italian prosecutors alleged that Telecom Italia SpA and FastWeb SpA carried out one of that nation’s largest VAT frauds ever. Phuncards-broker was a VoIP MTIC fraud embedded in a global money-laundering scheme. During 2003 and then 2005 through 2007, this fraud (allegedly) cost Italian taxpayers €400 million.\(^{19}\)

Italian arrests were ordered based on 1,600 pages of allegations. The phuncards-broker prosecutors went into great detail diagramming the alleged fraud, specifying the cash flows, and identifying the individuals and companies involved. Transcripts of wiretaps, interrogations and records of surveillance operations complete with undercover photographs of clandestine meetings were presented.\(^{20}\) The fraud probe snared Senator Nicola Di Girolamo. He quickly resigned, was arrested, and then publicly admitted to the fraud. He also confessed that there was widespread knowledge of the fraud within the companies.

There were directors of FastWeb and Telecom Italia (Sparkle) [who were] well aware of the illegality of the operations [and who] had to allow[ed] large sums of illicit money to accumulate [that were] generated by the[se] activities through the mechanism of VAT fraud.\(^{21}\)

Because of the importance of the phuncards-broker investigation, this paper follows these allegations, relates them to the earlier speculative paper on VoIP MTIC, and then demonstrates why this is a global problem with a digital solution.

INTRODUCTION


\(^{19}\) *Id.*, at B4.


\(^{21}\) Online Editor, Jerome: “Executives Sparkle Telecom and Fastweb Italy Knew of Fraud” – “I took 4 million euros, 1.7 of which remained to me, the other for a common fund for the purchase holding Runa” *CORRIERE DELLA SERA* (Mar. 11, 2010) available at: [http://www.corriere.it/cronache/10_marzo_11/digirolamo-dirigenti-sapevano_13563b58-2d31-11df-a00c-00144f02aabe.shtml](http://www.corriere.it/cronache/10_marzo_11/digirolamo-dirigenti-sapevano_13563b58-2d31-11df-a00c-00144f02aabe.shtml) (accessed Mar. 18, 2010).
The Telecom Italia/FastWeb indictments were the result of two separate investigations that crossed paths – one initiated by the ROS Carabinieri; the other by the Currency Police Unit of the Guardia di Finanza. The investigations crossed when an attempted bribe of ROS officers (in amounts reaching €500,000) lead to the same Panamanian company, Broker Management Ltd., that had been identified by the Currency Police Unit of the Guardia di Finanza as the recipient of suspiciously large sums of money. The Rome District Anti-Mafia prosecutors then stepped in to coordinate both investigations.

There are two distinct parts to the Operazione “phuncards-broker” investigation. Both involve VoIP MTIC fraud as well as money laundering. The first concerns phonecards (phuncards); the second concerns VoIP termination services provided with digital content (broker). In both cases the services alleged to have been sold were fraudulent – the phone cards were not real, and termination and content services were not provided to end-users.

THE PHONECARD ASPECT

This phonecard fraud begins in the United States where two companies, Global Telephone Services LLC and Worldwide Telecommunications Services, LLC, sell to Telefox s.r.l. (an Italian company) the rights to phonecards. These cards give the purchaser the right of access (for a limited time) to digital content that was to be made available over the internet to the end-user. Telefox is required to reverse charge the Italian VAT (20%). Telefox will be a “missing trader,” and will not file the required returns.

Telefox in turn re-sells these rights to either of two Italian companies in the CMC Group: CMC Italy s.r.l or its 90% owned subsidiary Web Wizard s.r.l. The CMC Group subcontracts with two other companies, the Graf Plastics Division in Rozzano (Milan), Italy and Print Media

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22 The ROS (Raggruppamento Operativo Speciale) or Special Operations Group is an elite unit of the Italian national police force. It was founded in 1990 to deal with organized crime (including the mafia).
23 The Guardia di Finanza is the oldest police force in Italy, dating back to 1774. It is a special police force responsible for financial and economic matters, reporting directly to the Ministry of Economic and Financial Affairs.
24 Global Telephone Service LLC is headquartered on Bayshore Drive, Coconut Grove, Florida. The company was established in October 25, 1993, but when the Guardia di Finanza made inquiries in June 25, 2006 the company was inactive. Operazione “Phuncards-Broker,” supra note 20, at 231.
25 Worldwide Telecommunications Service LLC was based in Dover, Delaware was registered on November 24, 2004, with a registered agent listed as Incorporated Services, Inc. (also of Dover Delaware) until April 17, 2006. Operazione “Phuncards-Broker,” supra note 20, at 231.
26 Telefox s.r.l. is a company established in Rome owned 95% by Fabio Arigoni. All interest in Telefox was sold to John Succcu on January 12, 2003, and then transferred to JVA Corporation in Panama. Operazione “Phuncards-Broker,” supra note 20, at 234.
27 Operazione “Phuncards-Broker,” supra note 20, at 230.
28 Under Presidential Decree 633/1972, Art. 7(4)(d) a compulsory reverse charge applies when services are provided to a taxable person residing in Italy from a non-resident taxable person. See also the SIXTH VAT DIRECTIVE, Art. 21(1)(b); VAT DIRECTIVE Art. 196.
29 Operazione “Phuncards-Broker,” supra note 20, at 260 (indicating that Telefox does not “… comply with tax requirements imposed by Italy.”)
30 CMC Italy s.r.l. was originally headquartered in Rome, but on December 12, 2003 transferred its seat to a non-existent address in London, U.K. C.M.C. is wholly owned by a Dutch company, Sworiba B.V. Operazione “Phuncards-Broker,” supra note 20, at 231.
31 Web Wizard s.r.l. is controlled by CMC Italy which hold 90% of the shares. A 10% interest is held directly by Sworiba B.V. Operazione “Phuncards-Broker,” supra note 20, at 233.
in Gallarate (Varese) Italy to reproduce the cards. The cards are never made, but as a domestic sale of services (Telefox to CMC Group) a 20% VAT is collected on the re-sale.

The CMC Group then re-sells the rights another time (which are supposedly embedded in actual cards) to another Italian company, FastWeb Spa. FastWeb pays Italian VAT on this transaction, and then (allegedly) exports the cards to the Kenworthy Group in the U.K (LBB Trading or Premier Global Trading UK Ltd., or Fulcrum Trading UK Ltd.) FastWeb is the first entity to make a profit on these the sale of the phonecards. It records a 7% profit on the sales to the UK. All prior transactions were at cost, and under credit purchase agreements.

FastWeb records 20% Italian VAT on its purchases, and zero-rates the sale of phonecards to the UK. FastWeb does not file for a refund because it is “VAT positive” (it has collected more VAT on other transactions than it has in overall VAT credits.) At this juncture some concern was raised among the parties about the proper VAT treatment of the sale.

If payment for the phonecards represented prepaid telephone traffic, then it would be likely that the UK firms would be liable for Italian VAT. If the phonecard transactions involve payments for a future service (access to a website with content protected by copyright law – assumed to be adult content), then tax would be due in the jurisdiction of final distribution. The fraudsters sought several legal opinions, and determined that Italian VAT did not apply. The sale was payment for a future service, and a UK reverse charge should apply.

A final re-sale of the cards was then made outside the EU either to Fulcrum Trading US LLC in Reno Nevada, or to Novellist International Ltd in the British Virgin Islands. These transactions were zero-rated and completely offset the impact of the UK reverse charge on the purchase from FastWeb.

Money laundering & VAT Fraud. The amounts money laundered and scope of the VAT fraud involved in the phonecard fraud is quantified only in rough terms. The investigation seems far more concerned with assembling documentation on the methodology of the fraud, and estimating its scope than it does with performing a formal VAT audit of FastWeb. This is very understandable. But, one is left with the impression that there is much more here.

32 Operazione “Phuncards-Broker,” supra note 20, at 253.
33 LBB Trading Ltd. is located in London, UK. In the year 2003 the company engaged solely incommmercial transactions related to the sale of phonecards. Operazione “Phuncards-Broker,” supra note 20, at 235. [The Italian documents appear to call this the Kenworthy group because Robert James Kenworthy and Adam Buckley Roger Kenworthy were the “counselor” and the “executive secretary” for LBB Trading, as well as the “administrator” and “company secretary” or Premier Global Trading UK Ltd.]
34 Fulcrum Trading UK underwent insolvency proceedings in March 19, 2003 concluding on December 18, 2003, but is controlled by Fulcrum Trading US LLC, located in Reno Nevada, US with essentially the same officers. Operazione “Phuncards-Broker,” supra note 20, at 236 & 256.
35 Operazione “Phuncards-Broker,” supra note 20, at 255.
36 Operazione “Phuncards-Broker,” supra note 20, at 229.
37 Operazione “Phuncards-Broker,” supra note 20, at 241 & 242 recording the e-mail of Carlo Focarelli to Bruno Zito and Andrea Conte on October 26, 2002.
38 There is not much information on Fulcrum Trading US Inc. in the documentation other than the names of the offices, the federal tax ID and street address in Reno, Nevada.
39 There is similarly very little information about Novellist International Ltd. in the documentation.
The international scope of the fraud is part of the problem. Aside from Italy, the UK, USA, Spain, Sweden and Austria, the investigation involved “... foreign “havens” such as the Dominican Republic, Panama, the British Virgin Islands and the Netherland Antilles and other places... [where] international letters rogatory [seeking evidence from foreign jurisdictions] were still only partially executed [at the time this case was presented before Judge Aldo Morgigni] ... but there is enough now to show that there are serious indications of guilt, and the circularity of the fictitious transactions carried out by the criminal organization.”40 For example, FastWeb was purchased by Swisscom in 2007. Italian customs sought the assistance of Swiss customs in October 2007 with aspects of this investigation, and it took until the week of March 14, 2010 for the Swiss federal penal court to authorize the request for assistance. An appeal is possible.41

There are even more complications. The fraudsters utilized a classical organized crime structure. Many of the entities involved have “dummy” ownership structures, but have the capacity to “support” huge flows of money through current accounts, and they can move this money from many different jurisdictions.42 As a result, transactions can be re-routed quickly in response to external events.43 One such event was identified during the investigation. It resulted in the dramatic termination of all relationships between FastWeb SpA and the UK firms. The cause of this disruption was the launch of an internal “due diligence” (or Kittel44) review by FastWeb’s Internal Control Committee.45

The phonecard investigation outlined in these court documents is a narrow window into a fraud that could have gone on long before 2003, and could have continued (admittedly through other channels) long after the close of this report. All of the financial transactions set out on pages 256 through 258, and the related cash flow diagrams on page 259 include only transactions that involve these specific companies and only in 2003. Among the fourteen sets of financial transactions examined, it is notable that all those that involve FastWeb terminate in July 2003.

40 Operazione “Phuncards-Broker,” supra note 20, at 227.
42 Operazione “Phuncards-Broker,” supra note 20, at 222 & 223. See the report of Ashley Seager recounted in Richard T. Ainsworth, CO2 MTIC Fraud – Technologically Exploiting the EU VAT (Again), 57 Tax Notes Int’l 357, 365 (Jan. 25, 2010). In this report a single fraudster and his companion demonstrate how to construct a carousel fraud ring. They loaded over 300 “dummy” entities onto a lap top computer and arranged the fraud among these entities within 10 minutes – moving different entities in and out of the chain with a mouse. This was a traditional carousel fraud that relied on the movement of goods (normally computer chips or cell phones). It is infinitely easier to do the same with services, particularly when those services (rights on phonecards) remain entirely intangible.
43 “One of the most significant elements of this investigation is the existence of a multiplicity of pipelines [for moving large sums of money] that are slavishly modeled on the same pattern, demonstrating that the activity is purposely designed for criminal purposes.” Operazione “Phuncards-Broker,” supra note 20, at 222.
44 The due diligence requirement is set out in Alex Kittel v. Belgium, Case 439/04 (July 6, 2006). It essentially requires purchasers to examine whether or not their counterparty is likely to be engaged in fraud:

... where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct.

(with the exception of a few payments made to CMC s.r.l. that continued until November 13, 2003). This is when due diligence began.

The investigation estimates that VAT losses from FastWeb’s phonecard fraud in 2003 totaled €33,933,798.26. The investigation did not indicate that Telecom Italia was involved in the phonecard fraud. The following diagram sets out the fraud pattern:
During the investigation a number of people were asked to explain why the parties engaged in multiple transactions in Italy [Telefox to CMC Group to FastWeb]. Phonecards could have been directly exported [either (1) Telefox to UK or (2) Telefox to CMC Group to UK]. Why was FastWeb involved at all?

Even the “top management” of FastWeb was asked by the Audit Committee to “verify the reason that CMC and Web Wizard sold [phonecards] through FastWeb rather than directly selling them to PGT and LBB…” The Committee did not receive a satisfactory answer. They were told by management: (1) “… FastWeb was needed to finance the VAT that the CMC Group cannot pay …” and (2) FastWeb should not complain because made a 7% profit on these

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46 Operazione “Phuncards-Broker,” supra note 20, at 253.
transactions for doing very little.47 As a result, FastWeb (a publicly held company) began its due diligence inquiry, and soon thereafter this channel was shut down. The investigation does not indicate any more about the termination – not the reason for it nor the persons responsible for it. One is left to surmise that the fraud was internally recognized.

In the words of the investigation, when you think about the whole series of transactions, it “… becomes apparent that the only real motivation of these transactions is to appropriate the VAT that FastWeb should be paying over to the Treasury on its actual receipts…”48

The VAT position of all the other parties was neutral. There was no mark-up between Telefox and the CMC Group, and no mark-up between the CMC Group and FastWeb. The only positive VAT payment should have come from Telefox which performed a reverse charge on the “importation” of services, and collected VAT on the re-sale to the CMC Group.49 This is the classic statutory alignment that allows MTIC.

Telefox, of course, goes “missing.” It does not file a return or make a tax payment. All funds are funneled overseas as part of the money laundering activity. Two cash flow diagrams quantify the VAT fraud.50 The first shows a circular flow of funds from phonecard transactions that remained “in process” when the data for the diagram was being collected. The second shows the funds that had been fully “laundered” and deposited outside the country. The investigation points to the second diagram to “… show that there are no end-users, and [it] is absolute proof that the transactions are fraudulent.”51

The gross amount of money laundered is €203,603,112.83 (€78,740,594.33 from the first diagram and €124,862,518.50 from the second). All of this money is directed to “safe havens.” The MTIC fraud is 20% or €33,933,798.26.52 This is the VAT fraudulently deducted by FastWeb.

THE PREDICTION: PHONECARDS & VoIP MTIC

Phonecards were identified as a potential source of MTIC in the earlier paper.53 The critical attribute of phonecards was that they carried cross-border services. They attract VAT, but their existence/usage can evaporate (along with the vendor) as soon as an audit is suspected.

In the earlier paper, figure 7 set out in a hypothetical the possibility that a kiosk vendor (associated with a fraudster) could provide WiMAX enabled cell phones to customers along with phone cards (or simply access codes) that would allow foreign termination in country around the

47 Operazione “Phuncards-Broker,” supra note 20, at 254.
48 Operazione “Phuncards-Broker,” supra note 20, at 254.
49 From one point of view, there is no VAT due at all on any of these transactions, because there is no economic activity, or in terms of the VAT Directive, the taxable persons are not “acting as such.” VAT DIRECTIVE, Art. 2(1); Wellcome Trust Ltd. v. Commissioners of Custom and Excise, C-155/94; 1996 E.C.R. 3013.
50 Operazione “Phuncards-Broker,” supra note 20, at 259.
51 Operazione “Phuncards-Broker,” supra note 20, at 259.
52 Operazione “Phuncards-Broker,” supra note 20, at 227, chart at Anno 2003 – Fastweb s.p.a. under column marked “Credito I.V.A.”
world. An associate of the kiosk vendor would provide termination through an array of
switching machine located overseas.

The kiosk vendor would purchase termination services (without VAT, but subject to a
reverse charge) and sell them to consumers (with VAT).\(^\text{54}\) If the Kiosk vendor decided to
disappear with the VAT, this would be VoIP MTIC.

What the earlier paper did not anticipate was that a fraudster might not have any intention
of making a final sale to an end consumer. If the main goal of the criminal gang was to launder
money (rather than steal the VAT on real transactions), then it would be sufficient that phone
cards representing termination services are sold. In this case, there would always be an
opportunity for MTIC if the cards were re-sold to a company with a positive VAT position
(which is exactly what happens in the Italian Job).

The Italian Job shows how an organization intent on laundering illegal profits from other
activities can also turn a 20% profit on the laundering operation. This is a considerable problem.
What has been discussed in all previous papers about MTIC is how a structural flaw in the EU
VAT allows fraudster to siphon off tax revenues. But the Operazione “phuncards-broker”
investigation shows is how this flaw can be used to subsidize even more serious criminal
activity.

THE VoIP MTIC ASPECT

This is the larger of the two frauds uncovered. It is the “brokers” side of Operazione
“Phuncards-Broker.” There is every reason to believe that actual VAT losses far exceed the
prosecutor’s estimate of €338,838,040.64.\(^\text{55}\) FastWeb and Telecom Italia are involved in
essentially the same kind of conspiracy to defraud the public fisc, although there are differences

\(^\text{54}\) VoIP is a service. The EU VAT Directive produces the first condition for MTIC (the reverse charge) in Articles
44 and 196. The rules that produce the second condition for MTIC (the onward sale with VAT) are in Articles 44
and 193. Article 44 is the general rule for services. It says:

The place of supply of services to a taxable person acting as such shall be the place where that
person has established his business. …

Article 196 obliges the buyer (not the seller) to remit VAT when the buyer is established in a different Member
State. The short-hand expression for this is a “reverse charge.” It states:

VAT shall be payable by any taxable person, or non-taxable legal person identified for VAT
purposes, to whom the services referred to in Article 44 are supplied, if the services are supplied
by a taxable person not established within the territory of the Member State. (emphasis supplied)

When services are supplied to persons established within the same Member State the place of supply rules are
irrelevant, but the reporting obligations are different. Article 193 states:

VAT shall be payable by any taxable person carrying out a taxable supply of goods or services,
except where it is payable by another person in the cases referred to in Articles 194 to 199 and
Article 202.

\(^\text{55}\) The €338,838,040.64 figure is the sum of VAT losses from Telecom Italia of €297,890,902.48, FastWeb of
€38,595,102.63, 1-Globe of €1,690,339.84 and Planetarium of €957,624.63. There are at least two other entities
involved where VAT losses have occurred, but evidence is not sufficient – these were the “paper companies” of
Telefoz International Ltd. and Global Phone Network Ltd. Telefoz is most likely liable for unpaid VAT, but only
partial records for Telefoz were found at Studio Sales Associates Saliva. Invoices related to Global Phone Network
Ltd were found but no VAT records. As a result no VAT losses are attributed to these entities. Operazione
138.
that deserve special consideration. The next section will consider the basic VoIP MTIC fact pattern. The Diadem UK/FastWeb relationship will be considered later.

**FastWeb & Telecom Italia – the basic pattern.** FastWeb and Telecom Italia are middleman – both provide wholesale telecommunications services. The FastWeb and Italia Telecom business model is to be a “carrier” of traffic from one telecommunications company to another in either VoIP or TDM (Time Division Multiplexing).56

Considered from the perspective of FastWeb and Telecom Italia (which is also the perspective of the investigation – a perspective that follows the money), there are two sides to this business: (1) the upstream side (from which funds flow into FastWeb and Telecom Italia), and (2) the downstream side (where funds flow out of FastWeb and Telecom Italia).

Traffic aggregators are upstream. These are foreign (non-Italian) firms that aggregate third-party demand for telecommunication services and funnel it to FastWeb and Telecom Italia. For VAT purposes the aggregators present themselves as brokers, or intermediaries. Her Majesty’s Revenue and Customs (HMRC) does not share this view. The problem is that the aggregators do not know the identity of the end-users. Calls appear to be coming from Tuvalu57 or Iridium,58 but the aggregators cannot demonstrate that the end-users are real. In other words, there is no proof that anyone actually pays for any call that the aggregators are directing to FastWeb and Telecom Italia. HMRC’s view is that it is hard to claim that you are an intermediary (one who acts in the name of and on behalf of another) when the other party is completely unknown.59

Thus, while the aggregators contended that they are providing exempt services,60 HMRC asserted that the most that can be proven is that the aggregators have purchased telecommunications services from Italy. The end-users could be in the UK or elsewhere. HMRC expects a reverse charge, with VAT determined based on the gross amounts paid to FastWeb and Telecom Italia. Following the general rule,61 the place of supply for intra-community telecommunication services is the customer’s establishment – the UK.62 This

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56 TDM is a type of digital or (rarely) analog multiplexing in which two or more signals or bit streams are transferred apparently simultaneously as sub-channels in one communication channel, but are physically taking turns on the channel. The time domain is divided into several recurrent time slots of fixed length, one for each sub-channel. It has higher quality and reliability and is much more expensive than VoIP. *Operazione “Phuncards-Broker,” supra* note 20, at 289, n. 159.

57 Tuvalu is a small island in the South Pacific. It has a population of just over 12,000 with a land mass of just over 10 square miles. It is the third smallest country by population and fourth by size.

58 Iridium Satellite LLC owns the largest group of satellites used to provide voice and data coverage to satellites (voice phones, pagers and integrated telephones). It covers the entire surface of the earth. The investigators were “… unable to identify an ‘end-user’ who had seen a charge on a bill for a call where a number was placed from Tuvalu or Iridium …” *Operazione “Phuncards-Broker,” supra* note 20, at 282. In fact the Internal Audit report of FastWeb reported that Colin Dines, of Diadem was similarly concerned. He asked for, “… evidence, for example, of the origin of the traffic that is delivered to an end-user in Tuvalu …” FastWeb told him that this information could not be disclosed because it was “commercially sensitive.” *Operazione “Phuncards-Broker,” supra* note 20, at 286.

60 SIXTH VAT DIRECTIVE, Art. 15(14); VAT DIRECTIVE Art. 153 (specifying that intermediaries act in the name of an on behalf of another with respect to transactions carried out outside the community).

61 SIXTH VAT DIRECTIVE, Art. 9(2)(e); VAT DIRECTIVE Art. 44.

62 Defined at SIXTH VAT DIRECTIVE, Art. 9(2)(e), 10th indent, second sentence; VAT DIRECTIVE Art. 24(2)
disagreement over VAT treatment, or perhaps a visit from the UK’s Organized Crime Agency, or maybe instructions from the money laundering operation encouraged the aggregators to move their operations to Finland in March of 2004.

The investigation identified four upstream aggregators – Diadem (UK); Acumen (UK) Ltd.; and Accrue Telemedia OY (Finland).

Downstream from FastWeb and Telecom Italia are two termination companies. Both are Italian: I-Globe s.r.l. and Planetarium s.r.l. These downstream companies provide termination minutes and content. As a result, both FastWeb and Telecom Italia are making taxable domestic purchases of services from these providers. Italian VAT (20%) is paid, and deducted by FastWeb and Telecom Italia.

I-Globe and Planetarium in turn, purchase their content (alleged to be high value, protected or copyrighted pornography) from two other Italian companies – Telefox International Ltd. and Global Phone Networks s.r.l. Once again, Italian VAT is due.

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64 Diadem (UK) Ltd. [VAT number GB824986388] commenced operations on November 19, 2003. Its’ stated capital of £2 is paid by Colin Edward Dines, and Andrew Charles Edward Dines. The place of incorporation (Archway House, 81-82 Portsmouth Road, Surbiton, Surrey KT6 5PT, Great Britain appears to be the accounting firm of Fallows & Company which is the listed accounting firm for Acumen (UK) Ltd. Operazione “Phuncards-Broker,” supra note 20, at 273.
66 Accrue Telemedia OY [VAT number F18826038] is incorporated in Warld Trade Center/ Aleksanterinkatu 17, SF-00100 Helsinki, Finland. It started operations on March 3, 2004 as Laatikko 1001 OY, changing its name to Accrue Telemedia OY on December 22, 2005. Its’ stated capital of €12.00 is paid by the same is paid by Andrew David Neave and Paul Anthony O’Connor. Operazione “Phuncards-Broker,” supra note 20, at 273.
67 Planetarium s.r.l. [VAT number I 09970701004] is registered in Rome – Via Domenico Azumi No 9. It commenced operations on April 23, 2004 and ended on September 13, 2006 following the transfer of the headquarters to Moscow. The transfer was motivated by “more job opportunities.” Richard Sweepers (who held 95% of the shares) is replaced by Mikhail Nikitin as the controlling shareholder. Operazione “Phuncards-Broker,” supra note 20, at 272.
There is one further downstream step. Pornographic content does not originate with Telefox International and Global Phone Networks. Both of these firms pay royalties74 to a Panamanian company, Coriano Capital Ltd. for the content.75 The amount paid over to Coriano is the full amount received from I-Globe and Planetarium (plus VAT). Neither Telefox International nor Global Phone Network complies with Italian tax obligations. They are the “missing traders” in this fact pattern.76

This is a traditional MTIC fact pattern, but it is presented by the investigators from the “other end.” Operazione “Phuncards-Broker” is primarily a money laundering case, and documentation follows the financial flows. A more traditional MTIC view would follow the services and start with Telefox International and Global Phone Network. These entities purchase services subject to a reverse charge, re-sell them with VAT and then disappear without paying over the VAT. The following diagram presents the basic FastWeb/Telecom Italia fact pattern in simplified form. Tuvalu is the sole end-user location, Acumen UK is the sole upstream traffic aggregator and I-Globe is the sole downstream termination/content provider.

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72 Telefox International Ltd. [VAT number I 07595751004] is registered in Rome – Via Cola di Rienzo No 52. It commenced operations on July 16, 2003. Telefox International occupies the seat as a different company (with a similar name) Telefox s.r.l. – VAT number I 07273961008. Telefox ceased operations on December 12, 2003. Ownership of the company was transferred to the JVA Corporation SA (a company incorporated in Panama). It was Telefox s.r.l. that was involved in the phone card VoIP MTIC fraud discussed earlier. The ownership interests in Telefox International are substantially the same as those of Telefox s.r.l. Arigoni Fabio held 95% interest in Telefox International, Antonio Ricci with 5% in Telefox International. In the case of Telefox s.r.l the 5% interest is held by Daniele Fabio together with Arigoni Fabio’s 95% interest. Operazione “Phuncards-Broker,” supra note 20, at 234 & 272.


74 Operazione “Phuncards-Broker,” supra note 20, at 332.

75 Coriano Capital SA was incorporated on November 17, 2003. Under Panamanian law a legal representative [which must be a law firm] is required. In this case it is Rosas y Rosas with offices on the 14th floor of the BankBoston building Panama City. The company owner is listed as a non-resident.

76 Operazione “Phuncards-Broker,” supra note 20, at 260.
This set of transactions did not make sense to the investigators. If the content and the termination are located in I-Globe, why would Acumen (Diadem or any of the other aggregators) contract with FastWeb or Telecom Italia to reach the content and termination services in I-Globe (or Planetarium)? Why not directly engage I-Globe? Working through FastWeb and Telecom Italia was expensive – these companies retained approximately 5% of gross sales. Internal audit at Telecom Italia asked the same questions.

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77 *Operazione “Phuncards-Broker,”* supra note 20, at 292 indicates [NOTE in this passage it is Diadem UK that is discussed not Acumen UK, however in this MTIC structure Diadem UK, Acumen UK and Acumen Europe are shell companies that can be moved in and out of the structure to give the transactions a different appearance]
Indeed, I-Globe s.r.l./Planetarium s.r.l. with equipment that it owned and was installed at Ubique TLC Italy s.r.l. (Rome, Via G. Imperiali di Francavilla No. 4) “simply” converted TDM traffic (back to) VoIP thanks to a connection … provided by FastWeb SpA, for which a fee was paid. It follows therefore that Diadem UK Ltd. could connect directly with I-Globe s.r.l./ Planetarium s.r.l. to send VoIP traffic without the intermediation of FastWeb Ltd. Therefore, if the interconnection by FastWeb had no reason to exist, then the economic and trade relationships between Diadem UK and I-Globe s.r.l. /Planetarium s.r.l. involved an unnecessary intermediary with whom operational margins needed to be shared.

78 *Operazione “Phuncards-Broker,”* supra note 20, at 300 records the following interview:
Gianfanco Ciccarelli, manager of network Sparkle Telecom Italy SpA, … on 11.06.2007 [was asked about] … the routing of traffic from foreign companies [Acumen UK, Acumen Europe, Accrue and Diadem UK] only to I-Globe/Planetarium. The real difference of the service provided with this trade agreement is absolutely rigid routing [TDM]. In other words, all that is received from the foreign companies just goes to these Italian companies. The [investigating] office at this point does not understand why the traffic is not channeled directly between the [foreign and Italian] companies, given that the cost to services rendered by Sparkle is about 4.8% on turnover of over one billion euro in 2006 alone.
Two answers were offered: (1) FastWeb and Telecom Italia were able to take VoIP from the internet and convert it to more reliable TDM connections, and (2) I-Globe did not have the resources to finance the VAT, and would prefer to be VAT-neutral, something it could not be if it dealt directly with Acumen. I-Globe was paying 20% on its purchases from Telefox and Global Phone Networks, and was zero-rating its sales to Acumen UK. As a result, I-Globe would need to subsidize the VAT until a refund was issued. FastWeb and Italia Telecom however were VAT positive, and would remain so after deducting the VAT from these transactions.

These decisions produce an unusual fact pattern. Telecommunications traffic flowing from the aggregators to FastWeb/Telecom Italia is internet-based (VoIP). It is converted to TDM on traditional landlines by FastWeb/Telecom Italia, and then re-converted back to internet-based VoIP for termination and content acquisition from I-Globe/Planetarium. In fact, the content itself is also (allegedly) internet-based. Telefox International and Global Phone Networks provide it through and have acquired it from an internet feed with Coriano Capital in

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Answer: I cannot give a concrete and convincing answer because I lack reliable data, but surely the question is legitimate and relevant.

79 Operazione “Phuncards-Broker,” supra note 20, at 300, citing from internal Working Papers of the Telecom Italia IT Audit and Compliance Services dated April 4, 2007, obtained on May 2, 2007:
In relation to these traffic patterns, the role of Telecom Italia, Sparkle (the control and charging of the call, monitoring traffic) appears, from a technical point of view partly overbuilt. This is especially true since both the client [I-Globe/Planetarium] the supplier [Acumen UK, Accuren Europe OY, and Accrue Telemetry OY] have the equipment necessary for dialogue (e.g., for the establishment/termination of the call). As a result, the same service could be provided by a direct line and eliminate the interconnection through Telecom Italia, Sparkle (whose role could be limited to IP service network connectivity). This would allow Accrue, Accumen and Diadem to achieve cost savings on interconnection charged by TI Sparkle of more than €71,000,000 in the three years.

80 Operazione “Phuncards-Broker,” supra note 20, at 289, n. 159 (explaining that the choice of TDM was for reliability purposes, although it was much more expensive than using VoIP). Although TDM is a more stable communication medium than VoIP, I-Globe s.r.l./Planetarium s.r.l. could not provide termination services in TDM, and needed to convert TDM back into VoIP. Operazione “Phuncards-Broker,” supra note 20, at 292 indicates:
In relation to the above, it appears that I-Globe s.r.l./Planetarium s.r.l. had no suitable network structures (nor ministerial authorization) to end TDM to other aggregators/content providers (physically located in different geographic locations that that of I-Globe s.r.l./Planetarium s.r.l.) and needed to convert TDM back into VoIP.

81 Operazione “Phuncards-Broker,” supra note 20, at 231, 225 & 292. The VAT aspect is clearly articulated by Charles Focarelli. Focarelli is the Marketing Director of CMC Group – an enterprise directly involved in the “phuncards” fraud investigation, - and is considered to be a “… central figure in the design and organization of the [“broker”] tax evasion scheme …” He indicates:
I-Globe had a significant financial problem in selling traffic directed to DIADEM, because it would involve, in addition to costs of connectivity, a special financial burden. I-Globe would not be able to immediately deduct the VAT it was paying its Italian suppliers [Telefox International and Global Phone Networks]. Considering that the average profit could settle between 8 and 10%, even though the operation was theoretically desirable, it was practically impossible, since I-Globe would very quickly run out of cash. The solution that I proposed to I-Globe was to identify a counterparty that had excess Italian VAT credits with whom to share the profit. This proposal was presented to and accepted by FastWeb …
Panama. As a result, throughout the entire chain, it is only the FastWeb/Telecom Italia-to-I-Globe/Planetarium link that occurs outside the internet. Diagram 3 adds these elements.

**DIAGRAM 3:** Basic VoIP MTIC – broker type – TDM & VoIP –

To see the MTIC fraud in this diagram one more element is needed. When FastWeb and Telecom Italia make purchases from I-Globe VAT is charged, just as when I-Globe makes purchases from Telefox and Global Phone Networks. FastWeb and Telecom Italia are VAT-negative on this transaction, but can absorb the deduction because they are otherwise in an excess VAT position. I-Globe is VAT-neutral (collecting VAT from FastWeb and Telecom Italia, and paying VAT to Telefox International and Global Phone Networks. Telefox International and Global Phone Networks however are VAT-positive (collecting VAT on their sales to I-Globe, but not paying VAT to Coriano Capital).

Telefox International and Global Phone Networks do not comply with VAT requirements. All of the funds received (including the VAT) are paid out to Coriano Capital. This is the traditional missing trader pattern. Rather than perform a reverse charge on the services (pornographic content) purchased from Panama, and report the VAT collected on the onward sale of these services these entities re-sell the service and go missing.

I-Globe/Planetarium play the role of “buffers” in this fact pattern. They allow FastWeb and Telecom Italia to claim that they neither knew nor did they have knowledge that the VAT they paid was for fraudulent services.\(^{82}\) This defense would seem to be very ineffective, based on the evidence collected.

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\(^{82}\) Although dealing with goods not services, the holding in Alex Kittel v. Belgium Case 439/04 at ¶ 60 (July 6, 2006) should apply:
Not only do the transactions not make good business or economic sense, but there are individuals high up within FastWeb and Telecom Italia who appear to have actual knowledge of the fraud. The external auditors have raised serious questions about these transactions. At one point knowledge of the fraud seems to be common knowledge within Telecom Italia. In 2006 an employee group, The Committee in Defense of Telecom Italy, Sparkle, posts flyers in the corporate lunchroom that accuse the executives of fraud and specifically identifies the transactions with Acumen as the problem. When the CEO hears about the flyers his e-mail correspondence indicates that he is upset with the flyers, but very well aware of the questionability of the Acumen transactions.

FastWeb has (allegedly) taken €38,595,102.63 in fraudulent VAT deductions, and Telecom Italia Sparkle has taken €297,890,902.48. Diagram 4 adds these aspects.

Where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of Sixth Council Directive … must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void … causes that taxable person to lose the right to deduct the value added tax he has paid. … By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct.

83 Operazione “Phuncards-Broker,” supra note 20, at 300 & 302.
85 The investigation cites both to Telecom Italia internal audit report, and to back up papers for those reports as follows:

... the needs of the customer (Accrue, Acumen and Diadem) differ from those of other clients … traffic is characterized by a single point of origin and one destination point. “ This is so much more explicit in the preparatory work from that report which adds that "in relation to that traffic patterns, the role of TI Sparkle (control and charging of the call, monitoring traffic) appears, from a technical point of view overbuilt, especially since both the client and the supplier have the equipment necessary for direct dialogue in signaling (eg. for the establishment / abatement of the call). Thus, the same service could be provided by a direct link between these devices and eliminating interconnection with TI Sparkle (whose role could limited to services IP network connectivity). This would allow Accrue, Acumen and sensitive Diadem cost savings of interconnection charged by TI Sparkle of more than € 71,000,000 in the three years.”

86 Among the e-mails recovered by the investigation was one from November 20, 2006 from Arturo Danesi (the head of wholesale operations for Telecom Italia) to Stefano Mazzitelli (the CEO of Telecom Italia) concerning flyers posted in the company cafeteria from a group calling itself The Committee in Defense of Telecom Italia, Sparkle asking, “Do you think that behind the glass barrier on the sixth floor there hides another company? Do you know what Acumen does?” To which the CEO responds, “People in the company are now beginning to doubt the real quality of our customer Acumen, and the true nature of the services for which Telecom Italia, Sparkle is handsomely paid … [which has allowed us to reach] inconceivable targets.” Operazione “Phuncards-Broker,” supra note 20, at 323-24.
From a MTIC perspective, much of the complexity of this case comes from the money laundering activity that is the source of the MTIC funds. VoIP MTIC produces a 15% return on all funds sent through the carousel, over and above the 5% return retained by FastWeb and Telecom Italia. The original source of these funds is not further specified, but it is alleged to come from illegal activities of the Ndrangheta mafia (a crime syndicate from the toe of the Italian boot).

The key to understanding the carousel nature of this fraud is in another Panamanian company, Broker Management S.A. and its relationship to Coriano Capital. Not only were these companies established at the same time, by the same law firm, with offices in the same building, but the internet contact for both companies as well as the bank accounts are controlled.

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87 Stacy Meightry & Sabrina Cohen, Billionaire Is Sought In Sweeping Fraud Probe, WSJ at B5 (Feb. 24, 2010); Operazione “Phuncards-Broker,” supra note 20, at 220. VAT fraud seems to have been the specialty of two members of the Ndrangheta, Carlo Focarelli and Gennaro Mokbel. The investigation indicates that these individuals have been for, “…fifteen years operating in the area of tax fraud at the highest level, benefitting from a proven and sophisticated laundering of proceeds from the VAT fraud in particular. They are acting more or less always with the same methods, and have succeeded in recent times, to infiltrate areas of high liquidity, increasing in exponentially and consequently the profitability of their criminal social and economic danger.” Operazione “Phuncards-Broker,” supra note 20, at 226.

88 Boker Management S.A. was established in Ciudad de Panama (Panama), and was incorporated on December 4, 2003. The Resident Agent of the company is the law firm Rosas y Rosas. The single recipient of Broker Management funds is Augusto Murri was born in Rome on May 19, 1968, resident of Spain and Kenya. Operazione “Phuncards-Broker,” supra note 20, at 275.

89 Coriano Capital S.A. was incorporated on November 17, 2003 had the same Resident Agent, the Rosas y Rosas law firm, had offices at the same location on the 14th floor of the BankBoston building located at Via Espana and Elvira Mendez, Panama City (Panama). The only person authorized to act on the company bank account was the same Augusto Murri. Operazione “Phuncards-Broker,” supra note 20, at 276.
by the same person.\textsuperscript{90} The bank accounts of both Broker Management S.A. and Coriano Capital were at the Banco Bilbao Vizcaya Argentaria (BBVA).\textsuperscript{91} The Italian investigation sought Spanish assistance to trace financial flows, and soon uncovered enormous sums of money passing rapidly from the Coriano Capital account to the Broker Management account and then back through all the MTIC traders.

The first complete carousel the investigation put together begins with one of the aggregators:

- **Acumen – BBVA (account number 151993)**
  - €1,852,323.10 is deposited in this account from two sources:
    - Three deposits of €359,735.72 each (all on March 23, 2005) from Celenkord S.A. (a company the investigation has identified as associated with criminal activities\textsuperscript{92}) from an account at Credem International (Luxembourg).
    - Two deposits of €358,739.22 and €414,376.72 (on March 24 and March 30, 2005) from another Acumen account at Barclays Bank.
  - €1,698,669.28 is withdrawn (April 4, 2005) in favor of Telecom Italia Sparkle

- **Telecom Italia Sparkle**
  - €1,968,120 is transferred to I-Globe immediately (April 4, 2005)
    - €1,640,100 invoice amount, and
    - €328,020 which represents 20\% Italian VAT is added
  - €53,900 is retained by Telecom Italia Sparkle (3.18\%)

- **I-Globe – Banca Antoniana Popolare Veneta (account number not provided)**
  - €1,961,016 is remitted to Telefox Int. four days later (April 8, 2005)
    - €1,634,180 invoice amount, and
    - €326,836 with represents 20\% Italian VAT
  - €7,104 is retained to pay for expenses

- **Telefox International – Banca Antoniana Popolare Veneta (account number not provided) on April 11, 2005**
  - €1,956,664.79 is transferred to a Telefox International account at BBVA
  - €4,351.30 is retained for expenses

- **Telefox International – BBVA (account number 151842)**
  - €1,950,030 is remitted to Corinano Capital S.A. on April 12, 2005, and
  - €6,634.79 is retained to pay for expenses.

- **Corinano Capital SA – BBVA (account number 151607)**

\textsuperscript{90} Using \texttt{www.whois.ws} the investigation determined that the web site \texttt{http://www.brokermanagement.net}, was registered on March 26, 2005 for account of the Panamanian company society Coriano Capital S.A., located at Via Brenta, 2 / A, Rome. The web site \texttt{www.corianocapital.com}, was recorded the previous day (March 25, 2005). In addition, for both sites the contact person of the company was Augusto Murri. Via Brenta, 2 / A, Rome, with an e-mail address of \texttt{augustomurri@hotmail.com}, and the same telephone number. The investigation further confirmed to data through the tax authorities and the City of Rome. \textit{Operazione “Phuncards-Broker,” supra} note 20, at 394.

\textsuperscript{91} Banco Bilbao Vizcaya Argentaria (BBVA) is a multinational Spanish banking group. BBVA is the second largest bank in Spain and 7th largest financial institution in the Western world. The bank has focused on overseas expansion, and now enjoys a dominant position in Spanish-speaking Latin American countries as well as a strong presence in southern European countries, especially Portugal and Italy.

\textsuperscript{92} \textit{Operazione “Phuncards-Broker,” supra} note 20, at 266, n. 98.
\* €1,945,030 is remitted to Broker Management S.A. (April 4, 2005)
\* €5,000 retained for expenses.

- Broker Management – BBVA (account number 151574)
  - €1,939,840.00 remitted to Acumen – BBVA Account number 151993
  - €5,190 is retained for expenses

- Acumen – BBVA (account number 151993) on April 13, 2005
  - €2,005,414.18 transferred to Telecom Italia Sparkle comprised of:
    - €1,939,840 from the Broker Transfer
    - €65,574.18 from the excess of the funds received by Acumen from the transfers on March 23 and March 28 from Celenkord S.A. and the Barclays Bank transfers.

This complete cycle took nine days. The first transfer from Acumen to Telecom Italia occurred on April 4, 2005, and the funds were back in Acumen’s account on April 12 ready for another payment to Telecom Italia on April 13. Foreign transfers all occurred among accounts in Banco Bilbao Vizcaya Argentaria; domestic (Italian) transfers used accounts in Banca Antoniana Popolare Veneta.

The investigation presents three more Acumen cycles following the one outlined above: (1) the €2,002,000 cycle from April 13 through the 28 of 2005; (2) the €2,277,000 cycle from April 29 through May 6, 2005; and (3) the €3,300,000 cycle from May 9 through May 16, 2005. It also presents a smaller cycle where Diadem UK is the aggregator for FastWeb. This began on May 5, 2005 and merged with one of the Acumen cycles when the funds arrived at I-Globe. The banks involved change among these cycles, but the basic carousel of funds generating VAT credits from Telecom Italia Sparkle and FastWeb does not.

Diagram 5 modifies the basic VoIP MTIC model used previously to isolate the financial elements considered above. It adds in Broker Management S.A. With this diagram it should be clear how the funds increase during the first cycle so that there is an even greater platform for fraud as the second cycle begins. The increase is the Italian VAT paid by Telecom Italia to I-Globe that is not ultimately remitted by the missing trader Telefox International. Additionally, it should be noticed how the alleged end-users in Tuvalu are completely irrelevant to the financial flows.

Thus, after an initial commitment of funds from illegal activities (money that needing to be laundered) this carousel generates net VAT receipts of €326,836 with aggregate expenses of €82,180.09 [€53,900 retained by Telecom Italia, and €28,280.09 by each of the other entities]. “Profits” from this activity are €244,655.91 (in addition to cleaning service provided by the carousel for the dirty money that was used to make it work).

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93 The VAT receipts are net € 326,836 because as long as the VoIP MTIC is going on I-Globe will file a return that will remit VAT. In this case I-Globe received €328,020 from Telecom Italia, and paid € 326,836 to Telefox International. Thus, a positive VAT return was most likely filed remitting €1,184.
Diadem-FastWeb. Diadem UK is a traffic aggregator that works initially with FastWeb, although in later years it also aggregates traffic for Telecom Italia. Diadem appears to have been engaged in this fraud before Acumen UK, Acumen Europe OY, or Accrue Telemedia OY became involved.

There are some important twists in the Diadem-FastWeb fact pattern that deserve special consideration as they seem to suggest how the fraudsters initially designed this VoIP MTIC operation, and then how it was modified to better avoid detection. These early patterns resemble the examples set out in the February 8 study on VoIP MTIC in the context of a money laundering arrangement that clearly was not anticipated in that paper. Those items include: (a) the physical location of the Diadem server within the FastWeb server farm in Milan, Italy; and (b) the ability to completely control Diadem’s servers remotely (over the internet);

94 Operazione “Phuncards-Broker,” supra note 20, at 261 (commenced operations on November 19, 2003, and from May 5, 2005 through March 2, 2007 made payments in favor of FastWeb totaling €203,734,058.63 at Banca Antonveneta from accounts at Barclays Bank Plc.)
95 Operazione “Phuncards-Broker,” supra note 20, at 262 (indicating that Diadem made payments from September 27 2006, totaling €151,813,601.91 at Deutsche Bank from accounts at Barclays Bank Plc.)
(a) Physical location of the Diadem server within FastWeb’ server farm. The previous article speculated on the probable location of a fraudster’s termination box, the critical server unit that takes an individual call from the internet backbone and transfers it to the domestic landline (or mobile phone network). In the earlier article the following hypothesis was offered, first as a general proposition, and then in the context of a specific example:

If a fraudster needs to disappear, the only asset “left behind” is a termination box. Although the termination box can be located in the jurisdiction where the fraud occurs (a high risk version of VoIP MTIC), in others instances it can be located in a foreign jurisdiction (a much safer kind of VoIP MTIC). … The VoIP broker may in fact be the owner of the termination companies in the UK, Spain and Italy. Each company may be no more than one (or more) Hypermedia VoIP GSM Gateway units in a storage closet of an office building.\(^6\)

Speculation centered on how to effectively hide the termination box, both geographically (in what country) and physically (for example, in a remote storage closet). One of the difficulties with the storage closet option is that this kind of storage closet needs to come equipped with a highly reliable power source, technical support, and an excellent link to internet backbone (for example an OC-255 connection).\(^7\)

The best place to secure reliable power, round the clock technical support, and an excellent connection to the internet backbone is not a storage closet. But the server farm of a major telecom is a different story. This is exactly what Diadem did. Diadem’s server was hosted in the FastWeb server farm in Milan.\(^8\) At the Milan location FastWeb converted Diadem’s VoIP feed into TDM and then transmitted it to content providers in Rome (I-Globe/Planetarium, and then to Telefox International/Global Phone Networks).\(^9\)


\(^7\) OC-255 stands for Optical Connection, and the 255 numeric indicates a speed of 13.21 Gbps ( gigabits per second).

\(^8\) *Operazione “Phuncards-Broker,”* supra note 20, at 282-83. The investigation indicates:

VoIP traffic was routed on a system / equipment owned by Diadem in that was housed (hosted) at the server farm Fastweb Spa. (More precisely at the server farm located in Milan, Via Bernina). That service was included in the award of two public IP addresses (81.208.64.140 and 81.208.64.141147 to 50 Mbps) streams from 2 to 16 MB with telephony numbering 02/8927322.

It is also very clear, based on the contracts between FastWeb and Diadem that the server equipment is owned by Diadem and is required to be physically brought into the server farm by Diadem. This is not a case where Diadem is leasing equipment owned by FastWeb. This level of specificity may have been deemed necessary to provide FastWeb with a reasonable level of deniability should the fraud become evident to internal or external auditors. *Operazione “Phuncards-Broker,”* supra note 20, at 285.

\(^9\) The investigation interviewed Joseph Crudele (Manager of Sales and Services for the Wholesale Division of FastWeb). In a summary of this interview and a direct quotation the investigation reports:

Traffic from England arrived on Diadem’s machine, owned by the customer, which was housed with us, in Milan and then, from there, we connected these flows in TDM on our network, where it was brought down in Rome, without providing any documentation. Also stated that "... then I will explain what our configuration, how that was done. Supervisors asked us to put their servers... We provided a gateway to VOIP where we virtually received VOIP traffic. We then made these flows available through TDM, from Milan, Rome, at Ubique, who was then the company that provided the collection of calls to I-Globe, and then, from there it became VOIP traffic again... " *Operazione “Phuncards-Broker,”* supra note 20, at 288.
Based on this aspect of the *Operazione “Phuncards-Broker”* investigation one might expect revenue authorities to undertake a more carefully survey of rental arrangements at major telecommunications providers. Close attention would be paid to those that leased server space to third-party providers of VoIP termination services. For example, if the massive Deutsche Telekom server farm at Müchen was engaged in leasing activities it might become well known for more than its’ revolutionary biogas power supply. If leases to fraudsters are uncovered, and particularly if Deutsche Telekom is found to be negotiating with those fraudsters for low cost termination, then such a scenario would make it extremely difficult for Deutsche Telekom to meet its’ Kittel due diligence burden.

In the ever-competitive telecommunications market-place the temptation (and the opportunity) is always present for major providers to purchase low cost minutes from fraudsters. If that fraudster is working within your own server farm and can assure you of service quality identical to your own, then the temptation may prove to be irresistible. In the previous study an example was drawn on a French company. The same analysis would be appropriate here (noting only that the German VAT rate is 19% and the French rate is 19.6%). The previous example stated:

> If the [intermediary telecommunications] broker was legitimate the best price he could quote the French firm is at cost. The fraudster however has a different margin. If it intends to go missing, its margin (even selling at cost) is 19.6%. Essentially what happens then is that the French broker enters into a price reducing negotiation with the fraudster whereby they essentially split the 19.6% margin between them.

For Kittel purposes this negotiation session supplemented with the rental of server space to the fraudster is more than damaging, and would most likely subject Deutsche Telekom to extended VAT liability. This level of proof was the clearly the objective of the investigators in *Operazione “Phuncards-Broker.”* It is difficult to see how the Italian investigation will not result in an enforceable VAT assessment against FastWeb.

(b) Remote internet-based control over the fraudster’s server. In several places in the previous study the fact that fraudsters can control termination servers remotely was identified as a critical, fraud-enabling aspect of VoIP MTIC. A remotely controlled termination box is a money machine that will continue to generate revenue for a fraudster until it is turned off. The trick would be never to be present when the authorities find the machine and pulled the plug.

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100 Deutsche Telekom is the largest telecom provider in the EU. All Deutsche Telekom subsidiaries have names starting with “T” including the very familiar T-Home (the legacy fixed line telephone provider), T-Mobile (a mobile phone provider), T-Online (an internet service provider), and T-Systems (a business division focused on providing services to large customers).


102 Alex Kittel v. Belgium, Case 439/04 (July 6, 2006), *supra* note 44.

This discussion was part of the initial hypothetical involving the Nigerian fraudster. It was assumed in this example that the fraudster had purchased a Hypermedia Systems VoIP GSM Gateway – for Call Termination server. It presently sells for $23,990 and has 72 GSM ports that hold 288 SIM cards. From the fraudster’s point of view, equally importantly to the call-capacity of the server is the ability to completely control this system remotely.\(^{104}\)

Diadem’s servers, hosted in FastWeb’s server farm in Milan, were remotely controlled.\(^{105}\) This created a series of problems for the investigation.\(^{106}\) In the first place Diadem was illegally operating a telecommunications business in Italy. Diadem UK did not register under Article 25 of the Communications Code for the resale of telecommunications traffic in Italy.\(^{107}\) There are two consequences to this omission (a) all sales of traffic from Diadem UK to FastWeb are domestic Italian sales, subject to VAT, and (b) it was impossible to acquire phone records containing the identification codes of the calls that came through the Diadem UK network. Thus, unlike the case with Acumen UK, Acumen Europe OY, or Accrue Telemedia OY it is not possible to determine if there actually were end-users for the Diadem calls.\(^{108}\)

In the previous study it was assumed that this would be the classic profile of a VoIP MTIC fraudster. Someone who would set up a termination box in a foreign jurisdiction, provide termination minutes into the domestic network (mobile or landline) and charge VAT for the service in another jurisdiction, but never register to do business, submit VAT returns or remit the tax collected. The fraudster would go missing when pursued. Under this fact pattern it would appear that Diadem UK is preparing to go missing, and perhaps what has happened in this case is that a potential “missing trader” (Diadem UK) has been re-conditioned by the fraudsters to play a role in a larger money-laundering scheme.\(^{109}\) All of the other aggregators discussed in Operazione “Phuncards-Broker” place their servers outside of Italy so that there is an intra-community sale of telecommunications services that qualify for reverse charge treatment.

The Diadem/FastWeb relationship can be diagramed as follows:

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\(^{105}\) Operazione “Phuncards-Broker,” supra note 20, at 284 (indicating that FastWeb regularly leased server space and routinely provided its customers including Diadem specifically with a manual [DB Access Housing – User Manual for External Users] that described the procedures for remotely accessing leased equipment at their server farm) & 285 (indicating specifically that the Diadem server was remotely accessible).

\(^{106}\) Access to the Diadem server was limited to Carlo Focarelli and Massimo Ronchi. When the investigation attempted to seize records related to Diadem from these individuals there was nothing available. Operazione “Phuncards-Broker,” supra note 20, at 285.

\(^{107}\) Operazione “Phuncards-Broker,” supra note 20, at 283.

\(^{108}\) Operazione “Phuncards-Broker,” supra note 20, at 283.

\(^{109}\) There are two other indications that the Diadem-FastWeb relationship had a history in VoIP MTIC that was more like the pattern hypothesized in the earlier paper. Both of these element disappear after I-Globe is established (April 23, 2004). First, FastWeb initially appears to have directly provided termination services for Diadem [after I-Globe is established this is I-Globe’s function and FastWeb merely transmits traffic via TDM]. Secondly, before I-Globe is established FastWeb does not appear to be involved with the Diadem transactions (although it was involved in the Phuncard aspect of the investigation. . rectly for contentfunction : (1) . mtradtional.a bit was
This diagram is a bit more difficult to design. It follows a similar diagram provided by the investigation. Diadem is physically located within FastWeb where the connection to the internet backbone is accessed. The representation is still made that pornography from Coriano Capital is provided to Telefox and Global Phone Networks, and then further provided through the internet to I-Globe. From I-Globe through TDM this content passes to FastWeb where it is used to satisfy demand that has been aggregated by Diadem.

Diadem (even though it is a UK company) does not aggregate this demand from another member state. It presents the demand (illegally) from Italy (within the FastWeb server farm in Milan). As a result, even though there are representations that the demand is coming from foreign locations, the illegality of the business model compounded by the remote control of the server prevent the investigation from confirming even the telephone numbers of the (alleged) end users. There are statements by the fraudsters that the end users are in Tuvalu, but there is no proof (not even the telephone numbers in Tuvalu that were presented in the other pattern).

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110 Operazione “Phuncards-Broker,” supra note 20, at 288. However it should be noted that the investigation places I-Globe within another box representing Ubique TLC Italia s.r.l. Ubique is a technology firm and server farm that is directly connected to the fraudsters. Ubique houses the I-Globe server much like FastWeb houses the Diadem server.

111 There are even complaints by FastWeb’s internal audit that they are not provided the names of the end-users. The response by Diadem (Colin Dines) was that this information was confidential, and “… considered it to be contrary to policy to disclose commercially sensitive information.” Diadem would only reveal to the internal audit that the traffic is assumed to come from an internet site [probably hosted in Tuvalu] and that the actual origin of the calls are not known to Diadem either. Operazione “Phuncards-Broker,” supra note 20, at 286.
CONCLUSION

The Italian Job clearly demonstrates that MTIC has crossed the border into services, and did so in this commercial sector at least as far back as 2003. CO2 MTIC is not the only service vulnerable to this fraud, although the EU Commission,\textsuperscript{112} and even of some very well respected doctoral programs (Rijksuniversiteit Groningen) see this threat only in CO2.\textsuperscript{113}

\footnotesize{\textsuperscript{112} See: the elections for domestic reverse charges under COM(2009) 511, \textit{supra} note 4. \textit{See also} the Press Release, Commission proposal on temporary measures for a consistent response to carousel fraud in certain sectors – Frequently Asked Questions.}

\footnotesize{\textsuperscript{113} Eleven days ago (April 15, 2010), or fifty-one days after \textit{Operazione “Phuncards-Broker”} splashed across the pages of the Financial Times and the Wall Street Journal a dissertation was published at Rijksuniversiteit Groningen. Redmar A. Wolf, \textit{Carrousel fraud - A European problem from a Netherlands perspective; an analysis of tax law and case law}, Rijksuniversiteit Groningen, dis. at \textsuperscript{3.3} (Apr. 15, 2010) available at: NDFR: Nederlandse Documentatie Fiscaal Recht (NDFR Netherlands Documentation Fiscal Law), Fiscaal Wetenschappelijke Reeks 15 (Fiscal Research Series 15), via \url{www.ndfr.nl}. It stated in part:}

\begin{quote}
It is certain new types of carousel fraud will emerge in the future. Using new parties or new routes to avoid detection, with new goods or even services. With regard to services, no theoretical barriers prevent fraudsters from using them. However, most services are not easily tradable; they are not for sale on any public market. The trade of CO2 permits is the one important exception.\textsuperscript{[27]} Fraud has been committed on this market as well.\textsuperscript{[28]} The recent development in this respect will be discussed in the next paragraph. (emphasis added)
\end{quote}

(Ongetwijfeld zullen er in de toekomst nieuwe varianten van carrouselfraude de kop opsteken. Met nieuwe partijen of met nieuwe omwegen om ontdekking te vermijden, met nieuwe goederen of zelfs met diensten. Want wat diensten betreft, bestaat er geen theoretische belemmering om deze toe te passen voor carrouselfraude. De meeste diensten zijn echter niet eenvoudig verhandelbaar; er bestaat geen markt waarop diensten kunnen worden ingekocht en verkocht. Op deze regel bestaat in ieder geval één belangrijke uitzondering: de handel in emissierechten. \textsuperscript{[27]} Deze markt blijkt immers getroffen te zijn door carrouselfraude. \textsuperscript{[28]} De recente ontwikkelingen dienaangaande bespreek ik in de volgende paragraaf.)

Footnote 27 discusses CO2 permits and how they are traded as well as how they are part of the Kyoto Accord. Footnote 28 says:

The European police agency, Europol, has said it is convinced many other carbon credit VAT frauds have been committed across Europe but the total losses to national governments are largely unknown, although probably run in to the hundreds of millions of euros.’ Ashley Seagar, \textit{Brussels targets carbon trading fraud ahead of Copenhagen summit The EU is desperate to get its house in order ahead of the Copenhagen climate change summit}, \url{www.guardian.co.uk}, Tuesday September 29, 2009.
There is a simple solution. It is primarily administrative. It works (albeit in a variant version) in the US under the Streamlines Sales Tax. The details of this solution have been considered in great detail not only in the previous study,\(^\text{114}\) but in a series of earlier papers as well.\(^\text{115}\)

In short, it would be impossible for Telefox and Global Phone Networks to go missing after receiving VAT from I-Globe or Plantarium in the “broker” fact pattern, or for Telefox to go missing after receiving VAT from CMC and Web Wizard in the “phuncard” fact pattern if such a system was in place. Each of the entities involved would be required to have certified tax software installed, and the VAT would be held by a certified service provider who would also file the VAT returns on behalf of the entities. If a system was not certified, then VAT would not be paid across. Funds would be remitted with the return filed by the opposing party.

Tax payers and tax administrations should recognize that the impact of the Italian Job is wide-ranging. For example, Vodaphone is a British multinational that is the world’s largest telecommunications network company (based on revenue) and has a market value of about £71 billion.\(^\text{116}\) It currently has operations in thirty-one countries, and partner networks in forty others. It provides termination services within the EU and in most countries around the globe, and as a result is an active purchaser of VoIP termination minutes on the wholesale market.

If Vodaphone (in Denmark) purchases UK termination minutes from a Danish broker that sells them at highly competitive prices, because he in turn has secured them from a Danish fraudster who considers his margin to include the 25% Danish VAT, then Danish VoIP MITIC is funded by Vodaphone’s desire for lower costs for termination. Has Vodaphone (in Denmark) performed a Kittel level of due diligence by just examining the broker? Would or should the

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\(^{116}\) Vodaphone, *Who We Are*, available at: [http://www.vodafone.com/start/about_vodafone/who_we_are.html](http://www.vodafone.com/start/about_vodafone/who_we_are.html)
Danish Skateministeriet (Danish Ministry of taxation) demand more from Vodafone? Will the Skateministeriet be asking HMRC for assistance under Council Regulation (EC) No 1798/2003 (Vodafone is a UK company after all)? There might well be an illegal termination box in the UK, as well as a fraudster in Denmark. Should Vodafone have known? Did the low cost of the minutes indicate that there was a problem?

But this MTIC variant is not just about VoIP, it is about the ability accomplish in many services exactly what fraudsters have been able to do in goods since customs oversight of internal EU borders was abolished on January 1, 1993. The only requirement is to find a service that can be re-sold – a service that is commercially treated like a good.

Thus, to see how broadly this fraud extends in just the telecommunications field, consider the following investment note on France Telecom. Look at it from the perspective of the MTIC fraudsters seeking new “opportunities:”

What is encouraging about France Telecom is that it has been more innovative and successful than other national telecom firms. This has meant it has embraced VoIP (Voice through the Internet), rather than treat it as a threat, and now has 7.6m users. It has also pursued digital Television strongly and now has 3.2m IPTV (TV through the Internet) subscribers and as such is the number one player in Europe.

Unlike some incumbent telecom firms, the group has also held on to its mobile business and expanded it internationally, and the purchase of Orange in the UK is a good example. In our view this is encouraging as the growth in the future will be from mobile services with the growth of smartphones. Mobile data demand looks set to surge with the introduction of tablets and the growth of smart-phone related services. In fact, mobile services could increasingly usurp fixed-line solutions.

There is no difference between reselling telephone conversation, or re-selling data transmission through VoIP, than there is in re-selling television content. All that is needed is a fraudster willing to provide the content across an EU border. We would simply be substituting IPTV for VoIP in the “Broker-to-Large-Business” example or even the “Broker-to-Retailer-to-Consumer” example that were explained in the first VoIP MTIC paper. We are simply applying old analysis to a new business line.

There is no boundary to digital services. When Acumen UK closed down operations in the UK, Acumen Europe OY continued the aggregation for Telecom Italia and FastWeb from Helsinki Finland. Accrue Telemedia OY also took up residence in Helsinki. Is there a reason for this? Should the Finish Tax Administration be concerned, given that their VAT is 25%, and

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just on the outskirts of Helsinki (Keilaniemi, Espoo) is the Nokia Corporation. Nokia offers internet services such as applications, games, music, media and messaging throughout the world on its Ovi platform.

What is perhaps the most troublesome aspect of this fraud is that it is not confined to the EU. The intra-EU rules for the taxation of services are the same rules that are applied to services in most jurisdictions when a domestic business purchases foreign services for domestic use. In addition, most analysts anticipate that telecoms will (a) expand significantly outside the EU over the next five years, but (b) experience flat investments in the EU coupled with significant pressures on profit margins within the community. This dynamic sets the stage for rapid spread of VoIP VAT fraud among the global economies that are the least able to raise effective enforcement measures.

For a final example consider the Telefónica Group. Telefónica is a Spanish firm, and the third largest telecommunications company in the world. It has a wide array of fixed-line, mobile and broadband services. It has significant assets in the EU and Latin America. For example, in Argentina Telefónica owns Telefónica de Argentina which is the largest fixed-line operator in the country. It also provides broadband, local and long distance telephone services in the southern part of the country as well as the Greater Buenos Aires area. The Telefónica Group has been in the country since 1990.

Suppose the Telefónica Group seeks an expanded revenue stream during 2010-2015, and identifies the Spanish-Argentine market as a likely candidate. Insight Research suggests that demand should be robust in the Argentine mobile phone market, but pressures will remain high on quality and service content in the EU market. For calls originating in Argentina termination minutes will be needed in Spain. If Telefónica de Argentina were to purchase these minutes from an Argentine broker who had in turn secured them through a local fraudster with access to a termination box (or simply access to termination minutes) in Spain, then the sale could be made below cost as the fraudster would have a 21% VAT margin to work with. Issues of termination quality may arise, but this will depend on where the Spanish termination box is

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121 Nokia is the largest manufacturer of mobile phones in the world. It has sales in over 150 countries, and employees in 120 of them.

122 The Insight Research Corporation, Telecommunications and Capital Investment: Looking Beyond the Financial Crisis 2010-2015 (Mar. 2010) available at: http://www.insight-corp.com/ExecSummaries/inv10ExecSum.pdf. During the 2010-2015 period the most notable observations are: (1) capital expenditure for line termination equipment by the major telecoms will decline in the 2010-2015 period – leaving the field open to fraudster who will finance termination capacity by using VAT margins; (2) capital investment in fixed-line operations will fall significantly; (3) mobile operators in developing countries will continue to expand to meet pent up demand for service attracting OEMs desperate for revenue streams; (4) mobile expansion in developed economies will be sluggish with significant concern about margins, but pressure from customers to maintain quality in service; (5) mobile operators will most likely come out ahead during this period because of greater flexibility in service. For example, annual capital expenditure in the 27 EU Member States will fall from $85 billion in 2008 to $74 billion or less during the 2010-2015 period, with no expectation that in any year capital expenditure will approach 2008 levels.


124 This example follows the “Broker-to-Large Company” example in: Richard T. Ainsworth, VoIP MTIC – VAT Fraud in Voice over Internet Protocol 57 TAX NOTES INTL. 1079, 1086-88 (Mar. 22, 2010).
located. In the Diadem/FastWeb fact pattern these quality issues were resolved by placing the Diadem server in the FastWeb server farm in Milan.

For calls originating in Spain the same scenario would play itself out in reverse. It would be Telefónica in Spain that would be looking for Argentine termination minutes. A fraudster in Spain who would secure them from a termination box in Argentina could provide them to a Spanish broker who would then sell them on to Telefónica. In this case the margin over cost, represented by the Spanish VAT, would be 16%.

Although there is nothing in the Operazione “Phuncards-Broker” investigation that sets out this dual VoIP fraud scenario, the blueprint has been drafted and published in Italian. One final note is needed.

MTIC is becoming a serious problem in such a large number of economic sectors that it is beginning to double up on itself. Not only are fraudster migrating from one type of MTIC to another, and not only is MTIC mutating from goods into services, but the proceeds of one MTIC fraud are clearly being laundered through another. A significant portion of the funds laundered through the VoIP MTIC funds in Operazione “Phuncards-Broker” came from previously successful CO2 MTIC frauds.\(^{125}\) It is only a matter of time before the true cost of MTIC is tallied.

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\(^{125}\) Operazione “Phuncards-Broker,” supra note 20, at 271.