



## *Tackling VAT Fraud: Possible ways forward* *Document for the workshops*

### **INTRODUCTION**

Tax fraud creates a significant distortion in the functioning of the internal market, prevents fair competition and also erodes revenues that should be used for the implementation of public services at national level. Combating tax fraud effectively is crucial for ensuring economic growth and creating jobs. It is therefore clearly not only a topic of interest for national governments; it is an issue of interest for the society as a whole.

VAT fraud, and in particular the so-called carousel or missing trader fraud, is highly important on the political agenda in several Member States. It is a type of fraud involving relatively few persons but the amounts at stake are considerable. However, it is obvious that there are other types of fraud like black economy, false deductions or under-reported supplies which also contribute to the losses in VAT receipts.

In 2004, VAT alone represented on average 17,4% of the total amount of collected taxes and compulsory social contributions in the EU, or 713 billion €. The estimates on the non collected VAT made available by a few Member States are around 10%. It is therefore understandable that the national tax authorities want to protect these revenues when they come under attack. In recent years Member States have implemented a variety of anti-fraud measures at an operational and/or legal level.

However, within the VAT system, businesses act as unpaid tax collectors. In that capacity they have certain obligations to fulfil, but by the same token they should also enjoy certain rights, such as legal certainty. Therefore, businesses acting in a responsible manner should not face undue compliance costs or exposure for revenue loss.

The Commission's Communication of 31 May 2006 concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud presented a range of ideas as a basis for a debate with all stakeholders involved. This communication covers direct and indirect tax but clearly the fight against VAT carousel fraud is a major issue within it.

Discussions on the content of this Communication are ongoing with the Member States in Council. The opinion of the European Parliament and the European Economic and Social Committee is to be expected over the coming months.

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The objective of this conference is to provide businesses with the opportunity to express their views on VAT fraud and the way it is tackled currently; to give comments on the ideas which have been put forward within the Commission's Communication; and to present any other idea which could contribute to the fight against VAT fraud.

Obviously the implementation of potential changes might have different timescales. Some of the measures could be put into place at short notice, others requiring changes of legislation at national or even Community level will take longer. It is useful to keep this factor in mind within the discussion on the various ideas.

Tackling VAT fraud is a very broad subject for a one day conference. Therefore, in order to allow for an in-depth discussion on several aspects, it was decided to have an important part of the conference in workshops.

This document presents some reflections on the different topics to be dealt with in each workshop, and upon which the group can build its discussion. It should be stressed, however, that these ideas are not exhaustive. The workshop participants are free to explore and investigate other areas of concern for businesses in relation to the topic of their workshop.



**WORKSHOP 1 "VAT FRAUD: WHAT PROBLEMS DOES IT CAUSE TO BUSINESS AND HOW CAN THEY ASSIST THE TAX ADMINISTRATION IN COMBATING IT?"**

*Chair:* Lynne Clare

*Reporter:* Olivier Hermann

There is evidence that VAT fraud, and carousel fraud in particular, has led to distortions of competition in certain business sectors since goods which have been used to perpetrate these frauds can finally be put on the market at a price lower than the normal market price. Additionally there is a reputational impact on businesses whose goods are used in such frauds.

On the other hand, measures taken by tax authorities with a view to strengthening the fight against tax fraud often have a negative impact on genuine business. The unilateral actions being taken by some tax authorities are creating disproportionate burdens on business without necessarily being successful in tackling the fraud.

These elements demonstrate that legitimate business and tax authorities have a common interest in tackling tax fraud.

Establishing (or improving the existing) communication channels between businesses and tax authorities could be a major element in this context. This covers different aspects.

Effective consultation between business and tax authorities before the introduction of new "anti-fraud" measures affecting businesses is a first element. This would allow legitimate businesses to provide a useful input in these measures based on their experiences and could result in better focused, more effective measures. On the other hand, tax administrations might fear that businesses might want to soften the envisaged measures and by doing so render them less efficient.

Several Member States have introduced into their VAT legislation the principle of joint and several liability, which makes taxable persons jointly liable to pay the tax when they "knew or should have known" that they were involved in dubious transactions. Businesses have an active interest in knowing their customers – not least to ensure they get paid, but also to be certain that their goods are entering into a genuine supply chain. This is where the tax authorities could assist by employing more effective screening of businesses which are seeking to register for VAT, in order to keep non-legitimate business outside the VAT family.

Arguably tax authorities could facilitate better understanding by businesses of their customers by sharing information about new fraud patterns, and newly affected sectors in order to raise the awareness of businesses; a so-called tax alert system. Here Member States might be reluctant to co-operate as they may consider this to be sensitive information that might jeopardise their control efficiency. However, what about a system which shared information between "trusted" businesses and the tax

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authorities? Might it be possible to use a triple A type rating system (similar to the forthcoming Authorised Economic Operator accreditation) to allow tax authorities to determine which businesses it can trust? Might such an accreditation system be welcomed by business as an acceptable measure of which businesses it can trust?

Alternatively, a contact point within the tax administration where legitimate business could report potential "dubious transactions" or concerns about particular businesses may also prove to be very useful. What is the business perspective of such a possibility?

What are the experiences of business in working with tax authorities, both positive and negative? Are there good practices which could be shared by the tax authorities to improve trust and working relationships with business and to bring about greater consistency across the EU? Are there areas where tax authority practices inhibit close working with business? How could these best be remedied? So, in general, where can businesses assist the tax authorities in their efforts to try and fight VAT fraud? And where can tax authorities assist businesses to help to fight VAT fraud?

Another idea mentioned in the Commission's Communication relates to the setting up of a partnership relationship between tax administrations and businesses. This already exists today in the Customs field and the question is whether it would not be worthwhile introducing a similar principle in the tax area.

- How could such a partnership work in practice?
- What could it cover?
- What would be the advantages for reliable traders?
- Could it be used for e.g. quicker refunds, fewer obligations, etc?
- To what extent would this ensure equal treatment within the EU?
- Would such a partnership have to fulfil certain minimum requirements laid down in Community legislation, some sort of centrally agreed guidelines, or should this be left for Member States to ensure a greater flexibility?

Finally, what could be the role of tax consultants (intermediaries, fiscal agents) in this picture? To what extent could they assist both businesses and the tax authorities in their efforts to tackle tax fraud?



**WORKSHOP 2: "ENHANCING THE FIGHT AGAINST FRAUD AND THE BURDEN ON BUSINESSES: STRIKING THE RIGHT BALANCE".**

*Chair:* Henk Wildeboer

*Reporter:* Karl-Heinz Haydl

Carousel fraud is typically a fraud where goods move very quickly between different Member States and more and more also between Member States and third countries. Companies involved in this type of fraud are set up and disappear again leaving huge amounts of VAT unpaid. Tax administrations mostly become aware of the fraud after a period of time which amplifies the difficulty for the tax administration to recover the VAT loss.

#### INFORMATION

Acquiring accurate and timely information from the stakeholders in the society is therefore identified as being a key tool for the tax administrations for the detection and the dismantling of this type of fraud. However, tax administrations have also to digest and use this information very quickly and in a proper way otherwise this information is losing its value.

A reflection on more frequent and more detailed exchange of information between tax administrations also raises the question on the opportunity to review the reporting obligations for taxable persons.

In this context, companies active at a European level are confronted with considerable differences within the national reporting obligations. In addition to the recapitulative statement of Intra-Community supplies, some Member States impose a recapitulative statement of Intra-Community acquisitions and/or a listing on domestic supplies. From a business point of view, it is difficult to understand why some tax administrations require this information whilst others can carry out their tasks without it.

As a consequence of the variety in the national regimes of obligations to which they have to comply, businesses need to adapt their computer systems accordingly for each national market and the question arises to what extent this is feasible and, more important, acceptable from a business point of view?

Communication is again a key element. It is important for the tax authorities to do away with the feeling taxable persons might have that the consequences of an inefficient functioning of the tax administrations is converted into additional burdens on traders.

It is also in the interest of business to combat fraud. In general, business is willing to provide information. However businesses need to be assured that the information is needed and used in an efficient manner, for instance information based upon a proper risk management system.



Bearing in mind that tax authorities have to digest and use the collected information in a quickly and proper way, the question arises whether all transactions should be reported or whether only the risky transactions based upon a risk management model need to be reported.

#### REGISTRATION AND INFORMATION

The requirement to register as a taxable person is in principle the first contact between the tax administration and the taxable person. Since the VAT identification number plays an essential role in the VAT rules applicable to Intra-Community trade, this registration procedure is of a major importance, both for the tax administrations as for the trader.

It is difficult for a taxable person to start trading before having obtained his VAT identification number. On the other hand, the registration procedure provides tax administrations the opportunity to gather the pertinent information allowing them to make a first assessment of the risk profile of the trader. Tax administrations have to find the right balance between these two elements.

Besides this, the question arises whether tax administrations can make better use of already available information, e.g. from European databases filled by countries.

#### EXCHANGE OF DATA AND INFORMATION

The exchange of data between tax authorities on the movement of goods between Member States is based on the periodical recapitulative statements taxable persons have to submit when they make Intra-Community supplies of goods.

Certainly considerable progress could be achieved by improving the exchange of the available information between the tax administrations - information related to transactions, however maybe also exchanging information related to business and or people that are involved in fraud. Again, the question arises whether we need a European approach instead of a bilateral approach.

Some Member States consider that receiving this information more frequently would enhance the control possibilities of tax auditors and improve their efficiency. This means increasing the frequency of submission of this information by traders. The information itself is already in an electronic format, so the issue is mainly the additional cost this increase in the periodicity of the transmission of the data would entail. On the other hand, would it make sense to require such information eg on a monthly basis when the Member State requires national data only on a quarterly basis and any cross-check may necessitate visits of the taxpayer?

Moreover, when discussing possible changes to the Common VAT system, one of the issues raised is the possibility to have additional reporting obligations for domestic supplies. Frequent reporting of domestic supplies (monthly or even within a shorter time period) is considered to be a control tool necessary to allow a domestic reverse charge system to operate properly. What do you consider such a measure would represent in terms of additional costs for businesses?



The question arises whether all transactions should be reported or whether only the risky transactions based upon a risk management model need to be reported and or exchanged.

#### JOINT AND SEVERAL LIABILITY

Some Member States have introduced specific legal provisions on "joint and several liability", as a measure to tackle VAT fraud. In this context there is a delicate balance between the need for tax authorities to fight fraud on the one hand and the need for legal certainty for traders on the other hand. The European Court of Justice has given some indications on the practical application of this principle and also on its limitations. It might be worthwhile discussing the practical consequences businesses have experienced from these provisions and the ECJ's ruling on it.

#### AUDITS

The running of tax audits is another factor where a balance has to be found between the duty of the tax authorities to control compliance by traders and the burden it represents for them. Audits will be acceptable when they are conducted in an efficient way, for instance based upon a risk model.

#### TECHNOLOGY DEVELOPMENTS

An important element to take into consideration when discussing the costs of the (additional) reporting obligations is the evolution in electronic technology since 1992. The reporting obligations which have been foreseen then took into account the possibilities provided by electronic technology at that time. Information which businesses would not be able to provide at an acceptable cost at that moment could be envisaged today. However, it needs to be kept in mind that often there is no "push the button" solution available. Information may be available but it is often spread over different systems and/or files, etc. and difficult to be captured.

Introducing nationally specific measures implies that businesses face the risk to have to introduce 27 different types of obligations in their individual computer systems. What does this mean for business in terms of work and costs?

This technological evolution might indeed provide new possibilities like for instance the delivery of a digital certificate, with a limited validity period, on the compliance status of a given trader. With such a digital certificate, tax administrations would provide assistance to businesses for the assessment they have to make on the legitimacy of a transaction, which is of major importance in the context of joint and several liability provisions.



### WORKSHOP 3: "CHANGING THE VAT SYSTEM: THE ULTIMATE SOLUTION?"

**Chair:** Jan Körner

**Reporter:** Jean-Claude Bouchard

#### Introduction

At the Economic and Financial Affairs Committee (ECOFIN) meeting on the 28 November 2006 the European Council issued a statement, in respect to combating tax fraud. In particular they asked the Commission to present, for its meeting in June 2007, the progress it has made in "...the examination of potential legal changes to the current VAT system in view of enhancing the legal possibilities for combating fraud such as joint and several liability."

Furthermore, "the possibilities to tax intra-community transactions or to use, on an optional basis, a general reverse charge system for dealing with the most costly forms of VAT fraud" should continue to be examined in the Council "in order to define orientations to the Commission at its meeting in June 2007 at the latest."

The aim of "Workshop 3 – Changing the VAT system: the ultimate solution?" is to look at some possible legislative changes in terms of their effects on businesses. The possible legislative changes detailed in this paper should from the basis of the discussion and they consist of,

1. An optional generalised reverse charge with a minimum threshold.
2. Taxation of intra-Community supplies based on EU VAT rate of 15% with the place of taxation of where the supplier is established.
3. Other legal changes to the VAT Directive (2006/112/EC).

The Commission has presented the options it believes to be the most relevant given the position of the Member States.

#### 1. General reverse charge

Both Germany and Austria see the use of an optional general reverse charge with a minimum threshold as the way forward to tackling carousel fraud and the loss of VAT receipts from insolvencies. It would, though, require some form of extra reporting obligations for businesses.

In practical terms those Member States that opted for a general reverse charge would require that where invoices were issued above a threshold amount (5.000€ could be an indicative figure) that the customer, when they are identified as a taxable person, would be liable to pay the VAT. For any supply below the threshold or to a non-taxable person the supplier would be liable for the VAT as is the case today under the normal rules.



In order to control the movement of "untaxed" goods subject to the reverse charge businesses would be required to fulfil extra reporting obligations. The exact nature of these obligations remains to be decided. However, as a minimum it is likely that the supplier would provide a periodic global listing detailing the customer (VAT number or perhaps specific reverse charge identifier) and the value of supplies. It may be that the customer is required to provide a purchase listing containing the supplier's details and the value of transactions to enable the tax authorities to match in global terms the supplies with purchases.

What is clear is that for businesses a general reverse charge would inevitably have consequences, not only in the Member State where a general reverse charge operated but possibly in other Member States too. Some of the key issues are the reporting obligations, legal certainty in correctly identifying the customer and the effects on cash flow.

## 2. Taxation of intra-Community supplies

As an alternative to the general reverse charge the Member States asked the Commission to look at the possibility of taxing intra-Community supplies. An option being considered is for the existing rules to be kept but instead of the supplier issuing an invoice for an exempt intra-Community supply, VAT at 15% is charged to the customer.

For a supplier this means that all supplies to taxable persons in another Member State are taxable at 15%. The normal rules on distance sales would apply so that supplies to a Member State above the distance selling threshold would still require registration in that Member State.

Also as the rates and scope are not harmonised throughout the EU businesses without a full right of deduction would be required to make an adjustment of the VAT to the rate applicable in the Member State where they are established. For instance for standard rated goods a bank in Denmark acquiring goods from another Member State would need to do a self supply charge of 10% (difference between the 25% standard rate in Denmark and the 15% EU rate) on the value of the goods. When the goods would be submitted to a reduced rate in the Member State of destination, the acquirer could make a comparable adjustment.

Concerning the obligations for businesses it could be imagined that all payment of the VAT, irrespective of where the customer belongs, would be paid to the Member State of establishment. All deductions for VAT, domestic and from other Member States, would be made on the VAT return and reporting obligations would be kept regarding recapitulative statements and additionally this would also be done for purchases. A monthly reporting period would be used for all reporting obligations.

For the Member States they would need to reattribute VAT revenues to the Member State where the consumption takes place. For instance the VAT charged by a Belgian business to a Dutch business would be collected by Belgium who would pay it over to the Netherlands.

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What does the workshop see as the advantages and disadvantages for businesses of such a system of taxing intra-Community supplies.

### 3. Other legal changes to the VAT Directive

#### a) Joint and several liability

Article 205 of Directive 2006/112/EC already allows Member States to "provide that a person other than the person liable for the payment of VAT is to be held jointly and severally liable for payment of VAT". The problem is that Member States have been ineffectual in applying the measure to combat fraud. This is especially so where the carousel fraud chain is long and it brings in legitimate businesses unaware of the fact that a fraud is being committed.

The key is how to make the application of the measure effectual whilst adhering to the principles of legal certainty and proportionality as identified by the European Court of Justice.

One possible way forward would be to make the supplier liable for any tax loss in the Member State of acquisition when the recapitulative statement was not completed. In this way the tax authorities would either receive timely information of an intra-Community acquisition in order to have the necessary control measures in place or else they would be able to make the supplier liable should there be any VAT loss. The honest businesses that complete and file accurate recapitulative statements can continue to trade normally. For the dishonest businesses wanting to mask a carousel fraud they risk being held liable for any VAT loss.

#### b) Amending the time of the right of deduction rules (tax point for input tax)

The current Directive (2006/112/EC) has under the chargeable event defined the point at which the tax is accounted for and the time at which the right of deduction shall arise. This tax point is the same for both events.

This represents a system weakness in that the tax authorities must allow a right of deduction for a business operating in good faith whilst at the same time, or in some cases even later, try to recover the tax from the supplier. Where fraudulent businesses register for VAT and subsequently go missing this presents a major problem of control for tax authorities.

The basic rule on the right to deduct (Article 167) could be enhanced to reinforce the link with the risk that a supplier does not fulfil his obligations. However, it would be too onerous for businesses to legislate that the right to deduct shall arise at the time when the supplier pays the tax authorities the VAT due on the invoice. This places an unfairly high burden on businesses receiving a supply as they must establish when the supplier has paid the tax authority and furthermore this delay creates a tax flow loss.



To allow honest businesses to trade normally the right to deduct would always be according to the normal rules when the supplier can demonstrate that they do not pose a risk to the tax authorities. Here they would be allowed to receive an authorisation from the tax authorities so that their customers can continue to pay them the VAT and have an immediate right of deduction. This is similar to a partnership agreement between the tax authority and the business.

The following ways could be used to demonstrate that "authorised suppliers" do not pose a VAT risk

- A partnership agreement between the supplier and the tax authorities;
- The lodgement of a security by the supplier;
- The acceptance by another party to be jointly and severally liable together with the supplier;

These measures should be indicated on the invoice and would be able to be checked in the VIES system.

In cases where the supplier is not able to provide such an assurance, the right of deduction could be challenged by the tax authorities should a tax loss arise. Nevertheless, a supplier fulfilling all his obligations would still allow his customer to have a right of deduction.

However, a customer could obtain an immediate right of deduction by payment of the VAT directly to the tax authorities instead of to the supplier. The supplier would be duly notified of this by the tax authorities.

### c) Taxable status and other obligations

Article 273 allows for the Member States to "impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion".

In this respect the legislation could expressly mention the requirement to provide security. Moreover, a direct link between could be made with the definition of a taxable person (Article 9). For instance,

‘Taxable person’ shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity *and fulfils those obligations required by the tax authorities under Article 273.* (italics added)

In this way a business could be prevented from charging VAT and go missing without paying the VAT collected over to the tax authorities, since they would not be deemed to be a taxable person until certain obligations were fulfilled. However, this does run the risk that a business avoids having to charge VAT by not fulfilling those obligation. A suitable penalty regime applicable to at least the standard VAT rate charged on turnover should be considered. Another risk will be that the customer of such “Non-VAT persons” pays VAT to them in bona fide and gets input tax credit denied.

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What would be the advantages and disadvantages for businesses of such legislative changes?

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