

# EUROPEAN PARLIAMENT

2004



2009

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*Committee on Budgetary Control*

6.3.2008

## **WORKING DOCUMENT**

on Special report No 8/2007 (pursuant to Article 248 (4), second subparagraph, EC) concerning administrative cooperation in the field of value added tax

Committee on Budgetary Control

Rapporteur: Bart Staes

## A. Introduction

### *Amount of public money lost due to VAT fraud*

A worryingly high amount of public money goes lost due to VAT evasion, avoidance and fraud across the European Union. In its present report the European Court of Auditors (hereinafter: the Court) quoted estimates ranging from 60 billion to 100 billion Euro per year. This implies that the amount of money lost every year may almost equals the size of the EU annual budget.

The Council on Economic and Financial Affairs (ECOFIN) observes in its conclusions of the meeting of 4 March 2008: *"Although few estimates are available of the volume of taxes not collected in the EU due to tax fraud, it is estimated to account for 2 to 2.5% of gross domestic product."*<sup>1</sup> This would mean that the overall amount lost due to tax fraud equals two or two and a half times the size of the EU annual budget.

Very few Member States published estimates of the magnitude of VAT losses in their countries. The Court quoted estimates provided by the UK according to which VAT revenue losses amounted to 18,2 billion Euro in the tax year 2005-2006. Estimates published by the German Federal Ministry of Finance state that VAT losses amounted to 17 billion Euro in 2005.

### *Impact of VAT fraud on EU finances*

VAT evasion and fraud affect not only on Member States budgets, but also the financing of the EU budget. The Court presents the following arguments. *"VAT evasion and fraud also impact on the financing of the budget of the European Union, as they result in an increased need to call from Member States own resources based on gross national income (GNI). The GNI resource is intended to cover the balance of total expenditure not covered of other resources. It follows that losses caused by VAT fraud affect the overall balance of the own resources system as laid down by the Community legislator. As the criteria for calculating VAT and GNI resources differ, those losses might also affect the incidence of the financial burden on the Member States, thus undermining the principle of equity."*<sup>2</sup>

The rapporteur fully supports the Court's view. He is convinced that the EU finances are at stake in this case. In his view the activities of the EU institutions, including the European Court of Auditors, provide added value in Member States' fight against VAT evasion and fraud.

However, not all Member States share this view. Germany refused to cooperate with the European Court of Auditors for the present special report (see paragraph 14). The German Federal Ministry of Finance argued that VAT losses had no direct impact on the EU finances and therefore, the European Court of Auditors was not competent to carry out audits in the field of VAT. According to a letter of President Barroso to the President of the European Court of Auditors the Commission considers the possibility of starting an infringement procedure against Germany.

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<sup>1</sup> [http://www.eu2008.si/en/News\\_and\\_Documents/Council\\_Conclusions/March/0304\\_ECOFIN.pdf](http://www.eu2008.si/en/News_and_Documents/Council_Conclusions/March/0304_ECOFIN.pdf)

<sup>2</sup> Paragraph 2.

It is worth noting that the Commission and Parliament consider that VAT fraud affects the financial interests of the Community within the meaning of Art. 280 EC Treaty. In its proposal on mutual administrative assistance for the protection of the Community against fraud and other illegal activities the Commission explains that *"large scale VAT fraud may negatively affect Member States' VAT revenues and consequently their contributions to the Community budget. As this aspect affects the financial interests of the Community, the Commission has a strong interest and indeed an obligation to take action in support of member states operational activities aimed at combating serious VAT fraud"*<sup>1</sup>. Parliament supported this approach<sup>2</sup>. By contrast the Council has not started the first reading of this proposal yet.

In its communication of May 2006 concerning the need to develop a coordinated strategy to improve the fight against fiscal fraud the Commission confirmed its view that VAT fraud affects the financial interests of the Community and added: *"The distortions caused by VAT fraud affect the overall balance of the own resources system which has to be "fair and transparent" in order to guarantee the well functioning of the Community."*<sup>3</sup>

## **B. The Court's audit**

### *Audit scope*

The Court's audit examined the functioning of administrative cooperation between EU Member States in the field of value added tax. The Commission's role in fostering, monitoring and evaluating this cooperation was also reviewed.

The Court noted that, although most of VAT evasion was linked to shadow economy, a significant part of VAT evasion occurred as a side effect of the VAT arrangements put in place with the introduction of the internal market in 1993: For intra-Community trade goods are exempted from VAT. The VAT is then payable in the Member State of destination. Cooperation between Member States authorities is necessary in order to ensure the proper application of these rules. In 2004, Regulation (EC) No. 1798/2003 was introduced in order to strengthen cross-border cooperation through clearer procedures, improved information exchange and increased direct contacts between local tax offices. Under this regulation a Standing Committee on Administrative Cooperation (SCAC) was established. It is composed of Member States' representatives and headed by a Commission representative. In addition, the multi-annual Community action programme Fiscalis was set up in order to improve the operation of the taxation systems in the internal market. It covers VAT among others. The financial framework for Fiscalis (2003-2007) was set at 67 300 000 Euro. For Fiscalis (2008-2013) it was set at 156 900 000.

In its audit the Court examined

- if the information exchanges between Member States under Regulation (EC) No. 1798/2003 are carried out in a timely and effective manner and whether adequate

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<sup>1</sup> COM(2004)509, paragraph 3.2.

<sup>2</sup> EP Resolution of 23 June 2005, P6\_TA(2005)0255 (DUCHON report prepared by CONT).

<sup>3</sup> COM(2006)254, paragraph 2.1.

administrative structures and procedures are in place to support administrative cooperation,

- the operation of the relevant Commission departments including the Commission's management of the Fiscalis programme,
- and the operation of the Standing Committee on Administrative Cooperation (SCAC).

Under Regulation (EC) No. 1798/2003 so called Central Liaison Offices are responsible for information exchanges. The Court visited Central Liaison Offices in seven Member States: France, Italy, Luxembourg, the Netherlands, Poland, Slovenia and the UK. The Court examined a sample of 420 exchanges of information on request, received or sent in 2005 by these Member States. In view of Germany's refusal to comply with an audit request the Court's observations concerning Germany are based on findings from audit missions to other Member States. The Court asked Member States to give details on how information obtained was followed up on by local tax offices in 23 cases selected from the sample. Audit reports by National Audit offices in Member States were considered and previous reports by the Court were followed up on.

### *The Court's findings*

The Court found that **administrative cooperation between Member States is not intensive enough** in order to tackle the problem of VAT evasion and fraud effectively. The Court did not find evidence that the introduction of Regulation 1798/2003 in 2004 triggered an intensification of cooperation.

In particular, the Court criticises that most Member States have not made use of the possibilities for **decentralisation**, allowing direct contacts between regional or local tax authorities. The Court quotes Finland and France as good examples, as these countries systematically delegated the responsibilities for information exchange to regional tax offices.

With regard to **exchange of information upon request** the Court found that almost 50 % of requests are not answered within the 3 months deadline and that interim replies are often missing. The ECA found that the Lithuanian and Slovenian authorities answered 90% of requests within the deadline. By contrast, in the case of the Czech Republic, Denmark, Spain, France, Italy, Luxembourg, the Netherlands and Luxembourg more than 50 % of the answers were delayed. In Italy and in the UK the Court even found requests which were outstanding for more than a year. The Court observed that in some Member States weaknesses in the organisational set-up of Central Liaison Offices contributed to delays.

In Italy, there are three liaison departments at central level which are insufficiently coordinated and not adequately supervised by the Central Liaison Office. In the Netherlands there are two independent operating units which are insufficiently coordinated. In Germany the responsibilities of the Central Liaison Office are split between three different units in the Central Federal Tax office; the other Member States were not informed who was heading the Central Liaison Office.

On a positive side the Court stated that, where requests were answered in a timely manner, subsequent investigations produced good results: In France an analysis proved that 34 % of replies received in 2005 confirmed or revealed the existence of fraud. An evaluation of 89 requests received in 2005 by the Slovenian authorities showed that 21 of these requests triggered administrative enquiries which led to the collection of additional VAT of 1,5 million Euro. In Poland 713 exchanges of information on request in 2006 led to the detection of 64 fraud cases.

However, the Court noted concerns of some Member States with regard to the **quality of information exchanged on suspected missing traders**.

With regard to **exchanges of information without prior request** the Court considered that the legal framework is not well defined. In theory there were broad obligations to inform other Member States, but in practice these obligations were limited to certain categories of information at the discretion of Member States.

The Court found that **information provided spontaneously** is not always systematically exploited. In this context the Court quotes an example of best practice, the so-called "Eurocanet" set up by several Member States at the initiative of Belgium. Within this network the participating Member States exchange information on a limited number of companies suspected of being involved in missing trader fraud. Eurocanet receives Commission support, but the Commission has no access to its data.

In the Court's view the **VIES (VAT Information Exchange System)** has serious weaknesses. It criticised that, although a decision to modernise VIES was taken in 2004, progress in implementing new features was slow. The Court highlighted that under the current rules it may take almost half a year until information on a specific intra-community purchase is available in VIES. It also stated that information provided by the VIES system on the validity of a VAT number is not fully reliable, as each Member States has its own interpretation on how to validate the VAT number.

Furthermore, the Court found that the instruments under Regulation 1798/2003 aimed at fostering **multilateral controls** are rarely used, although they are financed through the Fiscalis programme. The Court quoted however examples of very successful multilateral controls. In a control organised by the Netherlands in 2005 a further VAT amount of 35 million Euro could be established. The Luxembourg authorities reported a case where a 80 million Euro fraud with mobile phones could be dismantled through multilateral controls together with the UK authorities.

The Court found that most of the **proposals made by the Commission through the SCAC** to improve information exchange were not followed by Member States.

Finally, the Court quotes other factors which may hamper cooperation: **the absence of common rules for withdrawing VAT numbers, difficulties in cross-border prosecution and insufficient tools for quantifying and analysing VAT fraud**.

### *The Court's recommendations*

The Court made the following recommendations (see paragraphs 104-112 of the report):

"104. For combating intra-Community VAT fraud successfully, higher priority needs to be given by Member States to administrative cooperation, in respect of both the operational information exchanges and their administrative management.

105. Member States should encourage more direct communication between local inspection staff as an effective way to speed up the exchange of information. It would at the same time help to increase the intensity of cooperation and the quality of the information exchanged.

106. More efficient monitoring of exchanges of information between Member States is necessary to ensure that problems are swiftly identified and tackled and that each Member

State provides effective assistance to other Member States. Improvements in Member States own monitoring of exchanges of information would also be needed.

107. The procedures for exchanges of information without prior request need to be clarified. Information which is provided spontaneously should be systematically exploited by Member States.

108. To improve VIES, action should be taken to

- (a) radically shorten the timescale for collecting and capturing data;
- (b) ensure that inaccurate data are swiftly corrected;
- (c) improve the functioning of the validation of VAT numbers;
- (d) enhance the possibilities for cross-checks, for example by including data on intra-Community acquisitions; and
- (e) grant broader direct access to data to enable multilateral consultations.

109. The introduction of harmonised rules for withdrawing VAT numbers from traders involved in fraudulent activities should be considered.

110. Having comparable data on intra-Community VAT evasion would contribute to a better targeted cooperation between Member States. A common approach needs to be developed by the Commission together with the Member States to quantifying and analysing VAT evasion.

111. It should be considered how to improve cross-border prosecution of intra-Community VAT fraud in the Member States, for example by changing the Council's current interpretation of the Convention on the protection of the European Communities' financial interests which does not include VAT revenue.

112. With regard to the Commission proposal for an additional horizontal regulation on mutual administrative assistance for the protection of the financial interests of the Community<sup>1</sup>, the Court recalls its recommendation<sup>2</sup> that the Commission should make an effort to propose a simplification and consolidation of Community anti-fraud legislation with a view to avoiding duplications and overlapping or contradictory provisions. Existing weaknesses in cooperation between the Commission and the Member States could be addressed in the framework of such an overhaul."

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<sup>1</sup> COM(2006) 473.

<sup>2</sup> See paragraph 36 of Opinion No 8/2005 on a proposal for a Regulation of the European Parliament and of the Council on mutual administrative assistance for the protection of the financial interests of the Community against fraud and any other illegal activities (OJ C 313, 9.12.2005, p. 1).

### C. The Commission's replies

The Commission largely agreed with the Court's observations and also agreed with the Court's recommendations.

The Commission stated that the Court's analysis was in line with the Commission's communication of May 2006 concerning the need to develop a coordinated strategy to improve the fight against fiscal fraud<sup>1</sup>: The legal framework for administrative cooperation had been reinforced in 2004 but Member States did not make sufficient use of it. The Commission also highlighted the fact that with this communication it launched a political debate which is currently ongoing. In this context the Commission set up a policy oriented Anti Tax Fraud Strategy Group with Member States the mandate of which goes beyond the mandate of the SCAC.

The Commission draws the readers' attention to three obstacles to administrative cooperation, which were not mentioned by the Court:

- Community legislation in the field of VAT requires unanimity in the Council;
- administrative organisation within the Member States falls primarily under their competence;
- resources put into administrative cooperation are limited and some Member States even consider reducing them.

The Commission was less pessimistic than the Court with regard to the **intensification of cooperation** under Regulation (EC) No. 1798/2003, but believes that the time period analysed by the Court was too short for a comprehensive evaluation. The Commission stated that it would publish its own evaluation of the administrative cooperation in the field of VAT in 2008.

With regard to **information exchange upon request**, the Commission stated that the issue of quicker exchange of data has been addressed in the Anti Tax Fraud Strategy Group and that the Commission is currently assessing the impact of such a change on businesses.

Regarding **VIIES** the Commission stated that the work on its modernisation is ongoing and that it will press for an agreement with Member States about the cancellation of VAT numbers in particular.

The Commission is promoting **multilateral controls** through seminars under the Fiscalis programme. With regard to **cross-border prosecution**, the Commission is of the opinion that a comprehensive legal framework needs to be created and points at its proposals which are currently pending before the Council<sup>2</sup>. The Commission also informed that it has launched a study to obtain a **solid estimate on the amount of tax fraud in the EU Member States**.

### D. Next steps

The rapporteur will present his conclusions after the presentation of the special report and the exchange of views in the presence of the Court and Commission representatives at the committee meeting of 26 March 2008. In view of paragraph 14 of the special report he took the initiative to invite a representative of the German Federal Ministry of Finance to that

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<sup>1</sup> COM(2006)254.

<sup>2</sup> COM(2001)272 and COM(2006)473.

meeting. The committee will follow up on the special report through the hearing on VAT fraud which is scheduled for 5 May 2008. Authorisation for an own-initiative report on VAT fraud has been requested. The rapporteur of the present working document is also the rapporteur for the hearing and the own-initiative report.

In the hearing and in preparation for the own-initiative report, the rapporteur aims at deepening the aspects of criminal law and of cross-border prosecution of VAT evasion and fraud in particular, which go beyond the scope of the present special report.