

VAT Fraud - Economic impact, challenges and policy issues

Background

EU Member States (MS) lose billions of euros in Value Added Tax (VAT) revenues every year because of fraud and inadequate tax collection. This loss is commonly referred to as 'VAT gap', which can be defined as the difference between expected VAT revenues and VAT actually collected.

The European Commission estimated the EU VAT gap for 2000-2006 at EUR 90 - 113.4 billion. In 2015 only, the total amount of EU VAT lost was at EUR 151.5 billion. The latter represents a loss of 12% of the total expected VAT revenue and shows a significant increase over a 10-year period.

The Policy department A of the European Parliament prepared a study for the Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3 Committee) to discuss the economic impact, challenges and policy issues related to VAT fraud. The study was [presented](#) in committee on 10 October 2018.



Focus of the study

The study on [VAT Fraud - Economic impact, challenges and policy issues](#) has the following two main objectives:

- to clarify the features of the main cross-border VAT fraud schemes and to provide updated figures regarding the related loss of revenue for the MS; and
- to present and discuss the existing EU anti-VAT fraud regulatory framework, together with the most recent proposals made by the European Commission towards the adoption of the 'definitive VAT system'¹

Key findings

- Missing trader intra-Community fraud (MTIC)²/carousel fraud³ is the most damaging type of cross-border VAT fraud (EUR 50 billion losses on average per year). Immediate actions are necessary to control the damage.
- The 'definitive system' proposal will eradicate MTIC/carousel fraud as we know it. However, new forms of MTIC fraud will rapidly arise that have to date been overlooked.
- The creation of a 'certified taxable person'⁴ status under the 'definitive system' proposal will result in a discriminatory treatment of taxable persons and will open new opportunities for fraud. Moreover, the correct monitoring of this status would be extremely costly for MS.
- The newly adopted measures to deal with CP42⁵ and to tackle VAT fraud heavily rely on active administrative cooperation between MS. However, experience has shown that cooperation between tax authorities is sub-optimal.
- Non-registration, undervaluations and underreporting are three major risks that have not yet been properly addressed in the recently adopted e-commerce package⁶. Accompanying measures should also be adopted in order to prevent abuse of registration numbers in the case of imports.



- The current proposal regarding VAT rates might seem appropriate in the context of the proposed transition towards a destination based definitive VAT system. However, a diversification of the VAT rate structure of the MS would open new opportunities for fraud. Moreover, the monitoring of the correct application of a diversified rate structure will come at a far from negligible cost.
- The MS should be able to curb VAT avoidance schemes such as those recently revealed in the Panama Papers based on the current state of the Court of Justice of the EU case law.
- Digitalisation and tremendous changes in the way businesses operate are the main challenges that need to be addressed for the VAT system to remain a neutral, efficient and effective means of taxation. Traditional methods will not suffice to address these challenges.

Recommendations

Based on the findings the author of the study makes the following recommendations:

- Increased cooperation of MS within Eurofisc and active participation in the Transactional Network Analysis system.
- Better use of the existing EU bodies.
- An ambitious mandate for the European Public Prosecutor Office.
- Effective judiciary sanctions of VAT fraud at the national level.
- Amendment of the definitive system proposal to take into account new risks of fraud and tension between MS.
- Accompanying measures for the e-commerce package and further reflection on more structural changes.
- Investing in new technologies to improve the robustness of collection systems, in particular in the case where the liability to pay the VAT lies with non-EU taxable persons.

¹ Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final.

² MTIC fraud occurs when a supplier established in Member State 1, the so-called conduit company, supplies goods (VAT exempt) to a second company located in Member State 2, the so-called missing trader. The missing trader takes advantage of the VAT exempted intra-Community supply of goods and resells the same goods in the domestic market of Member State 2, at very competitive prices.

³ The MTIC scheme may also be implemented with more than two Member States, using the same VAT rules and advantages, and can be used repeatedly. The goods may also come back to a company in Member State 1 (to complete the circle) and can be repeated. This is called 'carousel fraud'.

⁴ When the customer qualifies as a certified taxable person, the supply will still be taxable at destination and there will be one taxable event.

⁵ Under customs procedure 4200 ('CP42') the importer obtains a VAT exemption when the imported goods are intended to be eventually transported to a business customer in different Member State from the Member State of importation (import followed by an intra-Community supply). When this procedure applies, the VAT is only due in the Member State of destination (by the purchaser, under reverse charge). This is a simplification for businesses.

⁶ The e-commerce VAT package consists of one directive and two regulations: Council Directive 2017/2455 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, Council Implementing Regulation (EU) 2017/2459 amending Implementing Regulation (EU) No. 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax and Council Regulation (EU) 2017/2454 amending Regulation (EU) No. 904/2010 on administrative cooperation and combating fraud in the field of value added tax.

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