

28/06/2018-TAX3 HEARING ON VAT FRAUD

WRITTEN REPLIES TO QUESTIONS

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‘End of the transitional regime, end of the VAT (carousel) fraud?’

1. Can you present the latest data on the VAT gap and specify the shares of VAT carousel fraud and other types of VAT fraud?

The latest Vat gap figures (2015):

	2011	2012	2013	2014	2015
VTTL* (expected VAT / EUR million)	1.051.055	1.083.057	1.095.853	1.137.342	1.186.869
VAT revenue (collection / EUR million)	906.082	925.531	935.869	979.135	1.037.354
VAT Gap (EUR million)	146.983	159.538	161.997	160.220	151.530
VAT Gap (%)	13.98	14.73	14.78	14.09	12.77

* VTTL- VAT Total Tax Liability is an estimated amount of VAT that is theoretically collectable based on the VAT legislation

Final figures for 2016 are not yet available. Preliminary initial estimations and updates from previous years confirm a decreasing trend of the VAT gap to around 12% at EU level. This will make 2016 the 3rd year in a row with a decrease of the VAT gap (2014-2016). The VAT gap estimations include bankruptcies, financial insolvencies and miscalculations. For the fraud part, it is safe to assume that intra-EU VAT fraud causes EUR 50 billion of revenues loss each year (Ernst & Young 2015 study).

2. Can you also elaborate on other types of VAT fraud (notably with the use so-called zappers) outside carousel fraud? Are these other types of fraud mainly at national level or do they also have a European level?

The main types of **cross-border VAT fraud** are the following:

- MTIC (Missing Trader Intra-Community) fraud or carousel fraud. The definitive VAT regime is a means to put an end to this fraud. At the same time, to contain carousel fraud pending the full implementation of the definitive VAT regime, a general approach on new measures was agreed upon in ECOFIN on 22 June 2018. Their objectives are to improve the use of information available at EU and national level to better and earlier analyse and

detect VAT fraud in Eurofisc and coordinate follow up actions. This includes new ways of cooperation between Eurofisc, Europol and OLAF. These measures have also been supported by ECON in its report adopted on 19 June.

- b) VAT fraud on imports made under customs procedures 42 and 63. Under conditions, these procedures provide for a VAT exemption in the country where goods are imported and for the payment of the VAT in the country where these goods are ultimately delivered. The main fraud scheme consists in importing goods under these regimes and to divert them onto the black market rather than delivering them in the country of destination. In this area, a general approach on new measures was agreed in ECOFIN on 22 June to improve the exchange of information between tax and customs authorities and to be more efficient in tracking the goods. These measures have also been supported by ECON in its report adopted on 19 June.
- c) VAT fraud on sales of second hand cars. In relation to means of transport, the VAT Directive provides for two VAT regimes, one for new or recent means of transport with VAT due on the whole sale amount and one for second hand vehicles where VAT is due on the margin only. The fraud scheme consists here to sell recent means of transport as if they were second hand cars. In this area, also, a general approach on new measures was agreed in ECOFIN on 22 June and access to vehicle registration information for Eurofisc officials will be a means to tackle these schemes. These measures have also been supported by ECON in its report adopted on 19 June.
- d) Frauds in the e-commerce sector where a business established in one Member State or outside the EU sells goods and electronic services to private persons in another Member State. VAT due on these transactions may not be paid in the country of the customers as it should be the case but rather in the country where the seller is established or not paid at all. Following the adoption by the Council of the VAT e-commerce Directive in December 2017, the extension of the e-commerce one stop shop to supplies of goods as from 2021 will improve the situation in this area.

At national level, the VAT gap is the consequence of different phenomena of which VAT fraud is only one amongst others. For instance, the lack of administrative capacities to correctly enforce the VAT law or to partly recover revenues explains the size of the VAT gap. Unrecoverable VAT debts, for enterprises falling into bankruptcy are another explanation. There may also be mistakes that cannot be considered as VAT fraud, for instance not applying the correct VAT rates to certain transactions or miscalculations in the amount of VAT to report and pay.

At national level, **the main VAT fraud schemes identified** are the following:

- a) Economic activities are not registered. This is the case when an enterprise operates at national level without being registered for commercial and tax purposes. Goods (diverted for instance by way of missing traders or import frauds) can be sold on the black market by way of non-registered businesses. This is also the case when a business operates and performs transactions subject to VAT but disappears before reporting and paying VAT to tax authorities.
- b) Use of fictitious or fake invoices to deduct VAT. This constitutes a means to reduce the amount of VAT due or to get a VAT credit further reimbursed by tax administrations. Usually, in this instance, the business that has delivered the invoice disappears once the fraud is committed and without remitting the VAT due to tax authorities.

- c) Transactions performed by legitimate enterprises and subject to VAT may not be reported to tax authorities. The most common way is to avoid the registration of these transactions, which is facilitated in the case of services, by the absence of cash registers and by the use of cash. To avoid this, national laws may impose the use of cash registers in specific instances or for specific activities like restaurants.

If the use of cash register by retailers is a means to combat these types of frauds, software developers have also developed the so-called 'zappers' whereby it is possible to register transactions in a software and to eliminate them afterwards. For instance, sales made with cash may be erased at the end of the day or the zipper may also erase transaction randomly. The use of these zappers may for instance rely on a specific software sold along with the legitimate software and made available on a USB key or by connection to a second software or a webpage.

To combat the use of these zappers, some administrations have imposed the use of secure and certified software, for instance in France, or secure and certified cash registers, like in Belgium. Others have also introduced sanctions for software developers that have contributed to tax fraud by selling these zappers.

3. Can you indicate how the Commission services assess the facts highlighted in the Paradise papers with regards to VAT avoidance? What actions did the Commission take after the revelations on the Paradise Papers?

With regard to the VAT treatment of yachts and aircraft, the Commission continued and intensified its investigations, initiated earlier in the year. In October 2017 the UK was requested to explain the situation in the Isle of Man as regards aircraft and in March 2018 infringement procedures were initiated against Malta, Cyprus and Greece as regards yachts. In order to ensure equal treatment of all Member States, requests of information have also been sent to other Member States with what appears to be similar schemes.

The problem linked to the yachts is that Malta, Cyprus and Greece, and possibly some other Member States, apply a scheme according to which the larger the boat is, the less the lease is estimated to take place in EU waters for VAT purposes. In certain cases VAT is consequently only due on 30% of the lease (or at a de facto VAT rate of 5.4%). In Malta and Cyprus there is also another problem since VAT is greatly reduced by wrongly treating supplies of goods as supplies of services.

The issue is also at the moment considered with care by Eurofisc, the network of tax administrations tasked with fighting fraud in the field of VAT.

As reported in a press release on 24 October 2017, Isle of Man's authorities have asked the UK Treasury to conduct an assessment of the practice for the importation of business jets into the EU through the Isle of Man, with a focus on the VAT treatment of aircraft leasing arrangements. The Commission expects that the results of these compliance visits will be shared with the Member States in Eurofisc.

As regards Isle of Man, the rules are clear: VAT is only deductible for business use. In cases where aircraft are used for private purposes, a company or individual cannot deduct the VAT paid for their purchase or import. Information we have received seems to indicate that these

rules have not been correctly enforced in the Isle of Man, allowing some companies and individuals to buy and register aircraft completely or largely VAT free. The UK is currently undertaking a review, which will be finished end-June.

4. The recent Commission proposals aim to create a more simple and transparent system that prevents and fights cross-border fraud. However, the Commission's proposals to allow changes to VAT rates entail some risk. This could make VAT rules even more opaque and complex, and increase the possibilities for VAT fraudsters. Does the Commission recognize this risk? And how will the Commission prevent creating a less transparent and more opaque system?

More flexibility in setting VAT rates for Member States does not increase the possibilities for VAT fraud. The only link between fraud and VAT rates is that the amount at stake when it comes to the different types of fraud could decrease if lower VAT rates were to be put in place. However, using lower VAT rates as a tool for combatting fraud is contrary to the aim of VAT itself, which is raising revenue.

The Commission's proposal as regards VAT rates will remove the currently huge unequal treatment of Member States: the flexibility of applying a reduced or a zero rate would be identical for all Member States.

The proposal also provides for the introduction of safeguards to avoid potential risks like revenue erosion, distortion of competition, unnecessary complexity and legal uncertainty. Member States will be required to ensure that reduced rates benefit the final consumer and, in order to protect revenues, that the weighted average VAT rate always exceeds 12%.

In addition, businesses will gain more certainty in knowing exactly which goods or services benefit from reduced VAT rates with quick and easy access to information through a dedicated EU-wide web portal.

Rules on VAT rates will therefore neither become more opaque and complex, nor increase the possibilities for VAT fraudsters.

5. The Commission also proposes to tackle VAT fraud by creating a Certified Taxable Person (CTP) as tax collector. Only certified tax collectors will be deemed reliable. This concept is quite similar to the Authorised Economic Operator (AEO), which seems to be working well. There seems to be quite some similarity between the requirements to obtain the CTP and the AEO status. Could the Commission give us numbers on the percentage of companies that is currently making use of the AEO status, and which percentage you expect to apply/be eligible for the CTP status?

There is indeed a similarity between the conditions for obtaining the AEO and CTP status. It should be acknowledged however that there are also substantial differences: the AEO status solely relates to imports from and exports outside the EU whilst the CTP status is only relevant for intra-EU trade. Moreover, a taxable person can only obtain the CTP status when the person intervenes in intra-EU trade as a supplier or as a customer. Conversely, customs agents of freight forwarding companies can obtain the AEO status.

There are currently more than 16.000 AEOs which represents 0,3% of the economic operators that have an EORI (Economic Operators Registration and Identification) number which is necessary for handling customs procedures in international trade. However, AEOs are involved in supply chains accounting for more than 70% of all customs declarations at import and export in the EU.

Because of the differences between the two systems, it is questionable whether these ratios related to AEO would be similar for CTP. In any event, three elements must be taken into account which might have an impact on the number of traders which are granted the CTP status: first, the CTP status is irrelevant for taxable persons that are only involved in domestic trade; second, taxable persons only involved on an occasional basis in intra-EU trade might not have an interest in acquiring the CTP status; and third, certain operators who are not obliged to present periodical returns for VAT purposes (for instance, farmers under the special scheme or taxable persons only involved in exempt transactions which do not open the right to deduct) are excluded from the CTP status.

6. Innovation can play a role in the fight against VAT fraud. It is said that the blockchain technology could help reducing VAT fraud. Is the Commission assessing this?

Whether the blockchain technology will reduce VAT fraud or entirely transform the public sector is too soon to tell. In theory, some models based on blockchain technology could help reducing VAT fraud. However, the use of such a technology in the VAT fraud area is only a part of a bigger picture requiring important transformation of current arrangements in the VAT field. The Commission is exploring the use of blockchain technology in different areas, notably customs and excise. At this time, the Commission proposals concentrate on creating a more simple and transparent system to prevent and fight cross-border fraud (see point 4).

7. Taking the different national VAT systems and enforcement rules in place, do you see that there is a risk of cross-border shopping and arbitrage by criminals? Could you comment on the concerns of some Member States in this regard?

As reported above, the size of the VAT gap is partly the result of impaired administrative capacities at national level to enforce national laws. Organisations or people involved in cross-border VAT crimes will rely on these weakened administrative capacities to commit their crimes and remain undetected.

This can be the case for instance in the area of MTIC fraud where a lack of national capacities to detect fraudsters could allow them to continue to commit VAT fraud. National authorities constantly report concerns about these phenomena when they affect their national revenues and request the Commission to act on this. To this end, several recent measures have been taken at EU level of which:

- a) The implementation of the transaction network analysis whereby a data analysis will be performed at EU level to better detect organised networks involved in VAT fraud;

- b) An reinforced cooperation of all authorities involved at EU level in the fight against financial crimes to better share and disseminate information about actors involved in VAT fraud;
 - c) The introduction of the concept of mandatory administrative enquiry whereby two Member States whose VAT due by an enterprise is collected by a third Member States, will be in a position to request this third Member State to carry out a national administrative enquiry to check the records of this enterprise. This will be particularly useful in the context of the expansion of the one stop shop where the national revenue will more and more be collected by another EU Member State.
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