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# VAT carousel fraud – Executive summary

VAT carousel fraud is a major problem within the European Union, with conservative estimates placing the cost of this fraud at €80-100 billion per year. This is an enormous and avoidable loss of public revenue, all the more so at a time of major fiscal difficulties and dramatic impacts for citizens across Europe. VAT carousel fraud is just one aspect of the wider problem of organised fiscal fraud, which is estimated to cost the EU €200-250 billion per year.

The removal of internal administrative borders and the failure to introduce an effective system of fiscal control within the EU has created massive opportunities for fiscal fraud. The absence of any EU-level coordination of VAT rates and the deficient systematic cooperation and information exchange are two major issues that have facilitated this fiscal fraud and make it more difficult for authorities to effectively tackle fraud cases.

Another major shortcoming is the absence of any formal or official definition of this particular form of fraud within the EU. A clear and uniform European definition of VAT carousels is absolutely necessary and a crucial step towards addressing the problem and allowing for better enforcement.

Eurofisc - a new initiative, providing for voluntary fiscal cooperation between EU member states - has so far failed to emerge as a meaningful platform for fiscal cooperation. Despite an annual reporting requirement, the deliberations of Eurofisc remain secret. Transparency on Eurofisc is a necessary step to improving its effectiveness.

## Causes of VAT carousel fraud

This report identifies five elements which specifically contributed to the emergence of the phenomenon of VAT carousel fraud: the grey or parallel trade, the increased national fight against tax fraud, the different VAT rates in EU member states, the intrinsic weaknesses of the VAT system, the disappearance of customs formalities within the EU and the easing of customs control from 1993.

An important principle of VAT is that it is a consumption tax, which ultimately is paid by the end consumer. Far too much VAT taxpayers do not properly fulfil their role as "VAT receivers", creating possibilities for VAT fraud through refunds from the exchequer. The problem of VAT carousel fraud first emerged in the Benelux countries after they dismantled fiscal borders in 1980 and subsequently spread to the wider European community after the implementation of the new European VAT system in 1993.

Business transactions are recorded in the invoice, which forms the basis both for paying the VAT due and the deduction of VAT. The invoice is the axis and also the weak link in the VAT chain. It is almost impossible for the tax audit services to monitor and control all the consecutive billing between supplier and customer. For malicious persons it is easy to produce fictitious and/or false invoices and misuse these.

The confusing circulation of goods, often involving multiple border crossings, makes it extremely difficult for national fiscal and judicial authorities to monitor, given the absence of proper fiscal coordination.

At present, the sectors most sensitive or exposed to VAT carousel fraud are: mobile phones, computer chips and microprocessors, hi-fi equipment, perfume, new and used vehicles, precious metals, construction, waste, and emissions allowances under the EU's emissions trading scheme.

## Solution by the system of 'reverse charge'

An obvious solution to the VAT carousels is a general application of the system of the 'reverse charge' of the VAT to the VAT return to be submitted periodically. This solution, which of course only applies to VAT taxpayers, is already applicable for some sectors in some member states, although often temporarily.

In the system of reverse charge the VAT is shifted from the supplier to the customer. The supplier does not charge any VAT but shifts the tax to the contractor, customer of the goods or services. The supplier is not allowed to mention either the VAT amount or the VAT rate on the invoice, only the taxable amount of the goods or services. The supplier then mentions the value in his VAT return. The buyer also submits this value in his VAT return and calculates the VAT due in the same declaration. It is then deductible for him to the extent that it is related to professional activities.

This eliminates two problems at once: the VAT amount is no longer on the invoice, which prevents theft; and the VAT amount, not yet received but due to be paid, no longer burdens the own financial resources. Digital monitoring of VAT returns makes life much easier for national tax authorities.

Uniform and simultaneous European introduction of the reverse charge will not completely eliminate VAT fraud but would effectively tackle the problem of VAT carousels. This was most recently demonstrated by the measures taken to address the problem of VAT carousel fraud in EU emissions allowances in 2009. Immediate action, including the suspending of trading, temporary exemption from VAT and, finally, the introduction of reverse charge for EU emissions allowances in 16 EU member states successfully contained the problem. The episode demonstrated that it is technically perfectly possible to implement the system of reverse charge in the member states within six months. It only requires political will.

## Reverse charge in the 27 member states

A comparative European inquiry conducted for this report, including the authorities of 25 member states, shows that there are almost no coinciding but rather different formulations of the coordinated directive on VAT, Directive 2006/112/EC. Some national legislation and definitions are complex and endless, the necessary information is not clearly centralised in one place or summarised. There is within the EU a wide range of sectors in which the reverse charge is applied. There is no European streamlining or coordination whatsoever. Each member state independently decides on this issue.

The construction sector and the trade in emissions allowances are the two sectors for which the application of reverse charge is most widespread (16 member states). The reverse charge mechanism for other vulnerable sectors is only applied in far fewer member states and moreover only temporarily.

Last year the European Finance ministers missed a unique opportunity to coordinate the struggle against the VAT carousels. In March 2010 they decided to revise the VAT Directive of 2006 (Directive 2010/23/EU). In the original proposal, it was suggested to apply the reverse charge to a list of goods and services of five fraud sensitive sectors (mobile phones, microprocessors and computer chips, perfume, precious metals, art, collecting objects and antiques, the trade in emissions allowances). Ultimately, reverse charge was only applied to the trade in emissions allowances however.

This highlighted that the political will is still lacking to take the necessary steps to address this problem.

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