

VAT fraud

Economic impact, challenges and
policy issues



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Abstract

Each year, the EU Member States lose billions of euros in VAT revenues on account of fraud. As the EU VAT system is undergoing profound modernisation, this study seeks (i) to take stock of the current state of play, (ii) to assess the current regulatory framework and the proposals under discussion, and (iii) to offer a selection of recommendations. An initial conclusion is that, while the European Commission has put a considerable amount of work into the modernisation of the EU VAT system, remaining risks of fraud cannot be ignored. A second substantial conclusion is that a different approach and the use of new technologies would allow the Member States to remove significant obstacles that currently impede an effective fight against VAT fraud.

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AUTHORS

Prof. dr. Marie LAMENSCH, Institute for European Studies at the Vrije Universiteit Brussel
Emanuele CECI, Université Catholique de Louvain

ADMINISTRATOR RESPONSIBLE

Drazen RAKIC

EDITORIAL ASSISTANT

Janetta CUJKOVA

LINGUISTIC VERSIONS

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To contact the Policy Department or to subscribe for updates, please write to:
Policy Department for Economic, Scientific and Quality of Life Policies
European Parliament
B-1047 Brussels
Email: Poldep-Economy-Science@ep.europa.eu

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LIST OF ABBREVIATIONS

AEO	Authorised Economic Operators
B2B	Business-to-business
B2C	Business-to-consumer
CJEU	Court of Justice of the European Union
CONT Committee	Committee on Budgetary Control of the European Parliament
CP42	Customs Procedure 42
CTP	Certified Taxable person
DG TAXUD	Directorate General for Taxation and Customs Union
ECA	European Court of Auditors
ECOFIN	Economic and Financial Affairs Council
EPPO	European Public Prosecutor Office
EU	European Union
EUROPOL	European Union Agency for Law Enforcement Cooperation
GDP	Gross Domestic Product
GRCM	Generalised Reverse Charge Mechanism
HMRC	Her Majesty Revenue & Customs
I-OSS	Import One Stop Scheme
MOSS	Mini one-stop-shop
MTIC	Missing trader intra-Community fraud
OLAF	European Anti-Fraud Office
OSS	One-stop-shop
QRCM	Quick Reaction Mechanism
TNA	Transactional Network Analysis
VAT	Value Added Tax
VEG	VAT expert group
VIIES	VAT Information Exchange System
VoIP	Voice over Internet Protocol

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EXECUTIVE SUMMARY

Background

In spite of a comprehensive anti-VAT fraud regulatory framework, the EU Member States are losing billions of euros each year on account of fraud. As the EU VAT system is undergoing profound modernisation, it is important to take stock of the current state of play and to assess the relevance and effectiveness of the current system and proposals for reform currently under discussion.

Aim

Against this background, the first objective of this study is 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 EU Member States. The second objective is to present 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'. The third objective of this study is to make selected recommendations.

Key findings

- MTIC/carousel fraud is the most damaging type of cross-border VAT fraud (EUR 50 billion losses in average per year). Whilst the 'definitive system' proposal (2017) is meant to put an end to it, its entry into application is not envisaged before 2022. Therefore, it is essential that the Member States take immediate actions to control the damage. This can be done within existing frameworks, in particular Eurofisc and the newly created European Public Prosecutor Office.
- The 'definitive system' proposal (2017) will eradicate MTIC/carousel fraud as we know it. However, new forms of MTIC fraud will rapidly arise that have to date been overlooked. Moreover, the one-stop-shop as currently designed is likely to create severe tensions between the Member States.
- The creation of a 'certified taxable person' status under the 'definitive system' proposal (2017) 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 the Member States.
- The newly adopted measures to tackle CP42 fraud (ECOFIN 2 October 2018) heavily rely on active administrative cooperation between the Member State of import and the Member State of final destination, keeping in mind that the goods may be rerouted to a different Member State of destination than initially foreseen. This means that unwavering dedication of all the Member States is needed to tackle CP42 fraud. However, experience has shown that administrative cooperation between tax authorities is sub-optimal. In this area in particular, the EU is a chain as strong as its weakest link and fraudsters will take any opportunity to exploit the holes. The risk of 'tax dumping' also arises.
- The newly adopted measures to prevent VAT fraud related to cars (ECOFIN 2 October 2018) seem appropriate to tackle this specific type of fraud. However, their success will once again depend on the effectiveness of the implementation by the Member States.
- Non-registration, undervaluations and underreporting are three major risks that have not yet been properly addressed in the recently adopted e-commerce package (December 2017). Accompanying measures should also be adopted in order to prevent abuse of I-OSS registration numbers in the case of imports.

- The current proposal regarding VAT rates (January 2018) might seem appropriate in the context of the proposed transition towards a destination based definitive VAT system. However, it should be acknowledged that a diversification of the VAT rate structure of the Member States would open new opportunities for fraud. Moreover, the monitoring of the correct application of a diversified rate structure (in order to avoid potential VAT fraud issues) will come at a far from negligible cost for the Member States.
- The Member States should be able to curb VAT avoidance schemes such as those recently revealed in the Panama Papers (aircraft leasing schemes) based on the current state of the CJEU 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, in particular to maintain a satisfactory level of protection against fraud. New technologies and strategies should be investigated.

Key (summary) recommendations¹

- Increased cooperation of the Member States 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, with the Criminalisation Directive as a 'minimum standard'.
- Amendment of the definitive system proposal to take into account new risks of fraud and tension between the Member States.
- 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 See [Section 6](#) for the detailed recommendations.

1. INTRODUCTION, OBJECTIVE AND OUTLINE OF THE STUDY

1.1. Introduction

The EU Member States lose billions of euros in VAT revenues every year because of fraud and inadequate tax collection systems. This loss is commonly referred to as the 'VAT gap', which can be defined as the difference between expected VAT revenues and VAT actually collected. The 'gap' thereby identified includes estimates of revenue losses due to tax fraud and avoidance, but also due to bankruptcies, financial insolvencies and miscalculations. However, most of the gap arises from VAT fraud.²

Many studies have tried to measure the VAT gap, sometimes even at a national level.³ In this study, we will mainly refer to estimation of the VAT gap at an EU level.

In 2009, the European Commission had estimated the EU VAT gap at an amount between EUR 90 and 113 billion for the period 2000-2006.⁴ In 2017, the total amount of EU VAT lost in 2015 was estimated at EUR 151.5 billion, which represents a loss of 12% of the total expected VAT revenue and a significant increase over a 10-year period.⁵ According to the European Court of Auditors ('ECA'), carousel fraud alone could account for EUR 40 to 60 billion of annual VAT revenue losses and 2 % of organised crime groups could be behind 80 % of the fraud.⁶ The gains that can be generated by this type of fraud explain why it is so popular among the fraudsters. Studies have, for example, shown that, in the sector of carbon emissions VAT fraud, an 'initial investment' of EUR 100 million could be 'multiplied' through VAT carousel into EUR 600 million within a few hours.⁷

According to the 2018 report on the VAT gap (released on 11 September 2018),⁸ the VAT gap for the year 2016 fell below EUR 150 billion and amounted to EUR 147.1 billion.

² N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 134.

³ See a.o. C. JEDRZEJEK, 'VAT Fraud in Selected European Union Countries and its Possible macroeconomic Implications', in *Risk Management in Public Administration*, Ed. K. RACZKOWSKI, Palgrave Macmillan, 2017, pp. 420 and 421; L. BARBONE, M. BONCH-OSMOLOVSKIY, G. PONIATOWSKI, 'Study to quantify and analyse the VAT GAP in the EU member states', *CASE Network Reports*, 124, 2015; Reckon LLP., 'Study to quantify and analyse the VAT gap in the EU 25 Member States', London, 2009, https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/reckon_report_sep2009.pdf.

⁴ European Commission, 'Fight against tax fraud: Commission publishes a study on the VAT gap in the EU', 30 October 2009, http://europa.eu/rapid/press-release_IP-09-1655_en.htm (last accessed: 7 June 2018). See also Reckon LLP., 'Study to quantify and analyse the VAT gap in the EU-25 Member States', London, 2009, https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/reckon_report_sep2009.pdf.

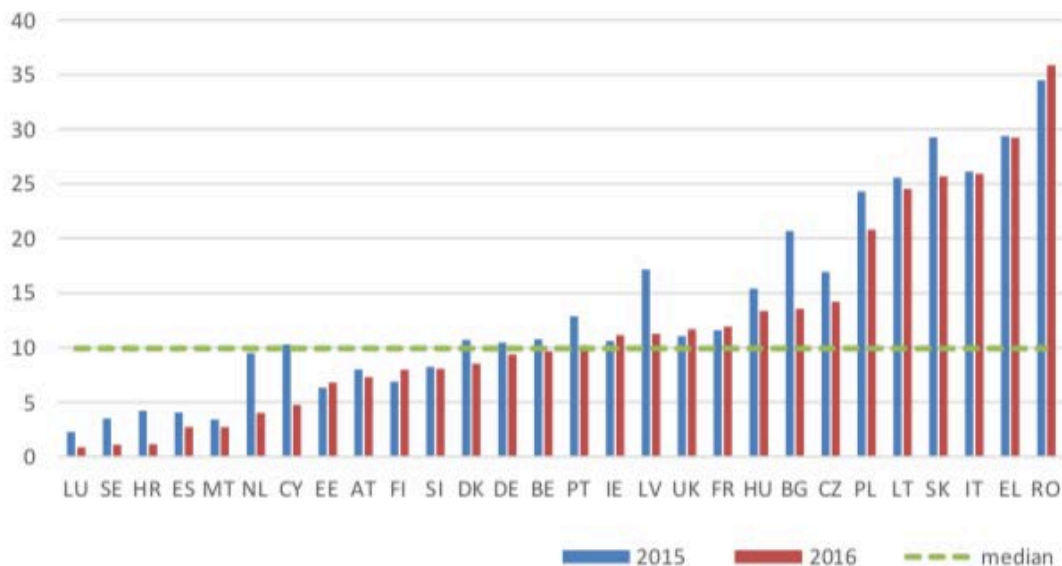
⁵ Center for Social and Economic Research & Institute for Advanced Studies (for the European Commission, DG TAXUD), *Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final Report*, 2017, p. 16. The report clarifies that 'in 2015, the overall VAT Total Tax Liability for the EU Member States grew by about 4.2%, while collected VAT revenues rose by 5.8%. As a result, the overall VAT Gap in the EU Member States saw a decrease in absolute values of about EUR 8.7 billion, down to EUR 151.5 billion. As a percentage, the overall VAT Gap decreased by 2.1% to 12.7%. In 2015, Member States' estimated VAT Gaps ranged from 1.4% in Sweden, to 37.18% in Romania. Overall, the VAT Gap decreased in the majority of Member States, with the largest improvements noted in Malta, Romania and Spain and increased in only seven – namely, Belgium, Denmark, Ireland, Greece, Luxembourg, Finland, and the UK'.

⁶ As reported by the European Commission in its Amended proposal for a COUNCIL REGULATION amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, 30 November 2017, COM(2017) 706 final. See also ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 9.

⁷ M-C. FRUNZA, 'Aftermath of the VAT fraud on carbon emissions markets', *Journal of Financial Crime*, 2013, vol. 20, n° 2, p. 225.

⁸ Center for Social and Economic Research & Institute for Advances Studies (for the European Commission, DG TAXUD), "Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report", TAXUD/2015/CC/131.

Table 1: The EU VAT gap in 2016



Source: VAT Gap in the EU-28 Member States, 2018 report

Based on these latest figures the VAT Gap share would have decreased in 22 countries⁹ but increased in 6: Romania, Finland, the UK, Ireland, Estonia, and France. The smallest Gaps were observed in Luxembourg (0.85 percent), Sweden (1.08) percent, and Croatia (1.15 percent). The largest Gaps were registered in Romania (35.88 percent), Greece (29.22 percent), and Italy (25.90 percent). Overall, half of EU-28 MS recorded a Gap below 9.9 percent.

Other recent studies have reached different (more pessimistic) conclusions. One of them concluded that in 2016 the VAT gap was around EUR 170 billion, while carousel fraud would remain stable (EUR 50 billion of revenue loss on average each year).¹⁰ In this study, the smallest gaps were observed in Sweden (1.24 %), Luxembourg (3.80 %) and Finland (6.92 %).¹¹ The largest gaps were observed in Romania (37.89 %), Lithuania (36.84 %) and Malta (35.32 %).

One thing is certain: the economic impact of the VAT gap remains extremely significant. It would represent approximately 1.5 % of Member States' GDP¹² and could reach levels up to 10 % of VAT receipts in some Member States.¹³ It should be remembered that the VAT gap affects not only the

⁹ Center for Social and Economic Research & Institute for Advances Studies, "Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report", TAXUD/2015/CC/131, p. 16. According to this study, the biggest declines in the VAT Gap of over five percentage point occurred in Bulgaria, Latvia, Cyprus, and the Netherlands.

¹⁰ L. SOKANOVIC, 'Missing trader fraud as part of organised crime in the EU', in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – The Legal Challenges of the Modern World*, Book of Proceedings, 2017, p. 161. Another study concludes that VAT losses in Bulgaria would reach EUR 400 million yearly and confirms that the 'Best VAT fighter' in the European Union is Luxembourg with an even lower VAT gap: only 1% loss on the theoretical tax obligation. N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 134.

¹¹ For more details regarding analysis and data regarding VAT gap per countries, see L. BARBONE, M BELKINDAS, L. BETTENDORF, R. M. BIRD, M. BONCH-OSMOLOVSKIY, M. SMART, 'Study to quantify and analyse the vat gap in the eu-27 member states', *CASE Network Reports*, 2013; Center for Social and Economic Research & Institute for Advanced Studies (for the European Commission, DG TAXUD), 'Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final Report', 2017.

¹² See N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 154.

¹³ F.A. BUKHSH, H WEIGAND, 'VAT Fraud: technical and ontological solutions', 2014, available at: http://vmbo2015.blogs.dsv.su.se/files/2015/02/VMBO2015_submission_14.pdf, p. 1.

Member States but also the EU, since a uniform rate of 0.3 % is levied on the harmonised VAT base of each Member State as one of the EU's own resources.¹⁴ It should also be stressed that VAT fraud also affects compliant businesses because fraudsters create competition distortions in the market.

Over the past decades, the EU has adopted specific anti-VAT fraud legislation, including a recovery assistance agreement¹⁵ and an assessment assistance agreement that together broadly provide for exchange of information and mutual assistance for the recovery of taxes.¹⁶ In addition, the EU Member States have the possibility to adopt quick measures in the case of 'massive and sudden fraud' or in relation to specific sectors particularly prone to major VAT fraud. One of these measures is the application, on a temporary basis, of the reverse charge mechanism. Opinions differ as to the effectiveness of the reverse charge system to thwart VAT fraud. However, the Council recently adopted a proposal for an optional generalised reverse charge system for transactions above a certain amount, subject to specific conditions.¹⁷

This legislative framework is further supported by additional EU tools, committees and bodies such as Eurofisc, OLAF, Europol and the newly created European Public Prosecutor office ('EPPO'). On the one hand, these bodies provide the administrative tools and instruments that are necessary to detect and identify the fraudsters and, on the other hand, they offer the judicial arm to recover the evaded revenue and sanction the fraudsters. Finally, the FISCALIS programme, the VAT Forum and the VAT Expert Group also support the European Commission and the Member States.

In spite of this rather comprehensive framework, VAT fraud remains a fact in the EU, as shown in the most recent VAT gap reports. Several studies have also shown that the current available instruments are unfortunately under-used and that '*Institutions such as OLAF, Eurojust and Europol are also seen as ineffective in defending EU financial interests*'.¹⁸ It is therefore necessary to question the appropriateness of the means currently deployed to tackle VAT fraud in the EU and to assess the newly adopted legislations and the recent proposals for reform.

It is widely acknowledged that the current EU VAT system is not '*well-fitted for today's society*'.¹⁹ Created over 40 years ago, it struggles in particular to keep up with the use of new technologies and the increased mobility of taxable persons. In fact, VAT fraud has been steadily increasing since the introduction of the EU Single Market in 1993.²⁰ The removal of internal borders in 1993 combined with the lack of effective fiscal controls within the EU have indeed opened many opportunities for fraudsters.²¹

¹⁴ European Union, *Public Finance*, 5th Edition, 2014, p. 191.

¹⁵ Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, OJ L 84, 31.3.2010.

¹⁶ See a.o. Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (recast).

¹⁷ Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold COM/2016/0811 final.

¹⁸ A. WILLIAMS, 'Fighting fraud in the EU: a note on icebergs and evidence', *ERA Forum*, 2013, p. 2.

¹⁹ As acknowledged by the European Commission. See http://europa.eu/rapid/press-release_MEMO-11-874_en.htm?locale=en (last accessed: 7 June 2018).

²⁰ K. GRADEVA, 'VAT Fraud in Intra-EU Trade', Goethe University Frankfurt, 7 August 2014, available at: <https://www.etsg.org/ETSG2014/Papers/378.pdf>, p. 29.

²¹ M-C. FRUNZA, 'Aftermath of the VAT fraud on carbon emissions markets', *Journal of Financial Crime*, 2013, vol. 20, n° 2, p. 223. L. SOKANOVIC, 'Missing trader fraud as part of organised crime in the EU', in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – 'The Legal Challenges of the Modern World'*, Book of Proceedings, 2017, p. 160; K. GRADEVA, 'VAT Fraud in Intra-EU Trade', Goethe University Frankfurt, 7 August 2014, available at: <https://www.etsg.org/ETSG2014/Papers/378.pdf>, p. 2. See also T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, pp. 14-18.

In the past few years, the European Commission has been actively seeking to address this situation.²² With the adoption of its 2016 VAT Action Plan,²³ it aims to create a single 'European Union VAT area'. As a follow-up to the adoption of its 2016 VAT Action Plan,²⁴ the European Commission has tabled a number of proposals to reform and modernise the EU VAT system and to make it more robust against fraud.

In December 2017, the EU Member States had already adopted the so-called 'e-commerce VAT package'.²⁵ This package provides for substantial amendments with respect to business-to-consumer ('B2C') electronically supplied services²⁶, intra-EU distance sales and distance sales from third countries (B2C imports). In this context, specific provisions have been adopted to improve the exchange of information framework. A key provision of this e-commerce package is also the obligation for online platforms 'facilitating' B2C intra-EU distance sales and distance sales made by third country suppliers (imports) to collect the VAT due on these sales. This provision was not part of the initial proposal submitted by the European Commission: it was added by the Council, most probably inspired by the European Parliament legislative resolution of 30 November 2017 (proposed amendment 7).²⁷ However, it is not immune to fraud.

Another flagship of the European Commission Action Plan is the proposal to adopt a 'definitive system' for intra-Community business-to-business ('B2B') transactions based on the destination principle, in replacement of the current 'transitional system' that has applied since 1993.²⁸ This proposal is of utmost importance as it is intended to tackle 'carousel' or 'missing trader' types of fraud, which, as discussed above, are responsible for most of VAT revenue losses. According to the European Commission, this new system 'shall reduce cross-border vat fraud by 80%, resulting in 40 billion EUR savings, which could be used to finance infrastructure and mobility, and enhance standards of living of EU citizens'.²⁹ As the definitive system would only apply as of 2022, the European Commission also proposed a series of interim measures to improve the current (temporary) system (that were adopted during the ECOFIN Council meeting held on 2 October 2018).³⁰

²² K. GRADEVA, 'VAT Fraud in Intra-EU Trade', Goethe University Frankfurt, 7 August 2014, available at: <https://www.etsg.org/ETSG2014/Papers/378.pdf>, p. 2; L. BARBONE, R. M. BIRD, J. VAZQUEZ-CARO, 'The Costs of VAT: A Review of the Literature', *CASE Network Reports*, 106/2012, p. 41.

²³ See https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat_en. See also T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, p. 20.

²⁴ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT: Towards a single EU VAT area - Time to decide, COM(2016) 148 final. In November 2016, the European Parliament adopted a resolution entitled 'Towards a definitive VAT system and fighting VAT fraud', welcoming the proposals by the European Commission and offering a number of suggestions (European Parliament resolution of 24 November 2016 on towards a definitive VAT system and fighting VAT fraud).

²⁵ The e-commerce VAT package consists of one directive amending the VAT Directive and two regulations. See <http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/> for a link to these legislations.

²⁶ The same rules apply to telecommunication and broadcasting services, which will not be addressed specifically in this report because the main risks of fraud that were identified concern Internet purchases.

²⁷ European Parliament legislative resolution of 30 November 2017 on the proposal for a Council directive 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 (COM(2016)0757 – C8-0004/2017 – 2016/0370(CNS)) (Special legislative procedure – consultation).

²⁸ Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final.

²⁹ N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 150. See also https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat_en; T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, p. 21.

³⁰ Proposal for a Council Implementing Regulation amending Implementing Regulation (EU) No 282/2011 as regards certain exemptions for intra-Community transactions, COM(2017) 568 final.

1.2. Objective and outline of the study

Against this background, this study aims (i) to offer a clear picture of the nature and extent of VAT fraud in the EU, (ii) to evaluate the applicable EU regulatory framework and the most recent proposals for reform and (iii) to offer a selection of recommendations to improve these framework and proposals.

To that aim, **Section 2** will summarise the key features and provide updated figures regarding the main VAT fraud schemes. **Section 3** will discuss the existing EU anti-VAT fraud regulatory framework and tools, and **Section 4** will outline the proposals recently made by the European Commission (some of which were recently adopted).

In **Section 5**, the robustness of the current/proposed measures to tackle the main types of VAT fraud will be assessed and, in **Section 6**, selected recommendations will be offered based on these conclusions.

This study was performed primarily on the basis of a comprehensive analysis of the EU legislative framework and current legislative proposals, and of the legal and economic literature. Interviews were also held with selected stakeholders (from national tax and customs administrations and from relevant EU bodies and institutions) in order to refine the conclusions and maximise the impact of the recommendations.

2. KEY FEATURES AND SCALE OF THE MAIN VAT FRAUD SCHEMES

In this study, we will discuss the main types of cross-border VAT fraud, including:

- Missing trader fraud ('MTIC fraud') and 'carousel fraud' (section 2.1.)
- Import fraud and more broadly e-commerce related fraud, in the sectors of electronically supplied services, intra-EU distance sales and imports (section 2.2.)
- VAT fraud related to cars (section 2.3.)
- Reduced rates fraud (section 2.4.)
- A new VAT avoidance scheme in the sector of aircraft leasing (section 2.5.).

We will summarise the main features of these respective fraud schemes and provide updated figures regarding the related VAT losses. These figures are taken from the annual VAT gap reports but also from ECA reports, from independent studies and from studies performed by national authorities. The methodology used in these studies is not always known. The most reliable figures probably come from the ECA reports, in view of the time and means dedicated thereto by the European auditors and their privileged access to the data of the Member States.³¹

2.1. MTIC/carousel fraud

What is MTIC/carousel fraud?

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.³² This missing trader is usually a 'fake' person, i.e., for instance, a new company with no real seat or real activity.

The issue here is twofold:

- ⇒ **On the one hand, although the missing trader charges VAT to its customer, it subsequently does not remit it to the tax authorities.**

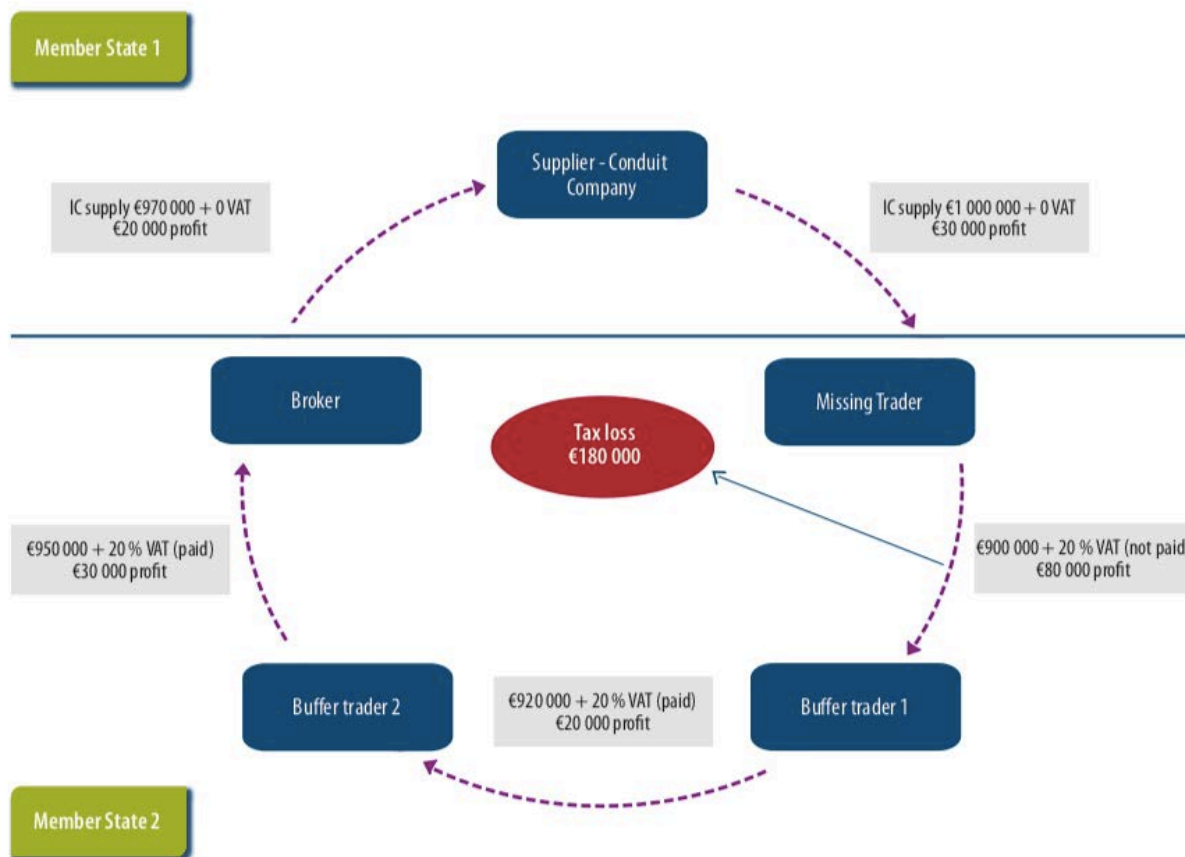
³¹ For its 2015 Special report on carousel fraud, for example, the auditors 'sent a survey to all Member States' tax authorities on the effectiveness of the administrative cooperation arrangements in the fight against intra-community VAT fraud. In addition, [they] carried out audit visits to the relevant authorities in five Member States (Germany, Italy, Hungary, Latvia and the United Kingdom). These were selected based upon a risk analysis taking into account the importance of their VAT base and their vulnerability to VAT fraud. In each Member State [they] have audited a sample of administrative cooperation tools: 20 exchanges of information on request, 10 new VIES registrations, 20 VIES error messages, 10 MLCs and 20 messages about risky traders (fraud signals) exchanged through Eurofisc working field 1. In the case of customs procedure 42 transactions, they analysed the exchange of information between customs and tax authorities of the supplying Member State in respect of a sample of 30 imports'. See ECA Special report 2015/24, 'Tackling intra-Community VAT fraud: More action needed', pp. 18 and 19.

³² Summary description of carousel fraud provided by the ECA in its Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', available at: https://www.eca.europa.eu/Lists/ECADocuments/SR15_24/SR_VAT_FRAUD_EN.pdf (last accessed: 7 June 2018). See also N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, pp. 137-142; L. SOKANOVIC, 'Missing trader fraud as part of organised crime in the EU', in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – The Legal Challenges of the Modern World*, Book of Proceedings, 2017, pp. 161-163; M-C. FRUNZA, 'Cost of the MTIC VAT fraud for European Union Members', 4 April 2016, Available at SSRN: <https://ssrn.com/abstract=2758566>, pp. 4 and 5; F. BORSELLI, S. FEDELI, L. GIURATO, 'Digital VAT Carousel Fraud: A New Boundary for Criminality?', *Tax Notes International*, February 2015, p. 708; F.A. BUKHSH, H WEIGAND, 'VAT Fraud: technical and ontological solutions', 2014, available at: http://vmb02015.blogs.dsv.su.se/files/2015/02/VMB02015_submission_14.pdf, pp. 1 and 2; S. PFEIFFER, P. SEMERAD, 'Missing Trader Fraud in European VAT', MENDELU Working Papers in Business and Economics, *Mendel University in Brno*, 2013, 41/2013 p. 2-3, <http://ideas.repec.org/s/men/wpaper.html>; F. BORSELLI, 'Organised VAT fraud: features, magnitude, policy perspectives', *Banca d'Italia Eurosystem*, No 106, October 2011, pp. 6-9.

⇒ **On the other hand, the customer is allowed to deduct the input VAT paid to the missing trader.**

The 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 (the so-called 'carousel fraud'). A 'never-ending circle' is the most interesting feature of a carousel fraud, because it avoids VAT disbursements and because the revenue significantly increases at each round.³³

Figure 1: Example of carousel fraud scheme³⁴



Source: European Court of Auditors, based on an example by the Financial Action Task Force³⁵

Against this type of fraud, the VAT Information Exchange System (VIES) and Intrastat reports that are meant to provide transactional information to the European Commission and the national tax administrations are often useless, simply because the information is not easily obtained and/or useable

³³ F. BORSELLI, S. FEDELI, L. GIURATO, 'Digital VAT Carousel Fraud: A New Boundary for Criminality?' *Tax Notes International*, February 2015, pp. 709 and 710.

³⁴ The authors note that, in their view, the box 'IC supply €970 000 + 0 VAT' (upper left) should be in Member State 2 (below the line instead of above) because it is in Member State 2 that the zero-rated intra-Community supply is actually taking place.

³⁵ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 14.

or because by the time information is received and useable, the fraudsters have already disappeared.³⁶

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Ten years ago, carousel fraud schemes mostly involved high value goods that were often small in size,³⁸ such as mobile phones, computer chips, microprocessors, hi-fi equipment, new and used vehicles and precious metals. However, in recent years, carousel schemes have also included intangible products such as carbon credits, gas and electricity, cloud computing and VoIP, and green energy certificates. According to Europol, VAT fraud on carbon emission trading caused an estimated EUR 5 billion loss between 2009 and 2010.³⁹ This new pattern can be explained by the facility to transfer such intangible products at a high-speed level, and by the difficulty in tracking these transactions.⁴⁰ Because of that lack of traceability, MTIC/carousel fraud may also involve cheaper goods such as basic food products (oils, sugar, coffee etc.) that are quickly consumed in large amounts and are therefore extremely difficult to trace.⁴¹

In fact, statistics show that the fraudsters tend to be 'opportunistic' and follow the development of the economy and the dynamic growth of demand for certain supplies.⁴² This means that it would be a mistake to focus exclusively on goods when seeking to tackle MTIC fraud.

What is the scale of the fraud?

Only Belgium and the UK publicly communicate figures on the extent of MTIC/carousel fraud in their countries.⁴³ In 2012, the Belgian Court of Auditors quantified carousel fraud at EUR 94 million for 2009,

³⁶ See C. JEDRZEJEK, 'VAT Fraud in Selected European Union Countries and its Possible macroeconomic Implications', in *Risk Management in Public Administration*, Ed. K. RACZKOWSKI, Palgrave Macmillan, 2017, pp. 425 and 426.

³⁷ Registration in itself can be an issue because a system which allow businesses to register for VAT very quickly opens doors to fraudsters and facilitates missing-trader fraud. Some countries (such as Romania, Poland, Germany, Ireland and the UK) have modified VAT registration procedures by undertaking some verifications and initial checks before registration and extending the time of registration. T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, pp. 31 and 32.

³⁸ R. T. AINSWORTH, 'UK Car-Flipping: The VAT Fraud Market-Place and Certified Solutions', *Boston University School of Law, Working Paper Series, Law and Economics*, Working Paper n° 07-19, 2007, p. 2.

³⁹ F. BRANGER, O. LECUYER, P. QUIRION, 'The European Union Emissions Trading Scheme: should we throw the flagship out with the bathwater?', *WIREs Clim Change*, 2015, 6:9–16, p. 12; VAT Carousel fraud on CO2 emissions was considered by some authors as the 'crime of the century' because of its damage and disruption to financial markets and its impact on the market equilibrium. M-C. FRUNZA, 'Assessment of EU's VAT gap due to shadow economy', 25 November 2017, Available at SSRN: <https://ssrn.com/abstract=3077312>, pp. 2 and 3; House of Lords, European Union Committee's 12th Report of Session 2012-2013 : 'The Fight Against Fraud on the EU's Finances', p. 22, box. 4. See also M-C. FRUNZA, 'Aftermath of the VAT fraud on carbon emissions markets', *Journal of Financial Crime*, 2013, vol. 20, n° 2, p. 223.

⁴⁰ M-C. FRUNZA, 'Aftermath of the VAT fraud on carbon emissions markets', *Journal of Financial Crime*, 2013, vol. 20, n° 2, p. 223.

⁴¹ N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 136. Some authors even mention that this kind of fraud is 'probably the most common and easy fraud to market'. M-C. FRUNZA, 'Assessment of EU's VAT gap due to shadow economy', 25 November 2017, Available at SSRN: <https://ssrn.com/abstract=3077312>, p. 2.

⁴² P. LASKOWSKI, 'Difficulties for law enforcement in uncovering and combating VAT-related crime', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, p. 37. VAT fraud on basic food products was for instance highly developed in Hungary in 2012. The main reason was probably Hungary's 27 % VAT rate on most food products (highest level in the EU) introduced in 2012 as part of efforts to cut national public debts. M-C. FRUNZA, 'Assessment of EU's VAT gap due to shadow economy', 25 November 2017, Available at SSRN: <https://ssrn.com/abstract=3077312>, p. 2.

⁴³ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 20. See also C. JEDRZEJEK, 'VAT Fraud in Selected European Union Countries and its Possible macroeconomic Implications', in *Risk Management in Public Administration*, Ed. K. RACZKOWSKI, Palgrave Macmillan, 2017, p. 420.

EUR 29 million for 2010, and EUR 28 million for 2011.⁴⁴ In 2015, the UK quantified intra-Community VAT fraud at GBP 0.5 to 1 billion for 2013-2014.⁴⁵ This figure was confirmed in 2015-2016.⁴⁶

At the EU level, the ECA and Europol estimated that MTIC/carousel fraud could account for EUR 40 to 60 billion of annual VAT revenue losses and that 2 % of organised crime groups could be behind 80 % of the fraud.⁴⁷ Some authors considered that this figure might even be an underestimation of the real figure.⁴⁸

When perpetrated by organised crime groups, the fraud is often used to finance illegal activities such as human trafficking, terrorism, etc.⁴⁹ For instance, in 2015, 'Italian investigations found a connection between EUR 1 billion VAT frauds on carbon credits and the financing of Islamic terrorism in Pakistan'.⁵⁰

MTIC/carousel fraud also distorts competition and directly affects compliant businesses, simply because fraudsters are selling goods (or services) below market price. Honest traders might eventually be tempted to also commit fraud by not reporting sales in order to survive in the market (another type of fraud, of smaller importance, but one that should not be neglected because it threatens the consistency of our tax system).⁵¹

2.2. E-commerce and import fraud

2.2.1. New challenges for the VAT system

The development of e-commerce is putting unprecedented pressure on the VAT system and it should be noted that the ECA is currently conducting an audit on whether the EU is properly addressing this new challenge in the area of VAT and customs. The auditors will examine whether '- the Commission has established a sound regulatory and control framework on e-commerce with regard to the collection of VAT and customs duties; - the Member States' control measures help ensure the complete collection of VAT and customs duties in respect of e-commerce'. A Press release and a background document have been published on the ECA website on 5 July 2018.⁵²

In March 2018, the VAT Forum summarized the issue that e-commerce is posing to national tax administrations as follows (see Box 1).

⁴⁴ Cour des Comptes (Belgique) : « Fraude intracommunautaire à la TVA. Audit de suivi réalisé en collaboration avec les cours des comptes des Pays Bas et d'Allemagne », submitted to the Belgian House of representatives in September 2012.

⁴⁵ HMRC, 'Measuring tax gaps', 2017 edition. Tax gap estimates for 2015-16, 26 October 2017, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/655097/HMRC-measuring-tax-gaps-2017.pdf (accessed 24 May 2018). HMRC acknowledges that 'These are our best estimates based on the information available, but there are many sources of uncertainty and potential error'. This data can in any case be considered as relevant, as HMRC is considered 'one of the most active national tax authorities in the fight against VAT evasion and has issued numerous reports measuring VAT losses'. See K. GRADEVA, 'VAT Fraud in Intra-EU Trade', Goethe University Frankfurt, 7 August 2014, available at: <https://www.etsg.org/ETSG2014/Papers/378.pdf>, p. 6.

⁴⁶ HMRC, 'Measuring tax gaps', 2018 edition. Tax gap estimates for 2016-17, 14 June 2018, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/715742/HMRC-measuring-tax-gaps-2018.pdf (accessed 22 June 2018).

⁴⁷ As reported by the European Commission in its Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, 30 November 2017, COM(2017) 706 final.

⁴⁸ See P. MARTIN, R. WALTERS, 'Fraud Risk and the Visibility of Carbon', *International Journal for Crime, Justice and Social Democracy*, 2013, 2 (2), p. 31; M-C. FRUNZA, 'Cost of the MTIC VAT fraud for European Union Members', 4 April 2016, Available at SSRN: <https://ssrn.com/abstract=2758566>, p. 20.

⁴⁹ See inter alia M.-C. FRUNZA, 'Aftermath of the VAT fraud on carbon emissions markets', *Journal of Financial Crime*, 2013, vol. 20, n° 2, 222-236.

⁵⁰ F. BORSELLI, S. FEDELI, L. GIURATO, 'Digital VAT Carousel Fraud: A New Boundary for Criminality?', *Tax Notes International*, February 2015, p. 707.

⁵¹ P. SEMERAD, 'How to stop VAT frauds on the fuel market: a usual price rule', *MENDELU Working Papers in Business and Economics*, 45/2015, Mendel University in Brno, p. 1.

⁵² Available at: <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=46490>.

Box 1: VAT challenges related to the development of e-commerce⁵³

'Large numbers of businesses are now able to reach a wide international consumer base by utilising the services provided by online intermediaries and/or payment service providers. This has created both fundamental and practical challenges for Tax Administrations in ensuring that these businesses are complying with their VAT requirements:

- **Non registration:** Businesses selling online may fail to correctly register for VAT when and where required either because they are unaware of the requirement to register or they seek to deliberately evade VAT. Tax Administrations often have no records to identify the businesses as such data is often held in another jurisdiction (in the country of establishment of the seller) or by a third party intermediary involved in the e-Commerce value chain.
- **Under declaration of VAT by registered traders:** Businesses selling online that are registered for VAT may fail to declare and pay the correct amount of VAT, either because the business is unaware of the requirements or due to evasion. As mentioned above, in these situations Tax Administrations often have no or only limited records to determine the correct taxable amount.
- **Disguised transactions as a result of criminal activity:** Organised criminals can also be involved in facilitating deliberate non-compliance disguised as legitimate transactions. This can include, but is not limited to, arranging for movement and storage of the goods, setting up fake businesses and selling counterfeit goods.
- **Access to and exchange of data:** The traditional cooperation to combat VAT fraud and non-compliance is between tax authorities and is based on sets of records/information held by the businesses directly involved in the transaction chain being at the disposal of tax authorities. However, in cross-border online supplies, this information may not be directly available, therefore the "traditional" cooperation between Tax Authorities is not enough. Data may for example be stored in another jurisdiction. Tax Administrations often need access to data held by online platforms, payment service providers and other intermediaries that are not part of the transaction chain, in order to identify any non-compliance. This presents legal and practical challenges depending on how and where the data is held.
- **Enforceability:** Many businesses involved in e-Commerce trade across borders. It is therefore often quite difficult to enforce local rules and requirements on businesses established outside the country of consumption, where their VAT liability arises. This is especially the case where there are no legal agreements in place between the countries involved. This potentially creates unfair competition for compliant businesses'.

The following sections seek to clarify the main issues that arise, per sector.

2.2.2. B2C electronically supplied services

Both EU and non-EU taxable persons may use the Mini One-Stop-Shop ('MOSS') to declare and pay the VAT due on their B2C supplies of electronically supplied services.⁵⁴ A distinction is made between the 'Union Scheme' for EU taxable persons and the 'Non-Union Scheme' for non-EU taxable persons;

⁵³ Consolidated report on Cooperation between Member States and Businesses in the field of e-Commerce/modern commerce, Prepared by the EU VAT Forum subgroup on administrative cooperation between Member States and Businesses in the field of VAT fraud, cooperative compliance and e-commerce.

⁵⁴ In accordance with Article 7 of Council regulation 282/2011 : 'Electronically supplied services' as referred to in Directive 2006/112/EC shall include services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology'.

however, both operate in a similar way. Under this simplified registration procedure, taxable persons may register in only one Member State (the so-called 'Member State of identification'), declare and pay all the VAT related to their supplies of electronically supplied services to EU final consumers via quarterly returns. The Member State of identification is then required to reallocate the VAT to the respective Member States of consumption (i.e. the Member States where the customers reside). When an intermediary (e.g. an online platform) 'takes part' to the supply, it becomes liable to collect and remit the VAT.⁵⁵ Member States of consumption remain competent to perform audits, to be coordinated by the Member State of identification.

The risk here is twofold:

- ⇒ **On the one hand, it is difficult for tax administrations to ensure that all taxable persons providing electronically supplied services to EU final consumers are registered under the MOSS.**

Mid-2016, 12 899 EU taxable persons had registered in the Union scheme. Only 1 079 non-EU taxable persons had registered in the Non-Union scheme.⁵⁶ Because many businesses supplying electronically supplied services are selling via platforms (which then become liable to collect and pay the VAT), it is difficult to determine the level of compliance with the registration obligation. The European Commission estimated that 83 000 EU businesses are providing electronically supplied services.⁵⁷ To our knowledge, there is no estimate of the number of non-EU taxable persons providing electronically supplied services to EU consumers. In any case, the difference between the number of registrations in the EU scheme as compared to the non-EU scheme is striking. A 2014 report by the German Supreme Audit institution found that a large number of non-EU traders do not pay the VAT on the electronically supplied services that they supply to EU consumers ('A large number of unregistered traders raises concerns that losses of related tax revenues may amount to millions of euros').⁵⁸ Although the tax authorities still have very limited evidence on the level of non-compliance, it seems reasonable to assume that the compliance level is lower amongst non-EU taxable persons and also small businesses (probably due to a lack of knowledge or understanding of the amended VAT rules).

- ⇒ **On the other hand, it may be difficult for tax administrations to verify that the amounts declared via the MOSS are correct.**

The amounts declared by registered businesses should also be verified in order to avoid underdeclarations (wrong amount) and underreporting (not all transactions being reported), which proves difficult in the case of electronically supplied services, as there is no movement of goods, no stocks to verify, and because intangibles can be duplicated at will (which means that it is not possible to monitor the balance between inputs and outputs and that inputs will in many cases not be incurred in the EU). A particular source of concern is that the Member State of identification has little incentive to carry out controls, since the potentially uncollected VAT belongs to the Member State of consumption (which itself has limited opportunities to undertake controls). This weakness had already

⁵⁵ 9a of Council Regulation 282/2011 as amended by Council Regulation 1042/2013. The European Commission has published extensive explanatory notes that clarify the concept of « take part ». Available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/telecom/explanatory_notes_2015_en.pdf (last accessed: 7 June 2018).

⁵⁶ Deloitte, 'VAT Aspects of cross-border ecommerce - Options for Modernisation Final report – Lot , Assessment of the implementation of the 2015 place of, supply rules and the Mini-One Stop Shop', November 2016, p. 17.

⁵⁷ Deloitte, 'VAT Aspects of cross-border ecommerce - Options for Modernisation Final report – Lot , Assessment of the implementation of the 2015 place of, supply rules and the Mini-One Stop Shop', November 2016, p. 17.

⁵⁸ ECA, 'Collection of VAT and customs duties on cross-border e-commerce', Background paper, July 2018, with reference to Bundesrechnungshof, Spring report 2014 on federal financial arrangement in 2013.

been highlighted in a 2015 report of the Lithuanian National Audit Office (and is a crucial element to keep in mind when assessing the 'definitive system' proposal, see infra section 5.3.2.).⁵⁹

VAT revenues of approximately EUR 3 billion were paid through the MOSS in 2015.⁶⁰ 'Data collected from Member States shows that more than 99 % of the VAT revenue processed via the MOSS is declared by about 13% of the taxable persons registered (with small differences across Member States)'.⁶¹

In the case of B2B supplies of electronically supplied services, the VAT is accounted for by the customer under the reverse charge mechanism in the case of both intra-EU and inbound supplies.⁶² In that case, the supplier must zero-rate the supply (exemption with right to deduct). However, he or she may only do so when a valid VAT number has been communicated. The only tool for a real time verification of VAT registration numbers (which is needed as the customer expects immediate delivery in the case of electronically supplied services) is the VIES.

However, the VIES system is not totally reliable:

- ⇒ **The VIES does not always allow for real-time verification of EU VAT numbers.**
- ⇒ **The VIES only allows confirmation of the validity of a VAT registration number; the risk exists that fraudsters might communicate a valid number that does not belong to them in order to benefit from a zero-rated supply.**

To our knowledge, there is no estimation of potential abuse of VAT numbers in the case of B2B electronically supplied services.

A 'new trend' in e-commerce may also result in a wrong allocation of the VAT among the Member States: the trend of 'virtual boxes'. Because most websites would only deliver in a selection of Member States, a new business model has developed that offers the possibility to customers that are not 'within delivery space' to have the goods shipped into another Member State and rerouted to their Member State of residence. The intention of the customer in this case is not (necessarily) fraud. In any case, the issue is that the supplier will take into consideration the address communicated for the delivery for the calculation and remitting of the VAT, causing a loss of revenues for the Member States where the goods will be finally consumed. This issue will not be settled (and might actually worsen) with the adoption of Regulation (EU) 2018/302 on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market.⁶³ As a matter of fact, as a consequence of the adoption of this Regulation, websites will no longer be allowed to refuse a sale; however they will remain allowed to ship in selected Member States only. The practice of 'virtual boxes' is therefore likely to further develop.

⁵⁹ ECA, 'Collection of VAT and customs duties on cross-border e-commerce, Background paper, July 2018, with reference to 'Executive summary of the public audit report, Electronic commerce control, 30 April 2015, Paper n° VA-P-60-12.

⁶⁰ Commission staff working document impact assessment, Accompanying the document Proposals for a Council Directive, a Council Implementing Regulation and a Council Regulation on Modernising VAT for cross-border B2C e-Commerce, SWD/2016/0379 final - 2016/0370 (CNS), p. 8.

⁶¹ Commission staff working document impact assessment, Accompanying the document Proposals for a Council Directive, a Council Implementing Regulation and a Council Regulation on Modernising VAT for cross-border B2C e-Commerce, SWD/2016/0379 final - 2016/0370 (CNS), p. 8.

⁶² In accordance with Article 196 of the VAT directive.

⁶³ Regulation (EU) 2018/302 of the European Parliament and of the Council of 28 February 2018 on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market and amending Regulations (EC) No 2006/2004 and (EU) 2017/2394 and Directive 2009/22/EC (Text with EEA relevance), OJ L 601, 2.3.2018, p. 1–15.

2.2.3. Imports

A. Undervaluation (small consignments exemption)

Import VAT is calculated on the basis of the value of the goods as declared in the import declaration. 'Since 1983, a VAT exemption applies in most Member States below a certain amount (the '*de minimis*' exemption', up to EUR 22) because the cost of handling VAT collection would outweigh the expected revenue in the case of such low value supplies'⁶⁴. This policy option was perfectly reasonable before the development of the Internet because the number of imports remained relatively limited. With the development of the Internet, however, the number of imports has rocketed up. In 2015, it was estimated that 144 million consignments benefited from the exemption, which was a 300 % increase over the preceding 15 years⁶⁵ and the amount of VAT that the Member States willingly give up on account of the exemption is growing accordingly.⁶⁶

Moreover, it is widely acknowledged that:

- ⇒ **A large number of goods declared as 'low value' actually have a value that exceeds the *de minimis* threshold.**
- ⇒ **Commercial shipments are routinely declared as gifts (which are exempt when they do not exceed EUR 45).⁶⁷**

Several sources offer figures regarding the loss of VAT due to undervaluations or misqualifications as gifts. All of them depict an alarming situation. A 2016 study by Copenhagen Economics reports that 65% of consignments from non-EU taxable persons sent through the postal channel are not compliant.⁶⁸ A 2017 ECA study confirmed that several courier companies are abusing the VAT exemption. The ECA found that even Authorised Economic Operators (AEO)⁶⁹ were routinely abusing the exemption threshold.⁷⁰

In the Commission e-commerce package proposal, it was estimated that between VAT foregone and non-compliance from cross-border e-commerce, losses amount to EUR 5 billion annually.⁷¹ It could actually be even worse because, according to the European Commission itself (as reported by the French Senate) only 1-5 % of the imports would be controlled.⁷²

⁶⁴ M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018.

⁶⁵ Impact assessment accompanying Proposal for a Council Directive 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, COM(2016) 757 final, p. 15.

⁶⁶ M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018.

⁶⁷ Undervaluations and misdeclarations also cause losses in customs duties revenue.

⁶⁸ Copenhagen Economics (2016): 'E-commerce imports into Europe: VAT and customs treatment'. See also M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018.

⁶⁹ 'The AEO concept is based on the Customs-to-Business partnership introduced by the World Customs Organisation (WCO). Traders who voluntarily meet a wide range of criteria and work in close cooperation with customs authorities to assure the common objective of supply chain security are entitled to enjoy benefits throughout the EU'. See European Commission, Authorised Economic Operator (AEO), available at https://ec.europa.eu/taxation_customs/general-information-customs/customs-security/authorised-economic-operator-aeo/authorised-economic-operator-aeo_fr

⁷⁰ ECA Special Report 19/2017, 'Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU', p. 50.

⁷¹ Proposal for a Council Directive 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, COM(2016) 757 final, p. 2.

⁷² Sénat français, Commission des finances, 'Le e-commerce : propositions pour une tva payée à la source, groupe de travail sur le recouvrement de l'impôt à l'heure de l'économie numérique', Rapport II, 17 septembre 2015, p. 29.

UK HMRC estimates that non-EU taxable persons selling online to UK customers have evaded GBP 1-1.5 billion of VAT in 2015.⁷³ More recent evidence gathered by the UK on e-commerce points to massive undervaluations of goods imported from the Far East and increasingly the United States, by a factor of anywhere between 10 to 100 times below the correct valuation.⁷⁴ According to the Belgian Customs, goods purchased via certain non-EU websites are systematically declared as goods with a value below EUR 22, while the consumer actually paid more.⁷⁵

In addition to the loss of revenue, this high level of non-compliance puts EU taxable persons at a disadvantage as they have to charge VAT (20% on average, up to 27% depending on the Member State) even on low value goods, while their competitors established outside of the EU do not (and moreover have the possibility to reduce VAT liability by making undervaluations with very little risk of being caught)⁷⁶. This is an additional source of concern, not only because competitive distortions result in economic losses for compliant taxable persons, but also because they further jeopardise the cohesion and coherence of the tax systems and create a generalised feeling of unfairness in the minds of the compliant operators.⁷⁷

B. Customs procedure 42

Under customs procedure 4200 ('CP42'),⁷⁸ the importer obtains a VAT exemption when the imported goods are intended to be eventually transported to a business customer in another Member State than 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.

The correct implementation of procedure CP42 implies that:

In the Member State of import:

- The importer provides evidence that the goods are intended to be supplied to another Member State and submits recapitulative statements that attest the sale to a customer in another Member State;
- Customs notify that information to the tax administration which compares the data with the recapitulative statements to ensure the completeness of the VIES.

In the Member State of final destination:

- Goods arrive and the recipient declares the VAT due (intra-Community acquisition);
- The tax administration compares the VAT declaration with the information provided in VIES.

⁷³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/507610/Fulfilment_House_Due_Diligence_Scheme_-_HMRC_consultation.pdf. See also M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018.

⁷⁴ ECA Special Report 19/2017, 'Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU', p. 53.

⁷⁵ See e.g.: 'Cel Cybersquad spoorde al 858 frauderende webshops op', article in *De Standaard* of 27 July 2015, available at: http://www.standaard.be/cnt/dmf20150727_01793127 (last accessed: 7 June 2018).

⁷⁶ M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018.

⁷⁷ Tax fraud undermines the key principle of horizontal equity, according to which taxable persons in a similar situation should bear a similar tax burden. Further, impunity of fraudsters is likely to encourage compliant operators to engage in fraud or avoidance schemes. Recently on this question, see R. de la Feria, 'Tax fraud and the rule of law', January 2018, Oxford University Center for Business Taxation, Working Paper 18/02. See also the campaign launched by a group of UK eBay and Amazon Business sellers at: www.vatfraud.org.

⁷⁸ Customs procedures No 42 (CP42) is governed by Article 143(1) of the VAT Directive. A separate procedure applies (customs procedure 63) in the case of a reimportation followed by an intra-Community supply.

However, in practice, controls often do not take place and therefore:

- ⇒ **Goods imported under this procedure risk either remaining untaxed in the Member State of importation or being consumed in the Member State of destination without VAT being charged.**

A difficulty with CP42 fraud is that even if a declaration is made upon importation that the goods are 'intended to be shipped' to a given Member State, this is only a declaration of intention and the goods may well eventually be rerouted to another Member State or remain in the Member State of import. When this happens, the alleged Member State of destination should be able to identify when no VAT is eventually declared. The Member State of import might also inquire. It should be noted that in *Enteco Baltic*,⁷⁹ the CJEU recently clarified that the Member State of import could not deprive the importer from the benefit of the exemption upon importation under procedure CP42 even in the case of subsequent non-payment on the part of the acquirer (unless the importer 'knew or should have known that he was participating in a fraud').

Once again, the scale of the fraud related to CP42 has grown dramatically with the development of e-commerce (although it is also used in the brick and mortar sectors of the economy). In a 2011 report, the ECA found that: 'the extrapolated amount of the losses in 2009 is approximately EUR 2 200 million, of which 1 800 million were incurred in the seven selected Member States and 400 million in the 21 Member States of destination of the imported goods in the sample. This represents 29 % of the VAT theoretically applicable on the taxable amount of all the imports made under CP42 in 2009 in these seven EU Member States'.⁸⁰

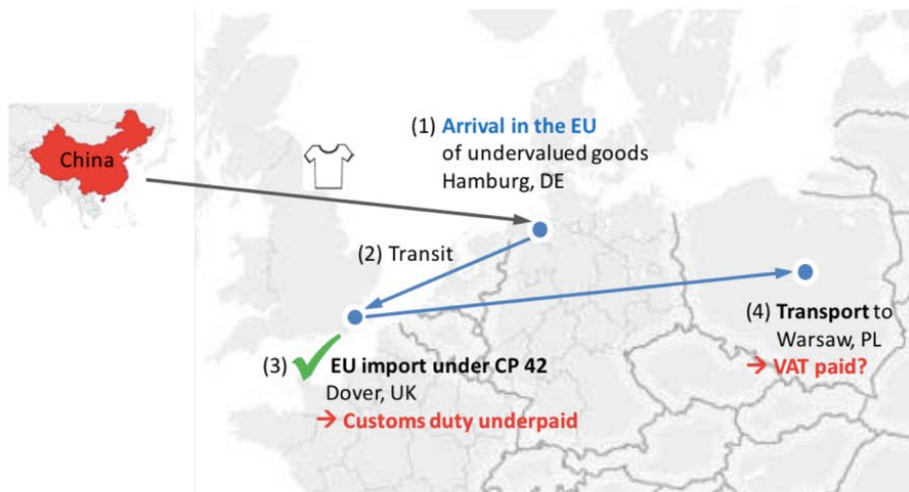
In a 2017 report, the ECA pointed at a particularly worrying situation in the UK where undervaluation and CP42 frauds were combined. 'Operation Octopus' (carried out in 2016 by the French customs with the cooperation of OLAF) highlighted the following scheme: significantly undervalued Chinese goods (textiles and footwear) were routinely cleared in the UK (customs duties fraud; fake invoices were 5 to 10 times undervalued) and then transported to continental Europe. The goods were sent from Hamburg to Dover, where they were released for circulation in the EU without release controls, and then transported back to Poland or Slovakia (without VAT being paid).⁸¹

⁷⁹ CJEU 20 June 2018, C-108/17 *Enteco Baltic*, ECLI:EU:C:2018:473.

⁸⁰ ECA Special Report No 13/2011, 'Does the control of customs procedure 42 prevent and detect vat evasion?', Executive summary p. 22.

⁸¹ ECA Special Report 19/2017, 'Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU'.

Figure 2: Import vat fraud from CN via the UK



Source: European Court of Auditors⁸².

It is noteworthy that increased controls in a Member State usually result in an increase in the average declared import prices but in a decrease in the volume of imports.⁸³ This was confirmed in an ECA Special Report No 23/2016: 'differences in customs control practices between Member States can make one port more attractive than others for global shipping lines'.⁸⁴ This is a major source of concern because, if more rigorous controls lead to less imports in a Member State, **the risk of tax dumping arises.**

2.2.4. Distance sales

Supplies of goods with transport are in principle taxable in the Member State of departure of the transport operation.⁸⁵ In order to avoid distortions of competition to the benefit of taxable persons established in Member States with a low VAT rate, specific 'distance sales rules' apply in the case of intra-EU remote B2C sales of goods (e.g. Internet sales, catalogue sales). Below a certain value of sales in a given Member State (per country threshold), taxable persons are allowed to charge and collect VAT in their Member State of establishment (origin taxation).⁸⁶ When the taxable person's sales exceed a destination Member State's national distance sales threshold, he or she has to register and collect VAT in that Member State (destination taxation). The thresholds vary from EUR 35 000 to EUR 100 000.⁸⁷

⁸² ECA Special Report 19/2017, 'Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU'.

⁸³ According to a Eurostat survey on five Member States (UK, IT, ES, PL, RO) for the period 2007-2016, the increase in the volume of imports in the UK was 358 000 tons, while the overall decrease in the other four Member States was 264 000 tons. As noted by OLAF, the UK should, as a consequence: 'have made available an estimated amount of 1.9874 billion euro (gross), or 1.5736 billion euro (net), more traditional own resources than it did from 2013 to 2016', DG Budget, 'Annual activity report 2016'.

⁸⁴ See paragraphs 82 and 93 to 99 of ECA Special Report No 23/2016 'Maritime transport in the EU: in troubled waters —much ineffective and unsustainable investment'.

⁸⁵ Article 32 of the VAT Directive.

⁸⁶ Articles 33 and 34 of the VAT Directive.

⁸⁷ A list of applicable thresholds is available at :

https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_anne xi.pdf.

Each Member State is free to set their distance sales threshold. However, the disparate distance sales thresholds are difficult to police and, as exceeding the threshold results in a substantial compliance burden for the taxable person, the risk of underdeclaration arises:

- ⇒ **In the absence of internal borders, it proves difficult for the Member State of destination to monitor the incoming goods.**
- ⇒ **The Member State of origin has little incentive to ensure that taxable persons established on its territory correctly apply the place of supply rule (i.e. remit taxes at destination rather than at origin when a national threshold is exceeded).**
- ⇒ **It also remains unclear how supplies made from a Member State that is not the Member State of establishment are being accounted for (i.e. whether the turnover threshold includes all supplies made by a taxable person, irrespective of the point of departure of the transport or not).**

According to a report of the French Senate, DG TAXUD acknowledged that compliance with the distance sales turnover threshold is in practice not controlled by the tax administrations of Member States 'and gave rise to enormous fraud', without being able to quantify it.⁸⁸

2.3. VAT fraud related to cars

Means of transport are subject to a different VAT regime depending on whether they are new (normal arrangement) or not (margin scheme applies) and it proves difficult to monitor the correct application of the relevant regime. Cars and automotive components have been an easy prey for fraud.⁸⁹ It is reported that the French car industry suffers an annual loss of EUR 5 billion on account of lost sales and that the French State suffers a corresponding loss of EUR 1 billion in uncollected VAT.⁹⁰ Belgium was also affected by a similar pattern of VAT fraud.

This type of fraud, which mostly concerns B2C transactions,⁹¹ mainly takes three forms:

- **The fraudsters (mainly via shell companies) buy luxury registered cars abroad (VAT-free) and sell them into another Member State at a more competitive price (directly to final consumers or via "linked" companies). Fake invoices are used to convince the VAT administration that VAT has already been applied.**
- **The fraudster sells new or nearly-new cars (for which the whole amount is taxable) as second-hand goods (for which only the margin is taxable)⁹².**
- **Expensive cars are sold to disabled persons (without VAT) and immediately flipped to third parties (this type of fraud seems particularly widespread in the UK).⁹³**

⁸⁸ Sénat français, Commission des finances, 'Le e-commerce : propositions pour une tva payée à la source, groupe de travail sur le recouvrement de l'impôt à l'heure de l'économie numérique', Rapport II, 17 septembre 2015, p. 21.

⁸⁹ M-C. FRUNZA, 'Assessment of EU's VAT gap due to shadow economy', 25 November 2017, Available at SSRN: <https://ssrn.com/abstract=3077312>, p. 2.

⁹⁰ M-C. FRUNZA, 'Assessment of EU's VAT gap due to shadow economy', 25 November 2017, Available at SSRN: <https://ssrn.com/abstract=3077312>, p. 2.

⁹¹ R. T. AINSWORTH, 'UK Car-Flipping: The VAT Fraud Market-Place and Certified Solutions', *Boston University School of Law, Working Paper Series, Law and Economics*, Working Paper n° 07-19, 2007, p. 3.

⁹² See European Commission - Press release, 'Fair Taxation: Commission proposes new tools to combat VAT fraud', 30 November 2017, http://europa.eu/rapid/press-release_IP-17-4946_en.htm.

⁹³ R. T. AINSWORTH, 'UK Car-Flipping: The VAT Fraud Market-Place and Certified Solutions', *Boston University School of Law, Working Paper Series, Law and Economics*, Working Paper n° 07-19, 2007, p. 2.

2.4. Reduced rates fraud

Reduced rates apply on certain commodities and services in basically all the Member States. Beyond the question of whether these reduced rates actually achieve their objective,⁹⁴ a diversified rate structure also opens opportunities for fraud as suppliers may be tempted to ‘misqualify’ their supplies in order to benefit from a reduced rate and thereby reduce the sales price for the consumer. A correct application of reduced rates requires effective controls and therefore comes at a cost.

To our knowledge, there are no estimates of the VAT losses due to intentional or (unintentional) misqualifications. Although it may be assumed that the amounts at stake are much lower than in the case of the other fraud schemes discussed in this study, we would like to highlight that a further diversification of the tax rate structure of the Member States, as proposed by the European Commission in January 2018,⁹⁵ might increase the risk. Moreover, improving controls to tackle that risk will come at a cost for the Member States.⁹⁶

- ⇒ **Although ‘misqualifications’ of taxable supplies with the purpose of fraudulently benefiting from a reduced rate remain rather marginal at the moment, the risk might grow in the future because it will be extremely difficult for the national tax administrations to monitor the correct application of a diverse rate structure.**

2.5. Aircraft leasing (VAT avoidance)

In accordance with general VAT deductions rules, a taxable person is entitled to deduct import VAT to the extent that the imported goods are used for business purposes. The Paradise Papers investigation has revealed that the Isle of Man⁹⁷ routinely allows owners of aircraft to claim 100 % refunds of import VAT on the grounds that the aircraft is part of a leasing business.⁹⁸ In some cases, however, the importer leases the aircraft to himself/herself or to a family member (typically a spouse). The advantage of this scheme is that VAT due on the leasing agreement is much lower than the VAT that would be due on import of the aircraft.

In the case where a leasing agreement in due form is concluded between the importer and the user of the aircraft, there is strictly speaking no fraud.

- ⇒ **However, when the real beneficiary of the leasing agreement is the importer, the scheme can be considered as avoidance.**

⁹⁴ See R. de la Feria’s hearing in front of the Committee on Economic and Monetary Affairs on 24 April 2018. See also R. DE LA FERIA, M. SCHOFIELD, ‘Towards an [Unlawful] Modernized EU VAT Rate Policy’, *EC Tax Review*, 26, Issue 2, 2017, pp. 89–95. The authors conclude that: “Article 113 TFEU could not be used as a legal basis for a Directive aimed at disharmonising VAT rates, and that any such Directive, would lack legal basis and, consequently, be unlawful under the EU constitutional principle of conferral of powers”.

⁹⁵ See Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, COM(2018) 20 final, 2018/0005 (CNS). In short, the proposal gives more flexibility to Member States by allowing the possibility, in addition to the VAT reduced rates of a minimum of 5% actually granted to Member States, to apply another VAT reduced rate between 5% and 0%. The Member States could also fix a zero rate on certain products. Regarding the list of goods and services subject to reduced rates, the Commission proposes a ‘negative’ list with goods and services that cannot be subject to reduced rates (for instance, alcohol, tobacco, weapons,...). To safeguard public revenues, Member States will also have to ensure that the weighted average VAT rate is at least 12%. The same remarks regarding the prevention of fraudulent behaviour have also been made.

⁹⁶ N. HANGACOVA, T. STREMY, ‘Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic’, *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 151.

⁹⁷ In accordance with Article 7 of the VAT Directive, the Isle of Man (together with other territories such as Monaco): ‘shall not be regarded, for the purposes of the application of this Directive, as third countries’.

⁹⁸ A related issue 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%).

The press reported that the 'Isle of Man Customs and Excise has raised more than 30 assessments for under-declared or over-claimed VAT against businesses in the aircraft leasing sector', for a combined VAT amount of approximately GBP 4.7 million.⁹⁹ On the basis of these tax avoidance schemes, more than USD 1 billion would have been refunded on the import of hundreds of private jets into Europe.¹⁰⁰

2.6. Summary

From this summary overview of the most frequent VAT fraud schemes and their scale we can conclude that:

- **Carousel fraud must be treated as a priority as it causes most of the VAT revenue loss for the EU Member States (EUR 40 to 60 billions of annual VAT revenue losses).**
- **Carousel fraud used to be confined to the sector of goods. It is now also used in the sector of services.**
- **Most carousel fraud schemes involve organised crime groups (80%). These groups are also involved in CP42 related import fraud.**
- **The risk of tax dumping exists as more lenient controls upon importation under procedure CP42 have resulted in higher volumes of import.**
- **E-commerce exacerbates the risks of import VAT fraud, both in the case of CP42 and in the case of B2C e-commerce.**
- **E-commerce allows non-EU taxable persons to easily serve the EU market. However, EU tax administrations have no means to monitor nor enforce compliance on them.**
- **VAT fraud in relation to cars remains a stable form of fraud that is difficult to detect.**
- **VAT reduced rates fraud (misqualifications) does not have an impact as significant as other types of fraud. However, the European Commission proposal allowing more flexibility on the application of VAT reduced rates is likely to create new opportunities for fraud.**
- **VAT avoidance in the sector of aircraft concerns few taxable persons but represents impressive amounts of VAT revenue lost.**

⁹⁹ <http://www.itv.com/news/granada/2017-10-24/iom-gov-deny-claims-made-by-investigative-journalists-of-aircraft-vat-avoidance/>;
<http://www.iomtoday.co.im/article.cfm?id=36593&headline=Manx%20government%20refutes%20aircraft%20VAT%20claims%20after%20Panorama%20and%20the%20Guardian%20investigate§ionIs=news&searchyear=2017>.

¹⁰⁰ <https://www.theguardian.com/news/2017/nov/06/isle-of-man-refunds-super-rich-private-jets-paradise-papers>.

3. CURRENT EU REGULATORY FRAMEWORK TO TACKLE VAT FRAUD

The EU Member States have adopted a comprehensive regulatory framework to fight VAT fraud (section 3.1.) and may further count on the support of several EU institutions, bodies and committees (section 3.2.).

3.1. Legislation

3.1.1. Recovery assistance directive

Even if the Member States have the right to impose collection obligations on non-resident taxable persons ('substantive jurisdiction'), their power to investigate and to recover taxes is limited to their national territory ('enforcement jurisdiction'). To close this gap between substantive and enforcement jurisdiction, the Member States have adopted **Council directive 2010/24/EU of 16 March 2010** concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures.¹⁰¹ This instrument applies for the recovery of any taxes in another Member State, including VAT.

Key features of the EU recovery assistance instrument¹⁰²:

- A 'requested' Member States should provide information on request, notify documents on behalf of the requesting Member State, recover a claim of the requesting Member State as if it was its own and take precautionary measures based on domestic instruments.
- Assistance requests may relate to any tax claims and related charges, involving all natural and legal persons.
- There is no need to exhaust domestic procedures before making a request, direct cross border notification of documents is possible without prior translation and national enforcement documents are replaced by a uniform EU instrument.
- Officials of the requesting state have the possibility to be physically present in tax offices and courts of the requested Member States and even to examine records and interview individuals.
- Taxable persons cannot hide behind banking secrecy.
- The information and the documents obtained through recovery assistance can be used not only for tax, but also for social security and other purposes, and by all judicial and other authorities. Information obtained can even be shared with third-party Member States.

3.1.2. Assessment assistance regulation

The Member States also committed to exchanging information that is relevant for the correct assessment and collection of VAT, in accordance with **Council regulation 904/2010 of 7 October 2010**.¹⁰³

Key features of the EU VAT information exchange instrument¹⁰⁴:

¹⁰¹ Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, OJ L84, 31.03.2010.

¹⁰² See S. VAN THIEL, 'European Union Action against Tax Avoidance and Evasion', *CESifo Forum*, 2/2012, pp.13-15.

¹⁰³ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010.

¹⁰⁴ See a.o. ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 15.

- Member States must exchange, **on request**, any information that may help to effect a correct assessment of VAT, monitor the correct application of VAT, particularly on intra-Community transactions, and combat VAT fraud, by electronic means.
- **Automatic** exchange of information should take place in cases where it is necessary for the effectiveness of the controls in another Member State or if there are reasons to believe that a breach of VAT law has occurred or if there is a risk of tax loss.
- Requested information should be exchanged as quickly as possible and no later than three months following the date of receipt of the request.
- Exchanges of information should be done through the VIES electronic database.
- Controls should be conducted simultaneously in two or more Member States (multilateral controls) and with the presence of tax officials in other Member States allowing them to obtain access to documentation held there or to attend ongoing enquiries.
- Use of Eurofisc (see Section 5.3.) for the swift exchange of targeted information between Member States about suspicious traders and similar issues.

A proposal to enhance this assistance framework has recently been adopted, see Section 4.3.

It should also be noted that the European Commission has recently negotiated a first international agreement with Norway relating to administrative cooperation in the field of VAT. Both recovery and assessment assistance for VAT claims are included in this agreement.¹⁰⁵ The rules are largely in line with the provisions of the EU recovery and assessment directives (even the EU electronic forms are to be used in the relations with Norway).

3.1.3. Quick reaction mechanism

Articles 199a and 199b of the VAT Directive (introduced by **Council Directive 2013/42/EU of 22 July 2013**) allow Member States to quickly react to cases of massive fraud, in particular carousel fraud.¹⁰⁶

- Article 199a of the VAT Directive offers an option to apply the reverse charge mechanism on a temporary basis in specific sectors: mobile phones, integrated circuit devices, supplies of gas and electricity, telecoms services, game consoles, tablet PCs and laptops, cereals and industrial crops, and raw and semi-finished metals.¹⁰⁷

If a Member State wants to apply the reverse charge mechanism to other supplies than those listed in Article 199a of the VAT Directive, a derogation can be granted according to Article 395 of the VAT Directive.¹⁰⁸ The adoption of such derogation requires a proposal from the Commission and unanimous

¹⁰⁵ The agreement was signed on 6 February 2018. See Council Decision (EU) 2018/1089 of 22 June 2018, O.J. 01.08.2018.

¹⁰⁶ On this topic, see a.o. B. TERRA, 'The European Quick Reaction Mechanism against VAT fraud', *World Journal of VAT/GST Law*, 1:2, pp. 185-190; I. LEJEUNE, S. DE MAEIJER, L. VERMEIRE, « Quick Reaction Mechanism against EU VAT Fraud », *International VAT Monitor*, March/April 2013, pp. 94-98.

¹⁰⁷ Council Directive 2013/43/EU of 22 July 2013 amending Directive 2006/112/EC as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud, OJ L 201, 26.7.2013. See also T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, p. 24.

¹⁰⁸ Article 395 of the VAT Directive: '1. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. (...)'. See full text of the article for the applicable conditions.

adoption by the Council, which takes time (up to a maximum of 8 months based on Article 395 of the VAT Directive). Article 199b of the VAT Directive offers a faster solution in the case of massive fraud.

- Article 199b of the VAT Directive offers a faster procedure for the introduction of the reverse charge mechanism as a Quick Reaction Mechanism ('QRM') in order to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses.¹⁰⁹ The QRM has however never been applied because it is difficult for Member States to fulfil the conditions.¹¹⁰

Articles 199a and 199b of the VAT Directive may be relied on until 30 June 2022 (the initial deadline – December 2018 – was prolonged on 25 May 2018). The reason is that the 'definitive system' is expected to enter into application in 2022 and is meant to solve the risk of carousel fraud (see however Section 5.3.2).

3.1.4. The e-commerce package

The e-commerce package was adopted on 5 December 2017.¹¹¹ It mostly provides amendments with respect to B2C intra-EU distance sales (A) and B2C imports below EUR 150 (distance sales from third countries) (B) with the objective to improve VAT collection in these sectors.

A. New measures for intra-EU distance sales

Because it was difficult to monitor and often led to abuses, the collection procedure for intra-EU distance sales has been modified, effective as of 2021. Instead of the current rule based on per country sales thresholds, an EU-wide threshold of EUR 10 000 will be applied (a similar threshold will apply for electronically supplied services as of 2019). EU taxable persons with a turnover related to cross-border sales below EUR 10 000 will be allowed to collect VAT at origin on all their sales. All those exceeding that EU turnover threshold will have to collect the tax at destination in cross-border sales. In order to facilitate the declaration and remittance process when the tax is due at destination, an extended version of the MOSS will be available (the MOSS will then become the 'one-stop shop' or 'OSS').

In addition, a 'deeming provision' applies when a platform 'facilitates' an intra-EU distance sales or a EU domestic sales made by suppliers not established in the EU.¹¹² When the provision applies, the platform is deemed to have received the supply from the initial vendor (deemed B2B supply) and to have supplied it onward to the customer (deemed B2C supply). As a consequence, the platform becomes liable to collect the VAT on the B2C supply to the EU non-taxable customer and to remit it, via the OSS if they wish to register – or via separate registrations in each Member State of consumption if they do not want to register to the OSS.

B. New measures for B2C imports

The VAT exemption threshold of EUR 22 will be removed in order to level the playing field between EU and non-EU taxable persons. With respect to collection, a dual procedure will apply as of 2021 for imports of goods below EUR 150 (the current customs procedure will continue to apply for goods that are above the EUR 150 threshold).

¹⁰⁹ Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud, OJ L 201, 26.7.2013.

¹¹⁰ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final, pt. 3.4.

¹¹¹ 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.

¹¹² Article 14a(2).

Under the new procedure, non-EU taxable persons will have the possibility to also register under the OSS (called 'Import One Stop Scheme' or 'I-OSS' in this case) and to declare and pay the VAT on a monthly basis (rather than quarterly in the case of electronically supplied services and intra-EU distance sales). If the non-EU supplier does not register, a fall-back procedure will apply whereby the 'person presenting the goods to customs' (usually the transporter of the goods) will be liable to collect and pay the VAT (also on a periodical basis). A condition to register under the I-OSS is the appointment of a tax representative in the EU who will be liable for the declaration and payment of the VAT.

In practice, if a non-EU taxable person has registered under the I-OSS, the import that it makes should be exempt upon importation, on the assumption that the VAT will be declared and paid via the OSS. The Member States committed to issue monthly listings of imports, per I-OSS registered taxable person, including value declarations.¹¹³ The objective is to compare import figures with the I-OSS returns data and thereby obtain an estimate of compliance.

If the supply is 'facilitated' by a platform, a deeming provision applies (cf. distance sales above): the platform becomes the deemed supplier of the import to the EU customer and is invited to register to the I-OSS (otherwise, the fall back procedure applies with the platform as deemed supplier).¹¹⁴

3.1.5. Criminalisation of fraud to the Union's financial interests

As already mentioned, VAT fraud directly affects the EU financial interests because part of Member States' VAT revenue is an EU own resource. Accordingly, the Member States have committed to criminalise forms of preparation and of participation in VAT fraud with the adoption of **Directive 2017/1371 of the European Parliament and of the Council of 5 July 2017** on the fight against fraud to the Union's financial interests by means of criminal law.¹¹⁵

*The key elements of this directive include:*¹¹⁶

- Member States are committed to ensure that fraud affecting the Union's financial interests constitutes a criminal offence when committed intentionally.
- The scope of the legislation is limited to the most serious forms of VAT fraud, in particular carousel fraud, VAT fraud through missing traders, and VAT fraud committed within a criminal organisation, which create 'serious' threats to the common VAT system and thus to the Union budget.
- Offences against the common VAT system should be considered to be 'serious' where they are connected with the territory of two or more Member States, result from a fraudulent scheme whereby those offences are committed in a structured way with the aim of taking undue advantage of the common VAT system and the total damage caused by the offences is at least EUR 10 000 000.
- Fraud committed within a criminal organisation in the sense of Framework Decision 2008/841/JHA¹¹⁷ will be considered to be an aggravating circumstance.

¹¹³ In accordance with new Article 17(1) of Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, the Member States should collect and exchange: '(e) data on the VAT identification numbers, referred to in Article 369q of Directive 2006/112/EC, it has issued and, per VAT identification number issued by any Member State, the total value of the imports of goods exempted under Article 143(1), point (ca), during each month'.

¹¹⁴ In accordance with new Article 14a(1) of the VAT Directive as amended: '1. Where a taxable person facilitates, through the use of an electronic interface such as a marketplace, platform, portal or similar means, distance sales of goods imported from third territories or third countries in consignments of an intrinsic value not exceeding EUR 150, that taxable person shall be deemed to have received and supplied those goods himself'.

¹¹⁵ Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law, OJ L 198, 28.7.2017.

¹¹⁶ See Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law, OJ L 198, 28.7.2017.

¹¹⁷ Council Framework Decision 2008/841/JHA of 24 October 2008 on the fight against organised crime, OJ L 300, 11.11.2008, p. 42–45.

- Both natural and legal persons can be sanctioned (imprisonment is foreseen for natural persons in some cases).
- The prescription period must be at least 5 years.
- Member States should take the necessary measures to ensure the prompt recovery of sums and their transfer to the Union budget.
- Member States may in principle continue to apply administrative measures and penalties in parallel in the area covered by this Directive. In the application of national law transposing this Directive, Member States should, however, ensure that the imposition of criminal sanctions for criminal offences in accordance with this Directive and of administrative measures and penalties does not lead to a breach of the Charter.
- Cooperation between Member States and the OLAF (and other EU institutions, bodies, offices or agencies) in the fight against VAT fraud in different ways: technical and operational assistance offered by the Commission and/or Eurojust, exchange of information, and communication of facts to competent bodies (such as OLAF).

Directive 2017/1371 entered into force on 18 August 2017.

3.1.6. CJEU case law

The Court of Justice of the European Union (CJEU) is playing a key role in the development of the EU VAT system by providing harmonised interpretations of the VAT Directive. In the past decades, the CJEU also clarified the consequences in the case of VAT fraud in the supply chain.

The consequences are rather straightforward in the case of ‘active fraud’.

In the *C-285/09 R* case,¹¹⁸ the CJEU decided that a taxable person who makes an intra-Community supply and conceals the identity of the true purchaser in order to enable the latter to evade payment of value added tax upon acquisition, may be denied the right to the exemption with respect to the intra-EU supply.

In the *C-332/15 Astone* case,¹¹⁹ the CJEU decided that the tax authorities of a Member State may refuse a taxable person the right to deduct input VAT related to invoices that were initially not recorded, but in relation to which deduction was eventually claimed when an audit revealed undeclared outputs.

In the case of ‘passive participation in fraud’, the CJEU developed its *Kittel* jurisprudence.¹²⁰ In *Kittel*, the CJEU decided that a taxable person who ‘knew or should have known’ (having regard to objective factors) that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, may be denied the right to deduct his input VAT. This typically concerns the customer of the domestic supply in a carousel fraud, who *knew or should have known* that his supplier would disappear without remitting the VAT due.

Finally, in the *C-105/14 Taricco* case,¹²¹ the CJEU decided that national legislation (in the case at hand, limitation period rules) ‘is liable to have an adverse effect on the fulfilment of the Member States’ obligations under Article 325(1) and (2) TFEU if that national rule prevents the imposition of effective and dissuasive penalties in a significant number of cases of serious fraud affecting the financial interests

¹¹⁸ CJEU 7 December 2010, *C-285/09, R*, ECLI:EU:C:2010:742.

¹¹⁹ CJEU 28 July 2016, *C-332/15, Astone*, ECLI:EU:C:2016:614.

¹²⁰ CJEU 6 July 2006, *C-332/15 Kittel*, ECLI:EU:C:2006:446.

¹²¹ CJEU, 8 September 2015, *C-105/14, Taricco*, ECLI:EU:C:2015:555.

of the European Union, or provides for longer limitation periods in respect of cases of fraud affecting the financial interests of the Member State concerned than in respect of those affecting the financial interests of the European Union'.¹²²

3.2. EU bodies, committees and programmes

3.2.1. EUROFISC

Eurofisc was established by **Council Regulation 904/2010 of 7 October 2010** with the objective to promote and facilitate multilateral cooperation in the fight against VAT fraud.¹²³ It functions as an early warning system: Eurofisc liaison officers communicate information regarding suspicious activities detected in the course of domestically-led risk analyses.¹²⁴

There are five working fields within Eurofisc that each focus on a specific type of fraud:

- Working Field 1 - MTIC fraud/Carousel fraud: encompassing all the provisions relating to MTIC fraud/Carousel fraud and fraud that does not fit in another Working Field;
- Working Field 2 - Cars, boats and planes;
- Working Field 3 - Abuse of CP42;
- Working Field 4 - VAT Observatory: identifies and examines new risks, trends, and fraud developments; it does not proceed to the exchange of data on specific economic operators;
- Working Field 5 - e-Commerce.

All 28 Member States participate in Eurofisc, but they can decide in which working fields they want to participate.¹²⁵

Recently, the 'transactional network analysis' (TNA) was developed, with a view to improving the ability to exchange information and detections of fraudsters within the framework of Eurofisc. The TNA should allow for a quicker and more efficient intervention of Eurofisc members by speeding up the detection of risks and the exchange of information, and by providing better visualization of carousel fraud chains and trends. In a nutshell, the TNA is based on data mining. It consists of the extraction of implicit data, previously unknown and potentially useful, from known data (identified missing traders, businesses under monitoring, VIES and VOW (VIES on the web) data). The TNA collects data from multiple sources, placed in a network, and then stores it in a registry for later processing. The large amount of data collected will initially be illegible. The TNA will render the data legible for the Eurofisc members, by using an algorithm to reveal networks between different operators, target, and score the risky operators according to the level of risk (each network and operator in the network will each be scored). Identifying networks and origin of the network are more useful than identifying straw men at the front.

The success of the TNA (which will go live at the EU level in 2019)¹²⁶ relies on the active participation of the Member States. In order for the TNA to be effective, liaison officers from each participating Member State will be obliged to carry out controls on the basis of the information collected by the TNA, the networks created, and the scoring done. Each Member State will in particular have to carry out controls

¹²² CJEU, 8 September 2015, C-105/14, *Taricco*, ECLI:EU:C:2015:555, point 58.

¹²³ L. SOKANOVIC, 'Missing trader fraud as part of organised crime in the EU', in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – 'The Legal Challenges of Modern World'*, Book of Proceedings, 2017, p. 163.

¹²⁴ L. SOKANOVIC, 'Missing trader fraud as part of organised crime in the EU', in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – 'The Legal Challenges of Modern World'*, Book of Proceedings, 2017, pp. 163 and 164.

¹²⁵ See Eurofisc, European parliament, TAX3 - Special committee on financial crimes, tax evasion and tax avoidance, Hearing on "VAT fraud", p. 1, <http://www.europarl.europa.eu/>

¹²⁶ The system is already used by several Member States.

on their nationals that have been identified as 'risky'. They will subsequently have to communicate the results of these controls to the TNA in order to allow an update of the data and move forward with the detection process.

At the moment, the TNA focuses on MTIC fraud/carousel fraud (Eurofisc Working field 1). A new Working Field (Eurofisc Working Field 6) has been created within Eurofisc for its development and management. However, new strategies should in the future also be used in the TNA to tackle other types of frauds covered by Eurofisc Working field 2 (Cars, boats, planes) and Eurofisc Working field 3 (CP42 fraud).

Although all Member States participate in the Eurofisc network, some Member States are not participants in the TNA.¹²⁷ No data will be collected by the TNA concerning businesses active in a Member State that does not participate. In addition, each participating Member State is allowed to set a 'white list' of actors regarding which the TNA will not be able to collect VIES and VOW data.

3.2.2. OLAF

OLAF is a supranational and independent body in charge of carrying out 'administrative investigations' to step up the fight against fraud, corruption and any other illegal activity affecting the financial interests of the European Union.¹²⁸ It has autonomous powers to open and conduct investigations, gather evidence, and draw recommendations. 'However, OLAF lacks coercive power, and therefore relies upon the assistance of the national law enforcement offices, whenever it is needed, during its activities on a Member State (or third country) territory.'¹²⁹

At the moment, OLAF mostly focuses on customs fraud and import VAT fraud. Based on the recent CJEU *Taricco* decision, it should also be entitled to investigate any intra-EU fraud situation that harms the financial interests of the Union.

The current OLAF framework is organised by **Regulation (EU, EURATOM) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office** ('OLAF Regulation'). This regulation is set to be amended (with effect by 2020).¹³⁰

3.2.3. EUROPOL

Europol was created by **Council Decision 2009/371/JHA** in order to 'support and strengthen action by Member States and their mutual cooperation in preventing and combating organised crime, terrorism and other forms of serious crime affecting two or more Member States.'¹³¹ Europol also works with some non-EU partner states and international organisations.

¹²⁷ In fact, All Member States but the United Kingdom (not participating), Germany and Slovenia (observer status) have joined Working field 6. See Commission Staff Working Document Impact Assessment, Amended proposal for a Council Regulation, Amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, SWD (2017) 428 final, 30 November 2017, p. 38.

¹²⁸ Art. 1, par. 1 and par. 4, Regulation 883/13 (OLAF Regulation).

¹²⁹ European Parliament, Committee on Budgetary control, 'Working Document on Investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations', 20 June 2018, p. 3.

¹³⁰ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) No 883/2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations, COM/2018/338 final.

¹³¹ <https://www.europol.europa.eu/newsroom/news/europols-new-regulation>. The Council Decision was replaced with Regulation (EU) 2016/794 of the European Parliament and of the Council of 11 May 2016 on the European Union Agency for Law Enforcement Cooperation (Europol). The main objectives and tasks of Europol remained however the same.

In a nutshell, Europol aims at the simplification of the exchanges of information between law enforcement agencies (customs, intelligence, border guards, etc.). It has set up a specific network that focuses on MTIC fraud (third countries such as Norway and Switzerland are also part of it).

Since 2017, Europol has developed joint investigation teams, which can be seen as a 'cooperation tool amongst national investigative agencies when tackling cross-border crime. They facilitate the coordination of investigations and prosecutions conducted in parallel across several States.'¹³²

3.2.4. European Public Prosecutor Office ('EPPO')

Currently, only national authorities can investigate and prosecute fraud against the EU budget. However, their powers stop at national borders. As to existing EU-bodies such as Eurojust, Europol and OLAF, they lack the necessary powers to carry out criminal investigations and prosecutions.¹³³ The establishment of the EPPO¹³⁴ should bring a solution to that situation. Once implemented, the EPPO will ultimately have the power to carry out criminal investigations and prosecutions in currently 22 participating Member States¹³⁵ (while OLAF will continue to conduct administrative investigations into fraud, corruption and any other illegal activity affecting those interests in the whole EU).

More precisely, the EPPO will be an independent and decentralised prosecution office of the EU. It will have the competence to investigate and prosecute crimes against the EU budget, such as fraud, corruption or serious cross-border VAT fraud. The EPPO's main first objective will be to tackle the fraudulent use of EU funds and cross-border VAT frauds. In order to preserve national sovereignty of Member States, the EPPO will only investigate cases worth more than EUR 10 000 000.¹³⁶

The EPPO will be built on two levels:¹³⁷ the central and the national level. The central level will consist of the European Chief Prosecutor, its two Deputies, 20 European Prosecutors (one per participating Member State), two of whom act as Deputies for the European Chief Prosecutor and the Administrative Director. The decentralised level will consist of European Delegated Prosecutors who will be located in the participating Member States. The central level will supervise the investigations and prosecutions carried out at the national level [...]. As a rule, it will be the European Delegated Prosecutors who will carry out the investigations and prosecutions in their Member State'¹³⁸.

'The EPPO will become operational by the end of 2020, at the earliest. By this date, the design of an efficient European Law Enforcement system dealing with fraud investigations should be in place.'¹³⁹

¹³² <https://www.europol.europa.eu/activities-services/joint-investigation-teams>.

¹³³ https://ec.europa.eu/info/law/cross-border-cases/judicial-cooperation/networks-and-bodies-supporting-judicial-cooperation/european-public-prosecutors-office_en#structureandcharacteristicsoftheppo.

¹³⁴ Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO'); OJ L 283, 31.10.2017, p. 1–71.

¹³⁵ 22 Member States have at this stage joined the enhanced cooperation: Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Portugal, Romania, Slovakia, Slovenia and Spain. Malta (despite suspicion of money laundering) has started the procedure in order to be part of the EPPO. Missing Member States are at the moment: Denmark, Ireland, Sweden and Hungary (for which the use of EU funds is subject to caution); Poland (recipient of the largest EU funds); and, obviously, the UK. See https://ec.europa.eu/commission/sites/beta-political/files/enhanced-cooperation-factsheet-tallinn_en.pdf.

¹³⁶ <https://www.euractiv.com/section/economy-jobs/news/eu-targets-terror-financing-with-vat-fraud-crackdown/>.

¹³⁷ https://ec.europa.eu/info/law/cross-border-cases/judicial-cooperation/networks-and-bodies-supporting-judicial-cooperation/european-public-prosecutors-office_en#structureandcharacteristicsoftheppo.

¹³⁸ http://europa.eu/rapid/press-release_MEMO-18-4767_en.htm.

¹³⁹ European Parliament, Committee on Budgetary control, 'Working Document on Investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations', 20 June 2018.

Interestingly, the Committee on Budgetary Control of the European Parliament (CONT) stated that ‘the setting up of the EPPO offers the momentum for re-considering OLAF’s powers and mandate entirely’.¹⁴⁰

3.2.5. EUROJUST

The role of Eurojust is to ‘support and strengthen coordination and cooperation between Member States’ investigating and prosecuting authorities in relation to serious crime affecting two or more Member States, or requiring a prosecution on common basis. Eurojust works on the basis of operations conducted and information supplied by the Member States and by Europol.¹⁴¹

Its meetings are opportunities to discuss VAT fraud. In 2014, a Eurojust meeting highlighted the fact that VAT fraud (and excise fraud) constitute some of EU’s biggest losses of revenues and identified two main types of challenges¹⁴²:

- Legal and prosecutorial challenges, which implies the need to create different approaches taking into account the evolution and the complexification of fraudulent mechanisms;
- Practical challenges, having noticed the weaknesses of control mechanisms which make control of goods, identity of traders and location of proceeds difficult to determine.

Eurojust analysed different solutions, such as training of investigatory and judicial authorities, development of specialised control mechanisms and improvement of exchange of information between Member States. Judicial support has been seen as a best practice to tackle fraud, which includes exchange of information facilitated through coordination meetings, joint action days and establishment of joint investigation teams.¹⁴³

3.2.6. FISCALIS

A multiannual EU action programme was established in 2013, the so-called ‘Fiscalis Programme’, with the objective ‘to finance initiatives by tax administrations to improve the operation of the taxation systems in the internal market’. This programme has recently been extended to 2020.¹⁴⁴ The regulation setting up Fiscalis 2020 insists even more clearly on the objective of supporting the fight against tax fraud, tax evasion and aggressive tax planning.¹⁴⁵ Fiscalis project groups are composed of experts from Member States.

In practice, the Fiscalis programme finances activities such as ‘communication and information-exchange systems, multilateral controls, seminars and project groups, working visits, training activities and other similar activities’. Its purpose is ‘to improve the proper functioning of the taxation systems in the internal market by increasing cooperation between participating countries, their administrations and officials (tax and customs)’.¹⁴⁶

¹⁴⁰ European Parliament, Committee on Budgetary control, ‘Working Document on Investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor’s Office and the effectiveness of OLAF investigations’, 20 June 2018.

¹⁴¹ L. SOKANOVIC, ‘Missing trader fraud as part of organised crime in the EU’, in *Economic and Social Development, 22nd International Scientific Conference on Economic and Social Development – ‘The Legal Challenges of Modern World’*, Book of Proceedings, 2017, p. 165.

¹⁴² O. SOKOLOVSKA, ‘Cross-border VAT frauds and measures to tackle them’, *MPRA Paper*, No 70504, March 2016, p. 5, online at <https://mpra.ub.uni-muenchen.de/70504/>.

¹⁴³ O. SOKOLOVSKA, ‘Cross-border VAT frauds and measures to tackle them’, *MPRA Paper*, No 70504, March 2016, p. 5, online at <https://mpra.ub.uni-muenchen.de/70504/>.

¹⁴⁴ Fiscalis 2013 covered the period 2008-13 with an allocation of EUR 156.9 million, while the financial envelope devoted to Fiscalis 2020 amounts to EUR 223.4 million. ECA Special report 2015/24: ‘Tackling intra-Community VAT fraud: More action needed’, p. 29.

¹⁴⁵ Regulation 1289/2013 of the European Parliament and of the Council of 11 December 2013 establishing an action programme to improve the taxation systems in the European Union for the period 2014-2010 (Fiscalis 2020).

¹⁴⁶ ECA Special report 2015/24: ‘Tackling intra-Community VAT fraud: More action needed’, p. 15.

3.2.7. VAT Expert Group and VAT Forum

Since 2012, the European Commission and the Member States also receive technical input from the private sector via the VAT Expert Group and the VAT Forum. The VAT Expert Group is composed of businesses, tax practitioners and academics. Together, they discuss legislative proposals made by the European Commission. The VAT Forum is composed of the Member States and a selection of businesses. Together they discuss practical issues with the current legislation. In both groups, current or future risks of fraud and ways to mitigate them are being discussed.

3.3. Summary

The EU Member States have adopted a rather comprehensive anti-VAT fraud regulatory framework, including traditional instruments of mutual assistance for the recovery of taxes and the exchange of information. They also concluded a first international agreement with Norway to extend administrative cooperation with this third country. They also dispose of specific measures allowing them to quickly react to fraud. With respect to carousel fraud in particular, the Member States cooperate via Eurofisc. The development of the TNA within Eurofisc can be seen as a milestone because it is expected to enable Eurofisc to detect and stop MTIC fraud at its roots and quicker than ever. Other institutions and bodies such as OLAF, Europol and Eurojust can usefully assist the European Commission and the Member States in preventing and controlling VAT fraud. The recent setting up of the EPPO should eventually ensure effective prosecution of the fraudsters. Constructive dialogue also takes place in the Fiscalis programme and within the VAT Forum and VAT Expert Group.

The Member States have also started modernising the harmonised VAT system itself in order to render it more robust to fraud, starting with the adoption of the e-commerce package. This is an ongoing process as several other proposals are currently in the pipeline, as will be discussed in the next section.

4. RECENT EUROPEAN COMMISSION PROPOSALS TO IMPROVE THE CURRENT REGULATORY FRAMEWORK TO TACKLE VAT FRAUD

4.1. Proposal for the definitive system

More than 25 years after the entry into application of the 'transitional' system for intra-EU B2B supplies of goods with transport, the European Commission has proposed a historical shift towards a 'definitive' system based on the destination principle.¹⁴⁷ The main change consists of the replacement of the two taxable events that occur under the transitional system (i.e. an exempt intra-Community supply + a taxed intra-Community acquisition with VAT remitted under reverse charge) by a single taxable event, i.e. an intra-Union supply of goods taxable at destination (at the VAT rate of the Member State of destination). Under the definitive system, the liability to assess, collect and pay the VAT in principle lies on the supplier who will be able to remit the VAT due via the OSS.¹⁴⁸ The collected VAT (in the Member State of origin) should then be transferred to the Member State of consumption. An advantage of that online system is that businesses will only have to register for VAT purposes in their home country.¹⁴⁹ Moreover, this new design should prevent carousel types of fraud as we know it, because the customer will not be able to go missing without remitting the VAT on the onward domestic sale.

'Under the current system, no distinction is made between reliable and less reliable taxable persons as regards the VAT rules to be applied.'¹⁵⁰ This might change, however, under the definitive system. The proposal in fact introduces the concept of 'certified taxable person' ('CTP'). When the customer qualifies as a CTP, the supply will still be taxable at destination and there will be one taxable event. However, it is the customer who will be liable to collect the VAT on a reverse charge basis (in this case the supply will thus be zero-rated by the supplier, like under the current system).¹⁵¹ The new concept of CTP is therefore a crucial element of the proposal.

Access to the CTP status would be based on harmonised criteria and certification provided by one Member State should be valid in the whole Union. In order to be treated as a CTP, a taxable person will have to satisfy the following criteria:¹⁵²

- Be a taxable person who has a place of business or a fixed establishment in the Union or in the absence of place of business and fixed establishment has his permanent address or usual residence in the Union;

¹⁴⁷ The 'definitive' regime proposal consists of three proposals: Proposal COM (2017) 569 for Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States; Proposal COM (2017) 568 for a Council Implementing Regulation amending Implementing Regulation (EU) No 282/2011 as regards certain exemptions for intra-Community transactions; Proposal COM (2017) 567 for a Council Regulation amending Regulation (EU) No 904/2010 as regards the certified taxable person.

¹⁴⁸ It is also interesting to note that Belgian Professor Vanistendael proposed in 1995 a system in which all cross-border transactions will be taxed at the rate of the country of destination, with a system of foreign tax offices based in origin countries with the objective to accept tax payments, issue refunds and handle all foreign VAT matters. See R. T. AINSWORTH, 'Tackling VAT Fraud: Thirteen ways forward', *Boston University School of Law, Working Paper No 13-36*, 13 August 2013, p. 2.

¹⁴⁹ N. HANGACOVA, T. STREMY, 'Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic', *European Journal of Crime, Criminal Law and Criminal Justice* 26, 2018, p. 150.

¹⁵⁰ Proposal COM (2017) 569 for Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, p. 1.

¹⁵¹ T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, p. 21.

¹⁵² See Proposal COM (2017) 567 for a Council Regulation amending Regulation (EU) No 904/2010 as regards the certified taxable person. Any taxable person established in the EU may in principle apply for CTP status (even if some of these criteria may be difficult if not impossible to comply with in the case of an SME), except some taxable persons such as those subject to the common flat-rate scheme for farmers, taxable persons covered by the exemption for small enterprises and taxable persons carrying out exempt supplies.

- Have not committed any serious infringement or repeated infringements of taxation rules and customs legislation, as well as not having any record of serious criminal offences relating to the economic activity of the applicant;
- Demonstrate a high level of control over his operations and of the flow of goods, either by means of a system managing commercial and, where appropriate, transport records, which allows appropriate tax controls, or by means of a reliable or certified internal audit trail;
- Provide evidence of financial solvency. This shall be deemed to be proven either where the applicant has good financial standing, which enables him to fulfil his commitments, with due regard to the characteristics of the type of business activity concerned, or through the production of guarantees provided by insurance or other financial institutions or by other economically reliable third parties.

At the moment, it remains unclear to what extent the procedural autonomy of the Member States will allow them to adopt different procedures to test the satisfaction of the criteria. In any case, taxable persons having AEO status will automatically be granted CTP status.

A Proposal laying down technical details for the implementation of the definitive system proposal has been released on 25 May 2018.¹⁵³

4.2. Proposal to introduce quick fixes to the transitional system

Pending the (adoption and) entry into force of the definitive system, the European Commission also proposed 'quick fixes' in order to improve the current (transitional) system.¹⁵⁴ These quick fixes have been adopted by the Council during the ECOFIN meeting held on 2 October 2018.

Of particular relevance to tackle fraud is the fact that mentioning the VAT number of the customer on the invoice will become a substantive condition for the exemption of the intra-EU supply (at the moment it is only a formal condition and the Member States are not allowed to deny the exemption – they are only allowed to impose fines). A reference in the Intracommunity Sales Listing to the person acquiring the goods will also be required.

Another relevant measure is the simplification offered regarding so-called 'call-off stocks'. Call-off stock' refers to: 'the situation where at the time of transport of goods to another Member State, the supplier already knows the identity of the person acquiring the goods to whom they will be supplied at a later stage and after arrival of the goods in the Member State of destination. This currently gives rise to a deemed supply (in the Member State of departure of the goods) and a deemed intra-Community acquisition (in the Member State of arrival of the goods), followed by a 'domestic' supply in the Member State of arrival and requires the supplier to be identified for VAT purposes in that Member State. To avoid this, these transactions, where they take place between two taxable persons should be, under certain conditions, considered as giving rise to one exempt supply in the Member State of departure and one intra-Community acquisition in the Member State of arrival'.¹⁵⁵ In practice, there would be no intra-Community supply at the time of transfer of stocks to the other Member State anymore. The intra-Community supply and acquisition would take place when the goods are being taken out of the stock when sold to the client. As will be discussed in Section 5, this might create new risks of fraud.

¹⁵³ 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.

¹⁵⁴ https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat/single-vat-area_en#quick_fixes.

¹⁵⁵ Draft (2 October 2018) Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system [and introducing the definitive system] for the taxation of trade between Member States, Recital 6.

4.3. Enhancement of the assessment assistance regulation

Still pending the adoption of the definitive system, the European Commission proposed to improve the current assistance framework with a view to tackling the most urgent cases of carousel fraud and VAT fraud related to imports and to cars.¹⁵⁶ The Council adopted this proposal during the ECOFIN meeting held on 2 October 2018. The measures should enter into effect in 2019 and 2020.

Measures to be applied as of 1 January 2019¹⁵⁷: Regarding carousel frauds, the new measures include the possibility for Member States to consolidate information on the businesses taking part in carousel fraud in different countries and to investigate suspicious activity more easily (e.g. the possibility to jointly process and analyse data on VAT fraud via the Eurofisc network of Member State experts). Another set of measures concerns the possibility to organise joint audits to assess companies operating cross-border or to allow EU tax officials to assess cases of VAT fraud in other Member States where their country has been losing out on tax revenues. The development of information and intelligence exchange between Member States' tax administrations in Eurofisc and law enforcement authorities at the EU level (with Europol) is also foreseen, as well as disclosure of serious VAT fraud situations with OLAF and the new EPPO.

Measures to be applied as of 1 January 2020¹⁵⁸: Regarding fraud related to imports into the EU, authorities in the Member State of import will have to share information on imported goods (e.g. VAT numbers, value of the imported goods, type of commodities etc.) with the tax authorities in the Member State of destination. The tax authorities in both countries should therefore be able to cross-check this information with the information reported by the importer and by the recipient in his VAT return.

Regarding fraud related to cars, the tax authorities of the Member States will be given access to information held in car registration databases so that fraud in the second-hand car market can be identified and acted upon as quickly as possible.

4.4. Generalised Reverse Charge Mechanism

Upon the request of certain Member States, the European Commission tabled a proposal for a Directive that would allow the Member States to implement a temporary generalised reverse charge mechanism ('GRCM') above a threshold of EUR 10 000 per invoice in order to address severe cases of carousel fraud. This proposal was adopted during the ECOFIN Council meeting held on 2 October, although the threshold was raised to EUR 17 500 per transaction. A Member State willing to implement a GRCM would have to show that its VAT gap is at least 5 % higher than the EU average, that carousel fraud accounts for more than 25% of its own VAT gap and that other measures would not be sufficient to tackle it. A Member State may also be allowed to apply the GRCM if it establishes that a serious risk of shift of fraud towards its territory exists because of the authorisation of the GRCM to a neighbouring Member State and other measures would not be sufficient to tackle that risk.

Even if adopted, the possibility to implement a GRCM would only be granted until the entry into force of the definitive system, meant to address the issue of carousel fraud by changing the collection process (as discussed in section 4.1.).

¹⁵⁶ Proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706 final.

¹⁵⁷ See Proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706 final.

¹⁵⁸ See Proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706 final.

4.5. Expected proposal for mandatory transmission and exchange of VAT-relevant payment data

Finally, the European Commission might issue a proposal to improve the quality of the data available to the tax administrations in the sector of e-commerce. One of the main difficulties in this sector is in fact that EU tax administrations have little means to identify and control taxable persons. In 2014, 94% of online payments for cross-border purchases occurred via online payment intermediaries, credit or debit cards, or prepaid cards.¹⁵⁹ Financial intermediaries do have reliable data regarding taxable supplies and the European Commission therefore launched a consultation to, *inter alia*, identify to what extent relevant VAT payment data could be exchanged and allow tax administrations to enforce the VAT. The consultation ran from 27 February 2018 to 25 April 2018.

Unfortunately, only three contributions were made to this consultation.

4.6. Summary

The Member States are currently discussing a possible shift towards a definitive VAT system based on the destination principle. One of the main objectives of the proposed reform is to curb MTIC /carousel fraud. Interim measures were also adopted to improve the current system, pending the entry into application of the definitive system, together with the possibility to apply a GRM in specific situations and under specific conditions.

The assessment assistance directive will also be updated in order to curb CP42 and VAT fraud related to cars (which would not be solved with the definitive system) through a more efficient exchange of information. Pending the adoption of the definitive system, an improved information exchange framework should also allow carousel/MTIC types of fraud to be better addressed.

Finally, the European Commission might propose the exchange of VAT-relevant payment data, in order to better monitor the collection of VAT on online sales and detect non-compliant taxable persons.

¹⁵⁹ International Post Corporation, e-Commerce logistic and delivery, eCom21 2016.

5. ASSESSMENT OF THE CURRENT REGULATORY FRAMEWORK AND PROPOSALS TO TACKLE VAT FRAUD

5.1. Recovery and assessment assistance

In December 2017, the Commission evaluated the recovery assistance directive and reported that the number of *requests* has steadily increased during the period 2011-2016:¹⁶⁰

Table 2: Total number of requests under EU recovery assistance instrument received by Member States in 2011-2016¹⁶¹

	Requests for information	Requests for notification	Requests for precautionary measures	Requests for recovery
2011	3 218	1 284	-	9 566
2012	6 081	1 323	-	7 661
2013	8 250	2 066	102	10 391
2014	9 988	2 195	80	14 123
2015	10 733	2 168	123	14 769
2016	1 3630	2 205	76	1 6403

At the same time, the total number of annual *communications* (new requests and follow-up of existing requests) between applicant and requested authorities in all EU Member States is also increasing. All Member States but one have confirmed that the current recovery assistance directive has made it easier for them to provide and to receive mutual recovery assistance, compared to the situation under the previous legal framework (the use of electronic forms is identified as a major asset).

Table 3: Total annual communications with regard to recovery assistance requests in 2012-2016¹⁶²

2012	2013	2014	2015	2016
125 163	98 493	138 628	139 402	166 457

¹⁶⁰ Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures COM/2017/0778 final.

¹⁶¹ Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures COM/2017/0778 final, p. 4.

¹⁶² Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures COM/2017/0778 final, p. 4.

In general, a large majority of Member States is of the opinion that cooperation under the current directive has improved the collection and recovery of their tax related claims. The statistical information available confirms that the amounts recovered on the basis of the EU legislation have increased again, after an initial regression in 2012.

Table 4: Overview of recovered amounts under EU recovery assistance instrument (2011-2016)¹⁶³

	Recovered at the request of other Member States	Recovered via requests to other Member States
2011	EUR 54 031 822	EUR 62 475 879
2012	EUR 30 641 451	EUR 32 076 738
2013	EUR 35 580 763	EUR 41 115 223
2014	EUR 42 839 876	EUR 46 395 481
2015	EUR 81 402 061	EUR 65 711 419
2016	EUR 76 500 163	EUR 67 019 250

Nevertheless, it can be noted from the consultations of the Member States' tax authorities that if recovery assistance is working well in simple situations (e.g. border workers), it is less the case when the non-collection is due to the fraudulent intention of the debtor. Figures also show that the amounts actually recovered are much lower than the amounts for which recovery assistance is requested.¹⁶⁴

The European Commission also reported that the 'Member States do not yet make use of the possibility for tax recovery officials of one Member State to go to another Member State and to be present during administrative enquiries – or even to participate in these enquiries by interviewing individuals and examining records – and to assist officials of the requested Member State during court proceedings in that State'.¹⁶⁵ In fact, only one case was reported. Unfortunately, the European Commission confirms that this is in line with the experiences relating to the lack of use of corresponding provisions in the other EU legislation concerning administrative cooperation between tax authorities.

The European Commission identified possible improvements for the future. In general, it noted that the success of mutual recovery assistance largely depends on sufficient resources and efforts to cooperate. A number of proposals for simplification have been analysed and to some extent discussed with the Member States, within the Recovery Expert Group and the Recovery Committee. According to

¹⁶³ Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures COM/2017/0778 final, p. 5.

¹⁶⁴ Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, COM/2017/0778 final, p. 4.

¹⁶⁵ Report from the Commission to the European Parliament and the Council on the operation of the arrangements established by Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures COM/2017/0778 final, p. 3.

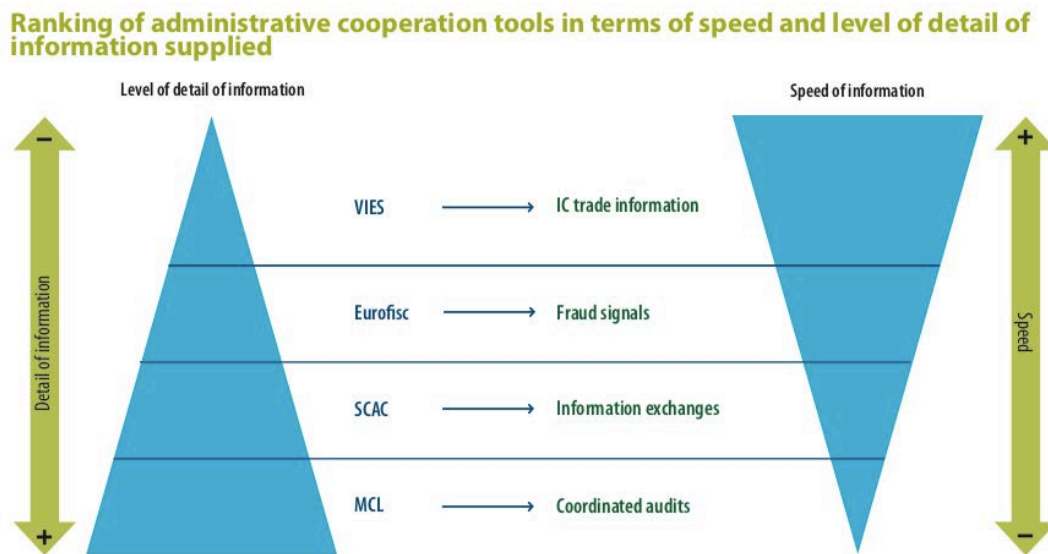
the Commission, priority should be given to improving the execution of recovery assistance requests at national level, within the current legal framework for recovery assistance.

The European Commission also acknowledged that the problem of missing debtors and assets is not only an intra-EU problem and that international cooperation should also be developed (see the agreement signed with Norway in section 3.1.2.).

The broad scope of application and automatic nature of the assessment assistance regulation make it a valuable instrument. However, its effectiveness again relies on a pro-active implementation by the Member States. Each Member State should indeed effectively seek to capture data that would serve other Member States and exchange it in a cooperative spirit. As resources in national administrations have been reduced in the past years in most Member States, this limits the practical impact of the instrument. Therefore, progress should again be made to make a better use of the existing instrument.

The following table ranks the performance of EU administration tools in terms of speed and level of detail of the information supplied.

Table 5: Ranking of EU administrative cooperation tools



Source: European Court of Auditors, based on information from Eurofisc¹⁶⁶.

Note: SCAC: Standing Committee for Administrative Co-operation; MLC (should read 'MLC') : Multilateral Controls.

Regarding extra-EU situations, the conclusion of a cooperation agreement with Norway is a positive development. However, in order to be efficient in the case of VAT fraud, international cooperation should be developed at a global level. The European Commission and the Member States are actively participating in the negotiations that take place to that effect at the level of the OECD.

¹⁶⁶ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 17.

5.2. EU Bodies, Committees and Programmes

5.2.1. Eurofisc

Because the most damaging VAT fraud schemes take place in more than one Member State, EU-level cooperation is a necessity. It seems to us that Eurofisc is the most promising forum for cooperation in that area, in particular to thwart carousel fraud. Nevertheless, **improvements are in order.**

The following weaknesses were pointed out by a 2015 ECA Report:¹⁶⁷

- feedback not frequent enough;
- data exchanged not always well targeted;
- not all Member States participate in all Eurofisc working fields;
- exchanges of information are not user friendly (using Excel sheets; Eurofisc coordinators have therefore to manually compile the information);
- data exchanges are too slow.

Significant improvements can be expected on these specific points with the recent adoption of several amendments to the assessment assistance regulation (see section 4.3). Moreover the development of the TNA is, in the authors' view, the most promising means to detect carousel fraud at an early stage. Full cooperation thereto by the Member States should therefore be strongly encouraged.

5.2.2. OLAF and the EPPO

The European Commission recently proposed the amendment of the OLAF Regulation because several shortcomings were identified, including the following:¹⁶⁸

- OLAF's investigative powers and tools are subject to conditions of national law (and therefore to different interpretations of the relevant provisions). The issue is that differences in national law lead to a fragmentation in the exercise of OLAF's powers in the Member States, in some cases hindering OLAF's ability to successfully conduct investigations.
- OLAF does not possess tools to enforce its powers in the case of obstruction or refusal. This in turn can limit the effectiveness of OLAF investigations, with divergences across Member States depending on the ability of national competent authorities to support OLAF with their own enforcement tools (a matter where there are also divergences in the applicable national law).
- OLAF's mandate and investigative tools in the area of VAT should be clarified and strengthened.

As a necessary complement to OLAF (and others') investigations, the setting up of the EPPO should ease the process of prosecuting fraudsters before national courts. Swift and entire cooperation under the auspices of the EPPO is considered as essential to tackle any large-scale cross-border VAT fraud.¹⁶⁹ It should be noted that a June 2018 report by the CONT Committee of the European Parliament also

¹⁶⁷ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 26.

¹⁶⁸ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) No 883/2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations, COM/2018/338 final.

¹⁶⁹ A. WILLIAMS, 'Fighting fraud in the EU: a note on icebergs and evidence', ERA Forum, 2013, p. 2.

highlighted the need to ensure a sound cohesive interaction between OLAF and the EPPO and makes several suggestions for reform.¹⁷⁰

5.2.3. Europol

The links between VAT fraud and organised crime, terrorism, money laundering etc. make Europol an obvious ally in the fight against VAT fraud. Europol has proved to be an efficient support to national law enforcement agencies, including national police forces in that area.

We already mentioned the successful Operation OCTOPUS II above (CP42 fraud).¹⁷¹ Another example is that in a recent joint operation led by the Spanish National Police, together with the Spanish Tax Agency and supported by Europol and Eurojust ('Operation Dreams'), an organised criminal group involved in pan-European VAT fraud and money laundering could be dismantled. The investigation revealed that the group issued false invoices for a value of over EUR 250 million in three years (the fake invoices were used either to import cars at significantly lower prices or to obtain refunds of VAT that was never paid to the Treasury). Europol supported this investigation by providing analytical and operational support.¹⁷²

5.2.4. Fiscalis

In 2015, the ECA examined the mid-term¹⁷³ and final evaluations¹⁷⁴ of the Fiscalis 2013 Programme. At that time the auditors could not *quantify* the effectiveness of the Fiscalis 2013 programme because of the absence of baseline figures and indicators for evaluation purposes (a performance monitoring system has only become operational in April 2014). From a *qualitative* perspective, the auditors noted that while the qualitative assessment based on the evidence reported in the evaluations or by practitioners in the visited Member States was largely positive ('survey participants and interviewees consider that Fiscalis contributes to a more effective fight against fraud in terms of reduced incidence of fraud, increased detection of fraud and increased amount of tax collected following the detection of fraud (tax recovery)'), none of the five tax authorities that the ECA visited during their audit have measured the outcome of their participation in Fiscalis in such positive terms.¹⁷⁵ The results of the evaluations should therefore be considered with caution.

The ECA further reported that in their view: 'cooperation between Customs and Police and between Customs and tax authorities is quite good, but that some obstacles to cooperation remain. The most important are restrictions on sharing information, lack of structured systems and connected databases, information being not timely or of a poor quality, and a lack of proper feedback'.¹⁷⁶ This conclusion also emerged from the discussions we had with concerned stakeholders: while the dialogue seems constructive during the meetings, cooperation in practice remains largely inefficient, either between tax administrations or between tax administrations and customs authorities.

¹⁷⁰ European Parliament, Committee on Budgetary control, 'Working Document on Investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations', 20 June 2018.

¹⁷¹ Pan-European VAT fraud crime group dismantled, Europol Press Release, 2 July 2018.

¹⁷² EU-Wide VAT fraud organised crime group busted, Europol Press Release, 4 May 2018.

¹⁷³ <https://publications.europa.eu/en/publication-detail/-/publication/e10d360a-4fd0-11e6-89bd-01aa75ed71a1/language-en>.

¹⁷⁴ https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/fiscalis2013_final_evaluation.pdf.

¹⁷⁵ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 37.

¹⁷⁶ ECA Special report 2015/24: 'Tackling intra-Community VAT fraud: More action needed', p. 37.

5.2.5. VAT Forum and the VAT Expert Group

Dialogue within the VAT Forum and the VAT Expert Group also contributes to a better organisation of the fight against VAT fraud. **However, once again, coordination could be improved:**

- VAT and customs issues could be addressed together in the discussions within the two groups.
- Coordination of the work of the VAT Forum and the VAT Expert Group could be improved if the same units were supervising their work (At the moment, the C1 unit supervises the work of the VAT Expert Group and the C4 unit supervises the work of the VAT Forum).
- Working in sub-groups (rather than in plenary sessions) allows for more specific and therefore more relevant input for the European Commission and the Member States.
- With respect to the VAT Expert Group:
 - Coordination with the Group on the Future of the VAT System should be under the responsibility of the same Unit.
 - Working in sub-groups (rather than in plenary sessions, which now seems to have become the rule) allows for more specific and therefore more relevant input for the European Commission and the Member States. It has, in the past, allowed the VAT Expert group to issue ‘opinions’ that are available on the European Commission website. The latest opinion dates back from September 2016.
 - Consultation of the VAT Expert Group at the early stage of drafting of the legislative proposals would allow for more relevant input. Several members of the VEG expressed their regret that consultation regarding the definitive proposal has not been more intense (while documents have been shared, very little *consultation* has actually taken place).

5.3. Carousel fraud

5.3.1. The interim measures

Requiring (as a ‘substantive’ as opposed to ‘formal’ condition) that the supplier mentions the VAT number of the customer in order to apply the exemption for intra-Community supplies is a positive development that will effectively allow tax administrations to better control the VAT exemption for intra-EU supplies. This will admittedly amount to an increased compliance burden for the taxable persons. However, the requirement seems reasonable and proportionate to attain the objective of tackling the risk of unduly exempt intra-Community supplies.

Regarding the newly adopted simplification for call off stocks, the initial proposal of the European Commission only targeted supplies made by CTPs. However, when adopting the simplification the Member States suppressed any reference to this concept and thereby have offered the simplification to all EU taxable persons. For the reasons explained below in section 5.3.2. we are not in favour of the creation of the CTP concept. However, in this case it seems clear that the call off stock simplifications might create new opportunities for fraud (similar to those offered by the current intra-Community acquisition system).

5.3.2. The definitive regime proposal

According to the European Commission, a definitive VAT system based on the destination principle would remove the risk of carousel fraud and should, consequently, reduce cross-border VAT fraud by

up to EUR 41 billion per year.¹⁷⁷ While carousel fraud – as we know it – would indeed be curbed, **it should however be acknowledged that the new system will inevitably create opportunities for new types of fraud and that the reduction of the revenue losses might not meet the expectations of the European Commission.**

The crux of the problem is that under the proposed system, the VAT will leave the Member State of consumption/destination upon payment by the customer to the supplier and is expected to come back via the OSS upon declaration and payment by the supplier. The collection of VAT will therefore be ‘outsourced’ to other Member States and while, from the perspective of the taxable person, the OSS is meant to provide one point of registration, from the perspective of the Member State the system of VAT collection will be ‘decentralised’.

In the case of suspicion of fraud, the Member State of consumption will have to rely on mutual assistance instruments to require the Member State of identification to investigate and recover the unpaid revenue (where applicable) from the supplier established in its territory. Beyond the fact that charging VAT in accordance with the rules that apply in the Member State of destination will constitute a non-negligible burden for the taxable persons (although the OSS is a single point of registration, applying the rules (rates, exemptions) of the Member State of consumption might in the end make it more burdensome for them to trade within the EU than to export),¹⁷⁸ **the OSS system thus implies a very high level of trust between the Member States. The Member State of consumption will have to trust that the Member State of identification will take all necessary measures to ensure the correct payment of VAT, which may include assistance for auditing the taxable persons.**¹⁷⁹

In practice, the Member State of consumption will periodically receive bulk payments with summary details regarding the taxable persons from the Member State of identification. Accordingly, it will take time before it realises that insufficient amounts of VAT (might) have been declared. A request for assistance should then be sent to the Member State of identification, which might take some additional time – sufficient time for the non-compliant supplier to go missing without remitting the VAT due. The immediate loss for the Member State of consumption is unavoidable because the customer was able to immediately claim the deduction/refund of the VAT paid to the non-compliant supplier.¹⁸⁰ **A new type of ‘missing trader’ is therefore likely to arise under the proposed ‘definitive system’ (the seller becoming the missing trader in this case).**

The evaded amounts will, per transaction, be lower than under the current system (because the circular feature of carousel fraud will no longer be achievable). However, if the number of transactions (or the margins) increases, the evaded amounts might eventually reach similar levels to those under the current system. Such an increase is not pure conjecture, as the chances to get away with the fraud will increase, first because as explained above, the reaction by the tax authorities in the Member State of consumption will be slower and, second, because the latter’s means of action will be more limited in

¹⁷⁷ 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.

¹⁷⁸ Another risk for taxable persons under the definitive regime is the issue of bad debt. In a destination based system, where the supplier is liable to pay the VAT within a specific timescale, it is not uncommon for them to have to pre-finance the VAT. If the customer subsequently fails to pay the VAT, the supplier might be able – or not – to recover the prefinanced VAT (conditions differ between the Member States, in particular with respect to the ‘irrecoverability’ of the debt).

¹⁷⁹ This includes verification of the correct application of rates (which would be an unbearable burden should the Commission proposal in the sense of VAT rate liberalisation be adopted).

¹⁸⁰ In this respect, it should here be clarified that linking the right to deduct to the payment of the VAT by the supplier to avoid this situation would be a disproportionate measure that would jeopardise the neutrality of the VAT system. In fact, it is only in cases where the customer ‘knew or should have known’ that he was helping the supplier to commit fraud (‘Kittel test’, see below section 6.3.4.) that the deduction should be denied.

view of the fact that most of the relevant data and auditing powers will be in the hands of the Member State of identification (which could also take time to react bearing in mind that the losses do not concern its revenue).

Contrary to what the European Commission claims, MTIC fraud and related losses of VAT will therefore not disappear. Quoting Ainsworth: ‘we are building half a dam in a river that still flows unimpeded around the far end of the barrier’.¹⁸¹ The author even foresees that the following fraud pattern will develop: Suppliers established in jurisdictions with a low VAT rate (like Luxembourg (17%), Malta (18%) or Germany, Cyprus and Romania (19%)) will sell to customers established in high tax jurisdictions (like Hungary (27%) or Croatia, Denmark and Sweden (25%)) and disappear with high amounts of VAT. As a consequence, the tax authorities in Hungary, Croatia, Denmark and Sweden will routinely be asking assistance from the tax authorities in Luxembourg, Malta, Germany, Cyprus and Romania with auditing their taxable persons. This means that the costs related to the enforcement of the definitive system will not be spread evenly between the Member States and the question may be raised whether it is reasonable to expect Member States to invest time and resources to ensure the correct payment of VAT to other Member States. As pointed by Ainsworth: ‘Would Hungary, Croatia, Denmark and Sweden trust Luxembourg, Malta, Germany, Cyprus, and Romania to be more cost effective and efficient in rooting out domestic missing traders that are impacting the VAT gap in neighbouring systems, than the countries suffering from the VAT gap would be in auditing their own taxpayers under the current system?’.¹⁸²

In fact, it should be acknowledged that under the definitive system, **Member States will have less control over the taxable persons collecting their taxes than under the current system and will fully rely on the faithful cooperation of other Member States, irrespective of their respective size and trade balance (net exporting countries receiving less VAT and monitoring the payment of more VAT to other Member States).** ‘Non-payment issues’ due to insolvencies and other failures on the side of the supplier will have to be dealt with and the question will arise of **to what extent a Member State of consumption could require from a Member State of identification receipt of VAT amounts that have been paid by customers and not remitted via the OSS by the suppliers.** Although the Member State of identification is not likely to be willing to pay a VAT that has neither been declared nor paid via the OSS, the Member State of consumption is not likely to be satisfied with (regular) notices of non-payments resulting from insolvencies or pre-bankruptcy arrangements etc. (which may result in interferences in the way default and insolvency situations are being prevented and controlled in the Member State of identification).

Another point of concern in the ‘definitive system’ proposal relates to the creation of the status of ‘certified taxable person’ (CTP). In the case where the customer is a CTP, the latter will be liable for the VAT and will have to pay it under reverse charge. The assumption is that there is no risk of MTIC fraud when the customer is a ‘reliable’ operator. However, in addition to the fact that creating two categories of taxable persons amounts to a different treatment of businesses (those complying benefit from the zero-rating while those not complying have to charge VAT at destination at the correct rate),¹⁸³ the risk of fraud cannot be ignored. **As a matter of fact, experience with AEO shows that it is extremely burdensome and costly to monitor ‘trustworthy’ businesses and guarantee continued**

¹⁸¹ R.T. AINSWORTH, M. ALWOHAIBI, M. CHEETHAM, C. TIRAND, ‘A VATCoin Solution to MTIC Fraud: Past Efforts, Present Technology, and the EU’s 2017 Proposal’, *Boston University School of Law Law & Economics Series Paper*, No. 18-08, 26 March 2018, footnote 20.

¹⁸² R.T. AINSWORTH, M. ALWOHAIBI, M. CHEETHAM, C. TIRAND, ‘A VATCoin Solution to MTIC Fraud: Past Efforts, Present Technology, and the EU’s 2017 Proposal’, *Boston University School of Law Law & Economics Series Paper*, No. 18-08, 26 March 2018, p. 14.

¹⁸³ This system could also lead to practical difficulties for VAT payers, who will have to adapt their operational treatment with the status of their customers. T. MICHALIK, ‘How the European Commission and European Countries Fight VAT Fraud’, 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, 2017, p. 22.

compliance with the qualifying criteria (see also in section 5.4.3. the ECA conclusions that AEO operators should also be closely monitored in the context of CP42 procedures because several cases of non-compliance have been identified). In the case of CTP for VAT purposes, the questions then arise of how much will this cost and whether it will at all be possible to prevent fraud. Even if it will become more difficult to commit fraud, **significant risk exists that organised crime bands will succeed in complying with the CTP criteria and commit the fraud while honest businesses might struggle to satisfy the requirements and as a result be subject to more burdensome compliance obligations.** In this respect, it should be kept in mind that, unless further harmonisation is achieved, the Member States will be free to adopt their own procedural rules to determine whether or not the requirements are met and that some Member States might be stricter than others. **Once again, this requires a very high level of trust between the Member States as no real transparency will be ensured regarding the implementation of this concept in the respective Member States.** Mutual recognition of CTP status is an essential element for the good functioning of this mechanism. However, the risks for the Member State are substantial.

It should also be noted that while the proposal optimistically foresees that 'The taxable person who has been granted the status of certified taxable person shall inform the tax authorities without delay of any factor arising after the decision was taken, which may affect or influence the continuation of that status',¹⁸⁴ fraudsters are not likely to comply with this requirement. Excluding fraudsters from the system will therefore exclusively rely on continuous monitoring of all CTPs.

More generally, authors have highlighted the technical difficulties and weak points of the OSS mechanism (as for instance the lack of clarity relating to tax audits).¹⁸⁵ One may also wonder whether it will be technically possible to broaden the current MOSS into the OSS and to make sure that it will be operational in all the Member States. Once again, it is worth highlighting that **each Member State will rely on effective functioning of the OSS in the other Member States to receive the VAT they are entitled to collect.**

5.3.3. Reverse charge (quick reaction and GRCM)

According to a 2018 Commission report,¹⁸⁶ the Member States generally consider that Article 199a of the VAT Directive (application of reverse charge mechanism, on a temporary basis, in specific sectors) has proved to be a very effective and efficient tool, reporting a significant decrease or complete disappearance of missing trader fraud in the defined sectors (such as mobile phones or computer chips).¹⁸⁷ In particular, all Member States applying the domestic reverse charge mechanism in emission allowances concluded that it was efficient for stopping the particularly aggressive fraud.¹⁸⁸ Businesses also reported that Article 199a of the VAT Directive decreased the risk of companies becoming part of VAT carousel fraud and has 'cleaned the sector from inexplicably low prices, recreating a level playing field for honest businesses'.¹⁸⁹ They do, however, stress the additional burden resulting from a non-

¹⁸⁴ Proposed Article 13A point 6 of the VAT Directive.

¹⁸⁵ T. MICHALIK, 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, Available at SSRN: <https://ssrn.com/abstract=2996600>, 2017, p. 21.

¹⁸⁶ See Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final, p. 5.

¹⁸⁷ F. BORSELLI, S. FEDELI, L. GIURATO, 'Digital VAT Carousel Fraud: A New Boundary for Criminality?', *Tax Notes International*, February 2015, p. 718.

¹⁸⁸ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final.

¹⁸⁹ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final.

uniform implementation in the EU. Some Member States applying Article 199a of the VAT Directive claim that a shift of fraud to other goods or services took place (an equal number of Member States consider that no shift of fraud to other goods or services took place) or that companies involved in the MTIC fraud shift their place in the fraudulent chain of transactions (e.g. from broker to conduit company). One Member State highlighted that fraudsters started using more than one commodity (product) within the fraudulent chain to make it difficult to assess the commodity impacted and the financial effect of the fraud.¹⁹⁰

The vast majority of Member States consider that article 199b of the VAT directive (QRM) is a useful tool for combatting particular cases of sudden and massive fraud,¹⁹¹ even though they emphasise the 'extraordinary character' of the measure, which should serve as a last resort only.¹⁹² Some Member States consider the measure as not useful, because the conditions are very strict and would be impossible to fulfil in practice. One Member State mentioned that the conditions 'sudden' and 'massive' are in practice mutually exclusive. If fraud occurs suddenly, it is indeed complicated to demonstrate that it is massive. The other way around, if the massive character of the fraud can be proven, the 'sudden' criterion cannot be met anymore. Only one Member State considered the measure as not useful, claiming that other measures provided for by the VAT Directive are sufficient.¹⁹³

A general conclusion that can be drawn regarding the reverse charge mechanism is that it undoubtedly allows to *stop* waves of carousel fraud in specific sectors. As such, it therefore constitutes an important 'tool' for the Member States. However, as mentioned already, the fraudsters may easily switch to other sectors. Accordingly reverse charge should not be seen as the 'ultimate measure' for addressing carousel fraud, but rather as one (efficient) tool with a specific objective (i.e. stop a specific wave of fraud) within a larger toolkit (that should cover prevention, detection and prosecution of the fraudsters, see Recommendations in Section 6). In fact, working on the design of the EU VAT system and make it *structurally* more robust against carousel fraud should remain a priority.¹⁹⁴ Accordingly, while we acknowledge the potential merit of a generalised reverse charge system for transactions above a certain amount in Member States that face high levels of carousel fraud, we also believe that the EU VAT system (characterised by a fractioned collection of the VAT throughout the supply chain) can be made more resistant to carousel fraud without the need to rely on exceptional measures of this nature (see recommendations in Section 6).

5.3.4. CJEU case law

Although the spirit of the CJEU case law under the Kittel jurisprudence (creating a 'knew or should have known' test) is easy to understand, its implementation is more complex.

An initial point is that the onus is upon the tax administration to demonstrate that the taxable person who 'passively participated' in the fraud 'knew or should have known about it'. While tax inspectors may have very strong feelings about such knowledge, it often remains difficult to prove. At the same time, a too lenient interpretation of the 'knew or should have known' test would counter the rule of law principle.

¹⁹⁰ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final, pt. 3.2.3.1.

¹⁹¹ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final.

¹⁹² Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final.

¹⁹³ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM/2018/0118 final.

¹⁹⁴ As noted already, the measures based on Article 199a and the QRM of Article 199b, and the adoption of the GRCM should only apply until the definitive regime enters into effect.

A second point is that by focusing on the 'passive participant' to the fraud, the tax administration may be in the position to recover the revenue. However, the 'real fraudsters' will remain untouched and will most probably continue their fraudulent activities.

A third point is that the responsibility that is put upon each trader to ensure that its counterparty is not involved in a fraud may lead to a situation where taxable persons might be reluctant to conclude deals with smaller and as yet unknown operators on the market.

5.4. E-commerce-related fraud

The e-commerce package has recently been adopted and will enter into force in 2019 and 2021. In our view, however, several issues still need to be addressed to prevent fraud.

5.4.1. Electronically supplied services

Member States generally seem satisfied with the MOSS as they collect higher amounts of VAT than previously. However, a primary point is that the change of place of supply rule that occurred in 2015 (taxation at destination rather than origin) had a major impact on the revenue collected by the respective Member States. As a matter of fact, before 2015 only the Member States where the providers were established used to collect VAT from these services. Because most of the businesses in the sector were established in the Member States where the VAT rate was the lowest, it meant that most of the VAT on electronically supplied services used to accrue to a limited number of Member States (those with a low rate of VAT). Under a destination based system, the revenue is now more adequately shared between the Member States and that - partly at least - explains the increase of revenue.

A second point is that it should be acknowledged that national tax administrations (in the Member State of consumption or in the Member State of identification) in fact have very little means to verify compliance with the MOSS for electronic services, simply because they are not in the position to monitor key elements of the transaction such as the price paid and evidence of customer location. It is indeed difficult for a tax administration (in the Member State of identification or consumption) to verify whether the data (including the price charged and the customer IP or payment details) provided in relation to a transaction involving 'intangibles' that took place online 6 months before are correct. The assessment assistance directive has been amended as part of the e-commerce package and now foresees the automatic exchange of information between the Member State of identification and the Member States of consumption regarding taxable persons using the (M)OSS and the declarations made through that scheme.¹⁹⁵ It also organises the procedure that applies if a Member State of consumption wishes to obtain the records of the taxable person¹⁹⁶ or if it wishes to carry out an administrative enquiry.¹⁹⁷ However, it remains unclear how the Member State can ensure the *quality* of the data regarding supplies made via the MOSS (the audit currently being performed by the ECA will hopefully provide more clarity on that point). In the meantime, the expected proposal towards exchange of VAT relevant payment information could assist national tax administrations. It remains to be seen, however, what the exact scope and practicalities of such an exchange would be.

At the moment, it also remains unclear how Member States can address the main issue of non-compliance by non-EU taxable persons. While the assessment and recovery assistance instruments may be relied on in the case of EU taxable persons (provided the Member States duly make use of them and

¹⁹⁵ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010.

¹⁹⁶ Article 47 i of Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010.

¹⁹⁷ Article 47 j of Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010.

are able to ensure the quality of the data), there is no such instrument in place with the main jurisdictions where providers of electronically supplied services are located (including the US, China and India). As a result, it remains largely impossible for the Member States to enforce registration obligations on non-EU businesses in the absence of voluntary compliance. In addition to a loss of revenue, this situation maintains an unlevel playing field between EU taxable persons (more likely to be compliant in view of the cooperation agreement in place between the Member States) and non-EU suppliers (upon whom registration and collection obligations cannot be enforced). This was identified as a weakness to be addressed when the e-commerce proposal was made. It has, however, not yet been tackled.

5.4.2. Distance sales

The new EU-wide threshold for intra-EU distance sales is simpler to apply and monitor and removes the uncertainty regarding the application of the per country threshold. However, the risk of underreporting related to the existence of a threshold remains. In this case, the verification of the amounts declared fully depends on the controls that would be performed by the Member States of identification (which would have to verify that businesses should not be paying VAT to other Members States). Once again, the expected proposal towards exchange of VAT relevant payment information might be useful for the national tax administrations in the Member States of consumption.

It should also be noted that a new risk of fraud might arise when the deeming regarding platforms applies. In the case where the platforms (deemed suppliers) collect and pay the VAT, it does indeed seem logical to require that they reimburse it if necessary (in practice the supplier should reimburse the sales price net of VAT and the platform should reimburse the VAT). The question then arises of what kind of evidence will be required by the tax administrations to avoid abuses (i.e. false reimbursement claims).

5.4.3. Imports

In the absence of implementing measures, major risks of fraud may be expected to arise from the provisions that will apply in the case of B2C imports as of 2021.

Firstly, major risks of abuse of I-OSS numbers are to be expected. In practice, in order to grant the exemption, customs authorities will have to verify, in real-time, the validity of the I-OSS registration number included in the import declaration (otherwise, customs authorities cannot control to whom they grant the exemption).¹⁹⁸ Customs authorities should in fact be able to verify that the I-OSS number included in the import declaration is valid and belongs to the supplier of the goods. Otherwise, major risks of abuse of I-OSS numbers are to be expected. The risk of abuse is even more acute for platforms, because suppliers using platforms to sell their products will be required to include the platform's I-OSS number in the import declaration in order to obtain the exemption. It is imperative to ensure that the same supplier will not use the platform's I-OSS number also for those supplies that the supplier makes without passing through the platform. In general, it is imperative to ensure that no one can abuse a platform's I-OSS number.

Monthly listings of import and I-OSS declarations (meant to verify compliance of the I-OSS registered suppliers) will not be sufficient to tackle this issue. The first problem is that a comparison between the two may not be relevant from a temporal perspective as the import may take place during a different

¹⁹⁸ Article 47h of Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010: 'Member States shall, upon importation of goods on which VAT is to be declared under the special scheme provided for in Section 4 of Chapter 6 of Title XII of Directive 2006/112/EC, carry out an electronic verification of the validity of the individual VAT identification number allocated by way of Article 369q of that Directive and communicated at the latest upon lodging of the import declaration'.

month than the corresponding I-OSS declaration. A second problem is that the case of returned goods that do not leave the EU (but are for example sent to outlet centres or even destroyed in the EU) is not taken into consideration in the statistics. Finally, even if a fraud could eventually be identified, the questions remains of whether a platform whose I-OSS number has been misused would be liable for the payment of the VAT in the meantime.

Secondly, the major issue of undervaluation has not been addressed. When a non-EU taxable person is registered under the I-OSS, it still remains to be verified that the declarations are correct. This is also a key element for the good functioning of the monthly import listings because comparing what is being declared at import with what is being declared via the I-OSS is only a good idea to measure compliance to the extent that the accuracy of the data declared at import is being checked (otherwise, a non-EU vendor declaring a value of EUR 3 and paying EUR 3 via the I-OSS will look like a match even if the imported good was in fact worth EUR 50).

In the case where the non-EU taxable person has not registered under the I-OSS, the person presenting the goods to customs (in practice the transporter) will be liable to collect the VAT due and remit it on a monthly basis. An initial comment is that since an I-OSS registration is not mandatory, import VAT is likely to be collected via this procedure in a large number of cases. And again, the issue of fraud has been overlooked. As a matter of fact, transporters will collect the VAT on the basis of the data provided by the non-EU suppliers and frauds based on undervaluations will still be possible. As indicated above (section 3.2.3.), levels of fraud are significant in this area and too little attention has been given to this under the newly adopted system. **It is indeed unlikely that those currently making false value declarations will suddenly start acting differently.** This means that transporters, and in particular postal companies, will have to improve their risk assessment procedures in order to address the issue of fraud. It remains unclear how much this will cost and whether this is realistic in terms of capacity. On that question, the Impact Assessment accompanying the Proposal for the e-commerce package simply suggested that the system developments from the recent changes of the Union Customs Code which have put security-related obligations on both postal operators and couriers (i.e. they will all need to provide advanced information by 2021 to EU customs administrations) may be the opportunity to also improve their risk assessment regarding false declarations.¹⁹⁹ This statement is overoptimistic. The transport sector will indeed have to cope with new obligations regarding security and surety (which everyone agrees is essential) but the procedures that need to be put into place to tackle undervaluations are of a different nature and will actually come as an extra burden.

Whether the I-OSS procedure applies or not, new forms of control to tackle undervaluations should thus be developed. In 2015, the French Senate concluded as regards the current system: 'the recovery of VAT on imports, based on a purely declarative system and extremely rare controls, is not adapted to the explosion of flows caused by e-commerce. States will be able to reinforce all possible reporting obligations on CN 22 or in the Delta X system, but as long as the procedure remains declarative, these efforts will be largely unsuccessful. There is no viable solution without a paradigm shift'.²⁰⁰ We believe that these conclusions remain valid under the legislation that will enter into application in 2021: **declarative procedures (either via the I-OSS by the seller/platform or via the I-OSS by the transporter, but based on data communicated by the seller) are not adequate. A paradigm shift is needed.**

¹⁹⁹ See M. LAMENSCH, 'Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One', *EC Tax Review*, Vol. 27, Issue 4, 2018

²⁰⁰ Sénat français, Commission des finances, 'Le e-commerce : propositions pour une tva payée à la source, groupe de travail sur le recouvrement de l'impôt à l'heure de l'économie numérique', Rapport II, 17 septembre 2015, p. 34.

Regarding CP42 fraud, the ECA concluded that the main issues are:²⁰¹

- The absence of effective cross-checks between customs and tax data in most of the Member States;
- Issues with the accuracy, completeness and timeliness of data despite the existence of tools allowing sharing of VAT information between Member States
- The lack of cooperation and an overlap of powers between administrative, judicial and law enforcement authorities.

In this context, the success of the recently adopted amendments to the assessment assistance instrument (requiring the state of import to share information on imported goods, e.g. VAT numbers, value of the imported goods, type of commodities etc., with the tax authorities in the Member State of destination) **will depend on their effective implementation (as of 2020).**

As a priority, the *quality* of the data in the VIES should be improved. In a 2015 report,²⁰² the ECA indeed highlighted a lack of completeness of VIES data concerning imports under CP42. More generally, the audits performed by the ECA showed numerous cases of undervaluations, lack of submission of recapitulative statements, invalid VAT registration numbers in import declarations and unreported triangular transactions.²⁰³ It is also stated that in the case of a request by a Member State for a copy of a VIES report, it may take a couple of months for the report to be delivered. Some improvements have been made (the possibility to obtain a report spontaneously in the case of something suspicious for the concerned national tax authority), but the situation remains complicated.²⁰⁴ The consequence is that tax authorities are not able to cross-check between customs data on imports under CP42 and the VAT recapitulative statements submitted by the importer. The auditors also highlighted that only 22 Member States exchange information through Eurofisc working field 3. If the recent adoption of new exchange of information provisions is a positive development, which seems to indicate that the Member States are willing to actively cooperate in this area, ‘the proof of the pudding is in the eating’.

The 2017 ECA report also insisted on the necessity to carry out effective pre-arrival risk analyses to guarantee a correct valuation in the context of CP42 procedures. **Interestingly, the report highlights that controls should also be performed in the case of simplified import procedures (including AEO) as frauds have been identified there as well, which is all the more possible because they benefit from fewer physical and document-based controls (this should be kept in mind when assessing the merit of the CTP status in the context of the ‘definitive system’ proposal).**²⁰⁵

Finally, technical flows should also be fixed. The ECA indeed found that in some Member States the electronic customs release systems accepted: 1) requests for an exemption for low value goods in respect of imports whose declared value was higher than EUR 150 and 2) requests for an exemption as gifts for goods declared as commercial consignments.

²⁰¹ O. SOKOLOVSKA, ‘Cross-border VAT frauds and measures to tackle them’, *MPRA Paper*, No 70504, March 2016, p. 4, online at <https://mpra.ub.uni-muenchen.de/70504/>.

²⁰² ECA 2015 special report, p. 32.

²⁰³ The assessment of a selection of Member States for example showed that the customs authorities of Germany and the United Kingdom do not send data on imports under CP42 to tax authorities. They also found that traders do not report separately, in the VAT recapitulative statement, onward intra-Community supplies following imports under CP42 in Germany, Italy and the United Kingdom. In Latvia, automatic cross-checks were available but did not prevent a case of under-reporting in the VAT recapitulative statement. Except in Italy, no automatic checking of the VAT numbers was available in the customs electronic clearance systems of the visited Member States.

²⁰⁴ R. T. AINSWORTH, M. ALWOHAIBI, ‘The first real-time blockchain VAT-GCC solves MTIC fraud’, *Boston University School of Law, Law & Economics Paper No 17-23*, 24 July 2017, p. 12.

²⁰⁵ ECA report, p. 53.

5.5. VAT fraud related to cars

The new measures concerning VAT fraud related to cars should allow the Member States to adequately address this type of fraud, provided the information exchange is effective (in the same way as in the case of CP42 fraud). In this case, the new legislative framework that is in place seems sufficient. Its effectiveness depends on its effective implementation by the Member States (as of 2020).

5.6. Reduced rates fraud

As already stated, the multiplication of applicable VAT rates across the Member States (as per the European Commission proposal dated January 2018) would not only result in a substantial compliance burden for the businesses having to assess and remit the tax in various jurisdictions of consumption. It would also entail significant risks of fraud (misqualifications). Monitoring that risk will prove extremely difficult and costly for the Member States.

5.7. Aircraft leasing (avoidance)

The substantial VAT savings that are gained through aircraft leasing (instead of import) do not constitute 'fraud' to the extent that a proper leasing agreement has been concluded between the importer and the user of the aircraft. However, the question arises of whether this may constitute an abusive practice because, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

In *C-255/02 Halifax*,²⁰⁶ the Court decided that: 'For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the (VAT Directive) and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage'.

In *C-251/16 Cussens*,²⁰⁷ the Court confirmed that a contractual construction involving a succession of leases with a view to reducing the VAT liability could be disregarded if it lacked economic reality.

5.8. Summary

The definitive system should put an end to carousel fraud as we know it. It should be acknowledged, however, that the fraudsters (in particular organised crime groups) will find new cracks in the system and that **the Member States should be ready to swiftly react to new types of MTIC fraud**. In fact, the effectiveness of the proposed 'definitive system' **relies on an unprecedented level of cooperation between the Member States to collect each other's' VAT and remit it in a timely manner. Risks of tensions between the Member States should also not be underestimated.**

Pending the adoption of the 'definitive system', it also seems relevant to clarify the respective roles and possibilities offered by the various EU institutions and bodies that deal with VAT fraud. While Eurofisc seems to play a central role (and the recent development of the TNA is most promising), other bodies such as Europol and OLAF also investigate and/or support VAT fraud investigations. **A rationalisation of the efforts and tools that exist to tackle this phenomenon is probably needed.**

²⁰⁶ CJEU 21 February 2006, C-255/02 Halifax, ECLI:EU:C:2006:121.

²⁰⁷ CJEU, 22 November 2017, C-251/16 Cussens, ECLI:EU:C:2017:881.

On a positive note, the creation of **the EPPO should facilitate the effective prosecution of fraudsters.**

As CP42 fraud will continue to arise after the implementation of the definitive system, the newly adopted measures towards more strict monitoring of the flows are most welcome. However, **the effectiveness of these measures will greatly depend on their implementation by the Member States and experience with the current administrative cooperation instruments shows that cooperation should be improved, in particular with respect to complex and organised fraud schemes.** To that effect, new strategies should be developed within Eurofisc. A very high level of vigilance is here required, as **organised crime bands are also behind CP42 frauds and are able to identify the weaknesses of the system and to target the Member States where the controls will be 'softer' or less rigorous.**

A new set of measures was recently adopted to render the VAT system more robust against fraud in the sector of e-commerce and to level the playing field between EU and non-EU taxable persons. **However, the main risks of fraud, i.e. non-registration by non-EU taxable persons and undervaluations/underreporting are not properly addressed and there is no indication that those who are currently not compliant will be compliant in the future. A new risk of fraud even arises from the absence of effective controls regarding the granting of an exemption at import for I-OSS registered taxable persons.**

New risks of fraud may also arise if the January 2018 proposal to liberalise VAT rates is adopted as it would be extremely difficult for the tax administrations to monitor the correct application of a diverse rate structure.

On a positive note, the current CJEU case law should allow the tax administrations to requalify VAT avoidance schemes that artificially rely on the conclusion of leasing agreements to avoid the payment of import VAT.

6. RECOMMENDATIONS

Based on the above, the authors would like to make the following recommendations.

6.1. MTIC fraud/Carousel fraud

Recommendations for the current (transitional) system

MTIC/carousel fraud is mostly committed by organized crime groups and action is needed on two fronts. On the one hand, swift detection and neutralization is key to stop the loss of revenue within the shortest possible timeframe. On the other hand, severe sanctions are needed to dissuade the fraudsters. Altogether, **carousel frauds should become an unprofitable and risky business.**

In order to swiftly detect and neutralize fraud, cross-border cooperation is needed and Eurofisc is the most suitable framework to that effect, taking advantage of recent developments of the TNA. As the risk of MTIC fraud would not be suppressed under the 'definitive system' as stated, and in any case because its adoption and implementation would take time during which enormous amounts of VAT would be lost if no action were taken (up to 60 billions per year), **active participation in the TNA is necessary, without delay, even if the design of the tax might eventually be amended.** The effectiveness of the TNA might be further improved if additional 'real-time' data were collected and communicated by the Member States. Several Member States have gained experience with real-time collection and reporting (Spain, Italy, Hungary).²⁰⁸ These examples could inspire other Member States and eventually facilitate the work done within Eurofisc. It might also allow detection of other types of fraud.

Regarding prosecution, the adoption of an ambitious mandate for the EPPO in collaboration with national judicial authorities will be key.

Recommendation 1: 'Dual' Action: (i) swift detection and neutralization: All Member States should actively participate in the TNA system in the framework of Eurofisc with a view to tackling MTIC/Carousel fraud. In particular, sufficient resources should be allocated at the national levels to actively contribute to this fraud detection system by reacting to risk notifications and providing appropriate feedback. Real-time collection and communication of transactional information by the Member States would increase the effectiveness of the TNA and would further allow the development of new strategies to defeat other types of VAT fraud; **(ii) prosecution and sanctions:** the EPPO should become effective as soon as possible in order to ensure the efficient prosecution of fraudsters before the national courts.

Once prosecuted, exemplary sanctions should be pronounced, not only in the cases foreseen under the Criminalisation Directive. The latter covers the most severe fraud cases (i.e. more than EUR 10 000 000). To the extent possible, anyone engaged in an organised VAT fraud scheme should be severely sanctioned in order to avoid a perception of impunity (see above: VAT fraud should become 'a risky business').

²⁰⁸ An example of 'real-time' collection of transaction data is the Spanish ISS system ("Immediate Supply of Information on VAT") that provides for the electronic transmission of billing records from VAT books both by suppliers (information regarding issued invoices) and customers (information regarding received invoices) to the tax administration. This allows for the development of new control models with information available immediately. As the invoicing is indeed closer to the effective realisation of the economic operation, it becomes possible to cross-check information in a most efficient way.

Recommendation 2: The Criminalisation Directive sets a standard that should be considered as a ‘minimum standard’ by the Member States. To the extent possible, any organised cross-border VAT fraud scheme should be duly prosecuted and the fraudsters should be severely sanctioned.

Recommendations for the definitive system proposal

If the definitive system proposal is adopted, the Member States will collect each other’s VAT in most B2B intra-EU supplies of goods. Although the main objective of this transition to a destination based system is to eradicate MTICs fraud, **it should be acknowledged that MTIC fraud will remain** and might eventually reach similar levels as under the current system. Moreover, **the decentralised nature of the OSS is likely to create tension between the Member States that should not be underestimated.** To address that situation, at least two approaches (or combined approaches) are possible:

- A centralised rather than a decentralised OSS

A centralised (EU level) OSS portal could replace the decentralised (Member State level) 28²⁰⁹ OSS portals. Each Member State would be represented in the ‘EU OSS’ portal and the allocation of taxing rights would remain unchanged (including the right for each Member State to set their own tax rates, in accordance with the VAT Directive).

Such a centralised approach would provide each Member State with a comprehensive overview of VAT payments and would allow for a swift redistribution of the revenue, in full transparency. Suspicious flows would immediately be identified (with the support of Eurofisc). A centralised portal would further allow for significant economies of scales (as one EU OSS portal would be less costly than 28 OSS portals) and would also reduce the reliance on the recovery assistance instrument.

- Replacing payments in fiat currencies by payments in digital currencies, with a single VAT purpose

One of the main issues allowing VAT fraudulent behaviours is the ‘cash profit’ that a fraudster can make. The question then arises of whether cash movements could be avoided while keeping an audit trail.

Discussions about the potential of blockchain technology have multiplied in the past couple of years. However, policy makers have so far remained extremely cautious and usually argue that the technology is not yet mature enough. Nevertheless, several tax academics have investigated the question and designed rather sophisticated proposals. Ainsworth, Alwohaibi, Cheetham and Tirand, for example, have proposed to place cross-border transactional data on a blockchain and to use secured digital currencies that can only be used for VAT payments (single purpose) instead of using fiat currency.²¹⁰ This proposal offers a radical solution to the issue of trust between the Member States under the proposed ‘definitive system’ proposal, because the revenue would not leave the taxing Member States (Member State of consumption). It does not change the decentralised structure of the OSS, but it eliminates the risk related to cross-border VAT payments (i.e. the ‘cash profit’ that the fraudster could make), as the digital currencies would only be used for VAT purposes.

²⁰⁹ This figure does not take in account the eventual completion of Brexit.

²¹⁰ In a nutshell, the customer making a cross-border purchase would request an allotment of VATCoins sufficient to pay the VAT due on the cross-border supply (from this moment on, the VAT due is in the hands of the taxing jurisdiction). The customer uses the VATCoins to complete the transaction and is able to claim a refund. The VATCoins are then transferred back via the OSS. The authors have also developed strategies to defeat cyberattacks and abuse of VATCoins. R. T. AINSWORTH, M. ALWOHAIBI, M. CHEETHAM, C. TIRAND, ‘A VATCoin Solution to MTIC Fraud: Past Efforts, Present Technology, and the EU’s 2017 Proposal’, Boston University School of Law Law & Economics Series Paper, No. 18-08, 26 March 2018. See also: R.T. AINSWORTH, M. ALWOHAIBI, M. CHEETHAM, ‘VATCoin: Can a Crypto Tax Currency Prevent VAT Fraud?’, Tax Notes International, Vol. 84, 14 November 2016.

Recommendation 3: The definitive system proposal must be rethought in order to properly address new risks of MTIC fraud as well as severe risks of tensions between the Member States. This could be done:

- Either by replacing the decentralised nature (Member State level) of the ‘OSS for EU taxable persons supplying goods to taxable persons in another Member State’ with a centralised (EU level) system.
- And/or by replacing fiat currencies with payment in digital currencies with a single VAT purpose.

The proposal to create a ‘CTP’ status under the ‘definitive system’ proposal is problematic on many accounts:

- It discriminates SMEs;²¹¹
- It is costly to monitor ;
- It might create tensions between the Member States ;
- It is not fraud proof, certainly not with respect to organised crime groups.

Therefore, we recommend **that the provisions related to the CTP status are not adopted and that a similar declaration and payment procedure for all taxable persons liable to pay tax in another Member State is provided.** Alternatively, the CTP status **could be reserved for AEO operators**, even if the AEO status has also shown some issues, one of which has been its cost of monitoring (see Section 5.3.2).

Recommendation 4: In view of the serious risks of abuse of the CTP status in the context of the definitive system proposal and the possible conflicts that a mutual recognition of this status might create between the Member States, it seems preferable to not introduce such a concept and to require from all taxable persons that they declare and pay VAT via the OSS, or to reserve this status to AEO operators.

6.2. CP42 fraud

The success of the newly adopted amendments to the assessment assistance instrument towards greater exchange of information to thwart CP42 fraud will depend on their actual implementation by the Member States. Unfortunately, experience with the current administrative cooperation instruments shows that cooperation is often laborious, in particular with respect to complex and organised fraud schemes.

A radical solution would be to suppress the CP42 procedure and to require from importers that they rely on the burdensome customs ‘transit arrangements’ if they wish to suspend the payment of the VAT. We would not be in favour of such a solution, as it would create significant barriers to entry the EU. We would rather suggest that new strategies be developed for tracking the goods that enter the EU under procedure CP42. Once again, the EU could draw from Member States’ experience, for example

²¹¹ This aspect has not been developed in this study but should also be kept in mind when evaluating the proposal.

the Hungarian transport monitoring system (EKAER).²¹² New technologies would further allow organising the 'electronic tracking' of the goods throughout the EU.

Recommendation 5: As exchange of information legislation might not be sufficient to thwart CP42 fraud or too costly and burdensome to put into place, new strategies to track CP42 goods within the EU should be considered.

6.3. E-commerce fraud

The main risks in the sector of e-commerce include non-registration of suppliers, undervaluations (i.e. declaring a lower amount for a supply) and underreporting (i.e. being registered but not declaring all supplies). With the adoption of the e-commerce package, the issue of abuse of OSS numbers will also arise, which will not be fully addressed by the exchange of import data by the Member States. Implementation measures should therefore be adopted before 2021. One possibility could be to impose a 'double check' at the point of import: a valid I-OSS registration number and a valid transaction number, as communicated by the platform to customs authorities prior to the import (pre-arrival data).²¹³ Although such an accompanying measure seems unavoidable to prevent massive I-OSS number abuses, it must be acknowledged that this will bear a significant cost. Therefore, alternative methods of collection should also be investigated for the long term (see recommendation 10).

Recommendation 6: Accompanying measures should be adopted by 2021 to prevent abuse of I-OSS numbers in the context of the exemption granted at import for OSS registered taxable persons.

Regarding electronically supplied services and intra-EU distance sales, the same conclusions as above can also be raised with regard to the decentralised nature of the collection method and the related risks of tensions between the Member States. Admittedly, the amounts at stake in the case of electronically supplied services are lower than in the case of supplies of goods. However, it should be acknowledged that Member States of identification are not likely to dedicate time and resources to help collect VAT belonging to other Member States, in particular in this sector where the supplies involve intangibles and the controls are therefore more complex to carry out. Hence, we would also recommend a structural change: from a decentralised to a centralised OSS system. As noted above, this would provide more transparency to the Member States and would facilitate controls, speed up the redistribution of the revenue to each Member State of consumption and reduce the administrative costs related to the monitoring of 28²¹⁴ (M)OSS portals and the recovery assistance procedures.

Recommendation 7: A centralised 'EU OSS portal for EU taxable persons supplying goods and services to EU non-taxable persons' should replace the decentralised (28 national level) (M)OSS portals.

²¹² This system requires that a supplier who sends goods (inside or outside Hungary) has to receive a number for the transport, which the carrier has at disposal for inspection. In case of failure to provide the correct number, sanctions can be applied (including confiscation of the goods). T. MICHALIK, T., 'How the European Commission and European Countries Fight VAT Fraud', 27 June 2017, , p. 32, Available at SSRN: <https://ssrn.com/abstract=2996600>.

²¹³ In this example the supplier completing a sale on a platform would receive a transaction number from the platform. The same number would be communicated to customs by the platform as 'pre-arrival data', together with information regarding the value of the transaction. In the import declaration, the supplier would need to indicate a valid OSS registration number and a valid transaction number in order to obtain the exemption. The declared value could also be cross-checked. This way, platforms OSS registration numbers could not be used fraudulently and the risk of undervaluation could be tackled..

²¹⁴ This figure does not take into account eventual completion of Brexit.

Recommendation 8: A centralized 'EU OSS portal for non-EU taxable persons supplying goods and services to EU non-taxable persons' should replace the decentralized 28 (M)OSS portals.

Because even a centralized EU I-OSS portal will not allow the Member States to tackle the issue of undervaluations and enforcement in general in the case of non-EU taxable persons, alternative collection methods for these supplies should be investigated for the longer term, because **relying on the good faith of non-EU taxable persons to collect EU VAT is not a sustainable option**. Such alternative collection models should not only target sales made via electronic platforms, but all sales made by non-EU taxable persons irrespective of the business model that they use. The authors suggest that 'technology-based' third party or customer collection systems should be tested. Estonia launched a pilot on a customer collection system in 2016 (which will have to be rescinded as a consequence of the adoption of the e-commerce package); the UK has launched a consultation on 'split-payment' in the sector of e-commerce; Argentina implemented a withholding system for B2C electronic services (via the payment service provider) in June 2018 and Norway is also testing a customer collection system for imports. One of the authors of this study has proposed a third-party collection model (2015) and a customer collection model (2017).²¹⁵ The latter research is ongoing. Finally, the authors find that using digital currencies for B2C supplies might prove more difficult. However, Ainsworth et al. also made a proposal that covers these transactions.²¹⁶

Recommendation 9: New technologies and methods should be investigated - that would not entirely rely on voluntary compliance and international cooperation - to tackle the issues of non-registration, undervaluation and underreporting in the case of supplies made by non-EU taxable persons in respect of which EU tax administrations have no enforcement jurisdiction.

The exchange of payment data would also be a valuable tool for detecting undervaluations and underreporting of sales. Hence, we would support the European Commission in its initiative to investigate such exchange.

Recommendation 10: New technologies and methods should be investigated in order to improve exchange of payment data for detecting non-registrations, undervaluations and underreporting of sales.

6.4. Reduced rate

Whereas the proposal to liberalise VAT rates in the Member States stems from a definitive switch to a destination based VAT system (under which different rates do not distort competition as the same rate will apply irrespective of the location of the supplier), the complexities related to the application by businesses of hundreds of different VAT rates in each Member States cannot be ignored, all the more so since tax administrations (both in the Member State of identification and in the Member State of destination) would have to dedicate significant time and effort for ensuring a correct application of the rates. For that reason, we would recommend not adopting the January 2018 proposal towards liberalisation of VAT rates in the EU.

²¹⁵ For a summary description of the proposed model, see M. LAMENSCH, M. SARASWAT, 'From clicks to compliance: A data conduit to collect VAT', *International VAT Monitor*, Vol. 28, issue 5. The models were also described in: 'The EU Customs and cross-border e-commerce, Final Report of the e-commerce Study Group established by the HL WG DG Customs of the European Council, January 2018.

²¹⁶ R.T. AINSWORTH, M. ALWOHAIBI, M. CHEETHAM, 'VATCoin: Can a Crypto Tax Currency Prevent VAT Fraud?', *Tax Notes International*, Vol. 84, 14 November 2016.

Recommendation 11: In view of the new risks of fraud related to a diversification of the VAT rate structure among the Member States, it seems preferable to not adopt the current proposal aimed at providing more flexibility to the Member States for the adoption of reduced rates.

6.5. Leasing arrangements and VAT avoidance

Leasing arrangements to avoid the payment of VAT on the import of aircraft is a typical case of tax planning that could be addressed via the adoption of a specific anti-avoidance rule. In the meantime, the case law of the CJEU allows the Member States to requalify such transactions and seek the payment of the import VAT.

Recommendation 12: In order to address the loss of revenue arising from aircraft leasing avoidance schemes, the Member States could adopt a specific anti-abuse rule that would allow the Member States to ignore the leasing agreement in the case where the importer and the beneficiary are the same person or are related persons. The current case law of the CJEU, however, already seems sufficient to actually solve that issue.

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Each year, the EU Member States lose billions of euros in VAT revenues on account of fraud. As the EU VAT system is undergoing profound modernisation, this study seeks (i) to take stock of the current state of play, (ii) to assess the current regulatory framework and the proposals under discussion, and (iii) to offer a selection of recommendations. An initial conclusion is that, while the European Commission has put a considerable amount of work into the modernisation of the EU VAT system, remaining risks of fraud cannot be ignored. A second substantial conclusion is that a different approach and the use of new technologies would allow the Member States to remove significant obstacles that currently impede an effective fight against VAT fraud.

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