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**Opinion Statement of the CFE Fiscal Committee on
the European Commission's proposal of directive and action plan
to better combat VAT fraud**

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This is an Opinion Statement on the “European Commission’s proposal of directive and action plan to better combat VAT fraud”, prepared by the Fiscal Committee of the Confédération Fiscale Européenne (CFE). The CFE is the leading European association of 32 national tax advisory organisations representing over 180,000 tax advisers

The CFE observes that the VAT system developed initially by France and later the EC has now been adopted by most of the countries of the World. It seems unlikely that this system faces major conceptual weaknesses. Only Europe seems to face substantial fraud called “missing traders” or “carousel”, while in other parts of the world, this seems to be limited to exports of goods. This kind of fraud has been observed since the introduction of VAT in Europe in cases concerning the acquisition of tax free goods from other member states or third countries, VAT free scraps¹, building contractors and VAT free exports. Before 1993, this kind of fraud was very common in trade between Belgium, The Netherlands and Luxembourg which had at that time abolished any physical controls at their borders (Benelux 50 procedures).

The CFE points out that the VAT is more strictly monitored than other taxes. As mentioned in the opinion statement about electronic invoicing and archiving (October 3, 2008), the CFE observes that, unlike most of the other existing taxes, the VAT system contains extremely detailed and frequent periodical reporting obligations to the tax authorities, in particular:

- periodic VAT returns, which require details of turnover, the VAT due and the VAT deductible, as well as corrections (article 250 and following of the VAT Directive);

¹ Immediately after the introduction of VAT, criminal organisations were collecting old cars in order to sell the iron and steel to large steel companies. They would issue formal VAT invoices using the names of beggars. The large companies would then seek to recover the VAT but the criminals would not account for the tax to the authorities. In order to prevent this fraud, France and Belgium have zero rates for the sale of second hand metal objects.

- subject to any claims for input tax, the payment of VAT for the period covered by a return (article 206 of the VAT directive). Any abnormal requests for a VAT deduction can be subjected to a tax audit;
- periodical sales listings (at least quarterly) detailing the supplies to taxable persons established in other EU Member States (articles 262 to 264 of the VAT Directive);
- Member States can also require traders to provide details of their acquisitions from other member states (article 268 of the VAT Directive);
- Member States can also require yearly listings that detail the turnover on supplies made to taxable persons established in other member states (article 270 of the VAT Directive);
- and, although it is not a specific VAT obligation, traders can be required to produce yearly accounts, income tax returns and statistical information (for example Intrastat).

The data communicated directly (and frequently on line) to tax authorities through these various returns are based on invoices. The invoice is a document generally issued by the supplier and its form is strictly regulated, there being 11 prescribed requirements, including that the invoice should contain a description of the extent and nature of the supplies (article 226 of the VAT Directive).

These strict, detailed and frequent reporting requirements are combined with obligations to make payments of VAT output tax to the tax authorities subject to the right of the trader to recover VAT input tax. Any abnormal discrepancies between VAT output tax paid to the tax authorities and VAT input tax deducted by the trader can result in an immediate audit by the tax authorities.

“Missing trader” fraud is easy to organize and requires minimal financial investment. It is caused by a combination of a severe weakness in the monitoring of intra-community trading in the VAT system and:

- the possibility of acquiring goods VAT free from abroad (intra-community acquisitions) or internally (eg. VAT exemptions with a view to exportation) as well as the possibility of selling goods without accounting for VAT but recovering VAT on the costs;
- the absence of harmonization of reporting procedures;
- slow communications between tax authorities.

Missing trader fraud has been encouraged by the fact that Member States have not taken adequate account of the essential characteristics of the VAT system, which only functions properly when goods and services circulate with a VAT charge and with a limited number of exemptions². Basically, the current VAT system, which permits VAT free transactions *within* the single market, is inconsistent with the idea of a single market and an anathema to the proper working of the VAT system. It is this feature of the system which is at fault. No other place in the world has this problem primarily because their systems operate on a national level and there is no similar opportunity on a national level to make supplies with no obligation to account for VAT output tax but with a right recover VAT input tax. The problem with VAT in Europe is that there are 27 states operating as a single market but there has been a failure to accept the logical consequences of that market.

In Cases C-439/04 and C-440/04, *Kittel and Recolta*, the ECJ ruled that a taxable person who knew or should have known that he was participating in a transaction connected with fraudulent evasion of value added tax is not entitled to deduct input VAT. In Case C-384/04, *Federation of Technological industries*, the ECJ ruled that a taxable person, to whom a supply of goods or services has been made and who knew, or had reasonable grounds to suspect, that some or all of the value added tax payable in respect of that supply, or of any previous or subsequent supply, would go unpaid, may be made jointly and severally liable,

² As noted in footnote 1 above, we accept that there are some instances where VAT exemptions may reduce the risk of fraud because it prevents traders from making supplies of high value, for example of construction services, and then committing a fraud by failing to account for VAT on those supplies.

with the person who is liable, for payment of that tax. Unless an exception is made to the Kittel judgment in cases where the VAT can be recovered, these two decisions could combine to doubly penalise traders who find that they are both liable to account for VAT on supplies made to them and yet at the same time lose the right to recover input tax. There is also a danger that the Kittel judgment may be relied upon to deny a right to recover input tax even though the tax authorities subsequently succeed in recovering the tax from the missing trader. In a chain of transactions, it might also be relied upon to deny the right to recover input tax to a number of traders, thereby resulting in windfalls for the Member States.

The imposition of joint and several liabilities on moveable goods, also requires business to perform detailed investigations about their purchasers and their suppliers. In practice, only tax authorities have the legal powers and the infrastructure to perform such investigations. The fact that the Kittel judgment and the provisions relating to joint and several liability penalise not only fraudulent traders but also negligent traders, who do not know that there has been a fraud but ought to have known of the fraud, clearly acts as a potential disincentive to inter-community trade, because even honest traders may have concerns that their right to recover input tax may be denied, on the basis that they have been guilty of neglect, or alternatively that they might be made jointly liable for the tax due from their suppliers.

The CFE therefore welcomes:

- the contemplated adoption of common minimum standards for the registration and deregistration of taxable persons: it is clearly desirable that member states should adopt common standards that seek to prevent fraud although care must be taken to ensure that these procedure do no inhibit legitimate business ;

- new provisions for the confirmation of information about traders: it is clearly desirable that traders should have the ability to verify both the VAT number and the address of traders that it has dealings with. In this regard, it is very important that there should be a procedure that enables traders in all member states to obtain this information in a form that is admissible in the Courts of all the member states, since otherwise there is a danger that traders may be penalised by the fact that they can not prove that they properly verified the status of their suppliers or customers in proceedings with their tax authorities;
- new invoicing rules: the current options offered to Member States and the legislative obstacles to electronic invoicing and electronic archiving artificially increase the costs of managing businesses and internal audits;
- attempts to ensure the VAT system is implemented in a more consistent manner in relation to intra-Community transactions: it is clearly desirable that Member States should seek to implement the rules in a consistent manner, so a consistent approach is taken when determining the chargeability of the VAT on intra-Community supplies and acquisitions of goods and also to ensure reporting takes place in both Member States at the same time;
- attempts to reduce timeframes: in an ideal VAT system, the communication of information between bodies in charge of the collection of the tax should take place immediately;
- attempts to harmonise the rules on exemption of VAT at importation: the rules regarding VAT exemptions on intra community operations should be identical since they have an impact on businesses established in other Member States;
- attempts to enhance cooperation between Member States: improved mutual assistance should assist in preventing fraud and may reduce delays and inconvenience for innocent traders whose affairs are being investigated by tax authorities in another Member State;

- the introduction of automated access to data on the databases of tax authorities in other Member State: this should again assist the fight on fraud and should also help to reduce inconvenience for innocent traders whose affairs are being investigated by tax authorities in other Member State;
- the proposed EUROFISC early warning mechanism for combating VAT fraud: this can hopefully help to develop common risk assessment procedures for intra-Community transactions and help to coordinate the exchange of information about transactions where there is a risk of fraud;
- the introduction of improved measures for the recovery of taxes: uniform instruments permitting enforcement or precautionary measures should reduce the administrative burdens upon tax authorities and allow quicker reactions which are crucial for the success of such co-operation;
- the introduction of a shared responsibility for the protection of all Member States revenues: it is clearly desirable that national legislation should grant comparable protection in terms of sanctions and criminal proceedings against VAT fraudsters, regardless of whether the fraud results in a losses of revenue in their own territory or in the territory of another Member State.

The CFE appreciates that any changes in reporting requirements and formalities will result in additional costs for businesses. However, the CFE considers that these costs are more than counterbalanced by the benefits of substantially reducing the risks of innocent business being the victims of fraudsters.

Therefore, the CFE encourages the Member States to adopt as soon as possible the measures contemplated in the action plan submitted by the Commission.

However, the CFE regrets the introduction of a joint and several liability, especially since it can be very difficult for a trader to discover whether its customers and suppliers are acting honestly and the rules encourage tax authorities to seek to rely on innocent mistakes and errors to transfer liabilities to innocent traders. This in turn discourages genuine inter-community trade. The proposals for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards tax evasion linked to import and other cross-border transactions (Brussels, 1.12.2008 COM(2008) 805 final) do not contain any provisions that will ensure that an importer will not be taxed twice, since he may be taxed once in the country of import under the joint liability rules and a second time in the country where he sells the goods. For the reasons outlined above, there are also dangers that the Kittel judgment, especially when combined with the provisions for joint liability, could result in double taxations and windfalls for Member States.

Finally, the CFE warns against any system centralizing sensitive business information such as invoices in tax authorities databases because such databases are almost impossible to protect against sophisticated computer piracy. This could result in commercially sensitive information falling into the hands of non-EU competitors and puts in danger the competitiveness or even the survival of EU businesses.