



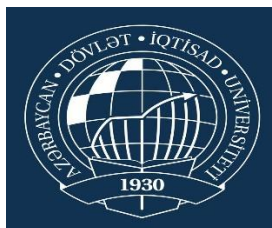
The Ministry of Education of Azerbaijan Republic

Missing Trader Intra-Community and Carousel VAT frauds

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May 2018

Acknowledgements

I express my respect and sincere gratitude to teacher K.S.Cabbarova who has given her priceless support collaboration and suggestions from time to time in successfully completing this diploma work. Additionally, I also praise my parents for the unceasing aid, care and attention. Along with my parents, I am also grateful to my group mates who assisted me to find reliable sources to obtain data about my thesis topic.

Abstract

Although the VAT functions well in many countries, its use outside the borders of Member States may be flawed and may lead to undesirable fraud activities. One of the most popular sorts of cross-border tax evasion is MTIC (Missing Trader Intra Community). In this sort of tax evasion, if the same supplies are performed many times across the same borders via the same supply chain, the more specific name for this fraud is MTIC fraud is carousel fraud. It is necessary to admit the reality that MTIC fraud is not limited to goods solely, but it can also influence traded services.

Under the principle of collecting VAT on the basis of a transportation point of destination, it is challenging for officials to control all transactions that happen over their borders. Therefore, many zero-rated purchases and their correspondence can cause VAT evasion, enabling companies to obtain high amounts of VAT from buyers, and then disappear before transferring these amounts to state authorities. It is complicated for tax authorities to estimate VAT losses in connection with MTIC accurately, but they merit attention and lead to significant losses for VAT.

This thesis establishes, to analyse different methods for identifying, preventing and combating fraud of MTIC. First, many significant evasion cases are designed to emphasise how MTIC happen in practice and how courts consider these facts to proceed from their decisions. Besides, numerous solutions to MTIC fraud are clearly described and evaluated regarding advantages/disadvantages.

The concluding observations are that MTIC was very severe about both the tax officials and the European Union. Decisions against MTIC fraud are many, but their weaknesses are that they can lead to high application costs, may impose high controlling costs or even transfer this fraud to other goods sorts when they are involved in the affected cases.

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Background

VAT is an important taxation income for each economy. It has an effect on each person's daily financial transactions and automatically leads revenue to the governments. In the EU, businesses deal with various VAT obligations in several states because of the specific regulations of trade within the Union countries.

VAT Fraud is noticed as a black economy or as a MTIC fraud – a missing trader Intra-Community evasion in various forms. These fraudulent actions affect the economic conditions of both the particular Member States in a case and of the EU as a whole. Although the MTIC fraud usually includes a finite number of agents, the caused VAT losses are remarkable. Additionally, this sort of fraud adjusts competition so that the dealers who do not meet their VAT obligation can trade commodities at lower prices than their rivals in the marketplace. Combatting against the MTIC fraud is one of the top preferences for both the EU and the Member States. Nevertheless, although some actions performed by government officials, this sort of fraud is becoming more complicated.

One of the critical issues, which the EU is currently challenging, is that how to properly operate a destination-oriented VAT system when the border controlling is not performed. The main purpose of this research is to present a complete demonstration of the functioning of MTIC fraud and to emphasise solutions to this deception. This study starts by presenting the readers to the system of VAT by classifying and explaining a group of related terms to inspect the whole situation. Then the study illustrates the system of MTIC fraud and the elements of the contemporary VAT system that enables MTIC fraud to survive. The study also highlights the economic consequences of this sort of cheating, from both a taxation and a strategic viewpoint. The study details techniques of catching and combatting against MTIC fraud, by giving reasonable solutions against such fraud.

Basic Principles and Terminology

Introduction to VAT

VAT, the brief variant of Value Added Tax was originally introduced in 1954, in France¹. Then in 1967, the Member States in the EEU (European Economic Community) agreed to replace their national turnover taxes with a general VAT method. In the European Union, this tax is recognised as a consumption tax to be performed to the value added to services or goods. It is obtained at every step of the chain of producing and delivering and finally given to the revenue officials by the merchant of the services or goods. By the process of subtracting VAT paid to officials for supplies and of summing up the VAT received from customers, the final users are the real payers of this tax². In other words, VAT is not a hardship on the companies, as it is neutral to their company and eventually funded by the clients. It may also be true that the companies are operating as unpaid tax collectors.

A more comprehensive look at the background of VAT would consider that VAT was established in April 1967 in the European Economic Community in the Directive 67/227/EEC and was expected to throw the market misuses of indirect taxes relevant on the full amount of transactions.

The goal of the VAT is to assure clarity and fair opposition between the commodities suggested by the Member States. Before the presentation of this notion, the taxes charged by the Member States were not explicitly traceable and could have easily cause to export payments by exaggerating the fees refundable on exportation. ‘The achievement of the purpose of establishing an internal market presumes applying in the Member States of law on turnover tax fees which do not change conditions of opposition between competitors or limit the free transfer of goods or services. Therefore, it is necessary to perform such kind of harmonisation of regulation on turnover taxes employing a system of VAT as far as possible, factors that may distort the environment for contemporary competition, at the level of both national and Community.’³

Here definition of MTIC VAT fraud by Europol:

“The fundamental MTIC fraud type includes well-established, wisely planned actions that attempt to use variances in how various EU Member States handles VAT. The perpetrators build a structure of associated businesses or corporations and individuals over these states to violate both federal and foreign trading and revenue-accounting systems.

¹ COM(2010) 695 final

² DG TAXUD webpage, General overview of VAT

³ Council Directive 2006/112/EC

It is also defined as a carousel fraud that uses the advantage of the law that enables VAT free trading within Member countries: VAT is performed only to commercial activities at the current domestic rate within a Member country. Each VAT amount charged on trade activities must be reported and given to the Member State's tax authority. In MTIC fraud, the earliest company in the private chain imposes VAT to a customer but does not pay this amount of money to the government and be a missing trader by doing this illegal activity.

The partnership connection between 2 sides is hard to track by government officials, therefore it makes it difficult to detect this crime activity easily and this usually makes it more challenging for officials. Before vanishing, the primary entities that are liable for the tax loss, in this case- the missing traders, usually work only for a couple of months and get a lot of money by cheating government tax officials.”⁴

Methods of Computing VAT

Three methodologies for calculation of VAT are used in general.

- The subtraction method. In each stage, the tax obligation matches the rate of tax multiplied by VAT basis estimated as the variance between input and output charges.⁵
- The addition method. This method refers to; the tax obligation is the tax rate multiplied by the value-added calculated by summing up wages and savings.⁶ Or it is the whole amount of the rates of profits and wages. This may be recognised as an extra layer of the tax burden on the peak of income taxes of businesses and individuals. However, in theory, it can be practised to replace income tax of both individuals and corporates
- The credit method called “invoice-based”. This method is widely used when officials assess VAT, and it is most popular method among them. It established that businesses charge VAT to their clients on the chain step of production & distribution. Then they pay their tax to the national tax administrations and receive back the VAT that paid on inputs.

⁴ Europol Official Website - MTIC (MISSING TRADER INTRA COMMUNITY) FRAUD

⁵ Le, Tuan Minh (2003)

⁶ (Le, Tuan Minh (2003)

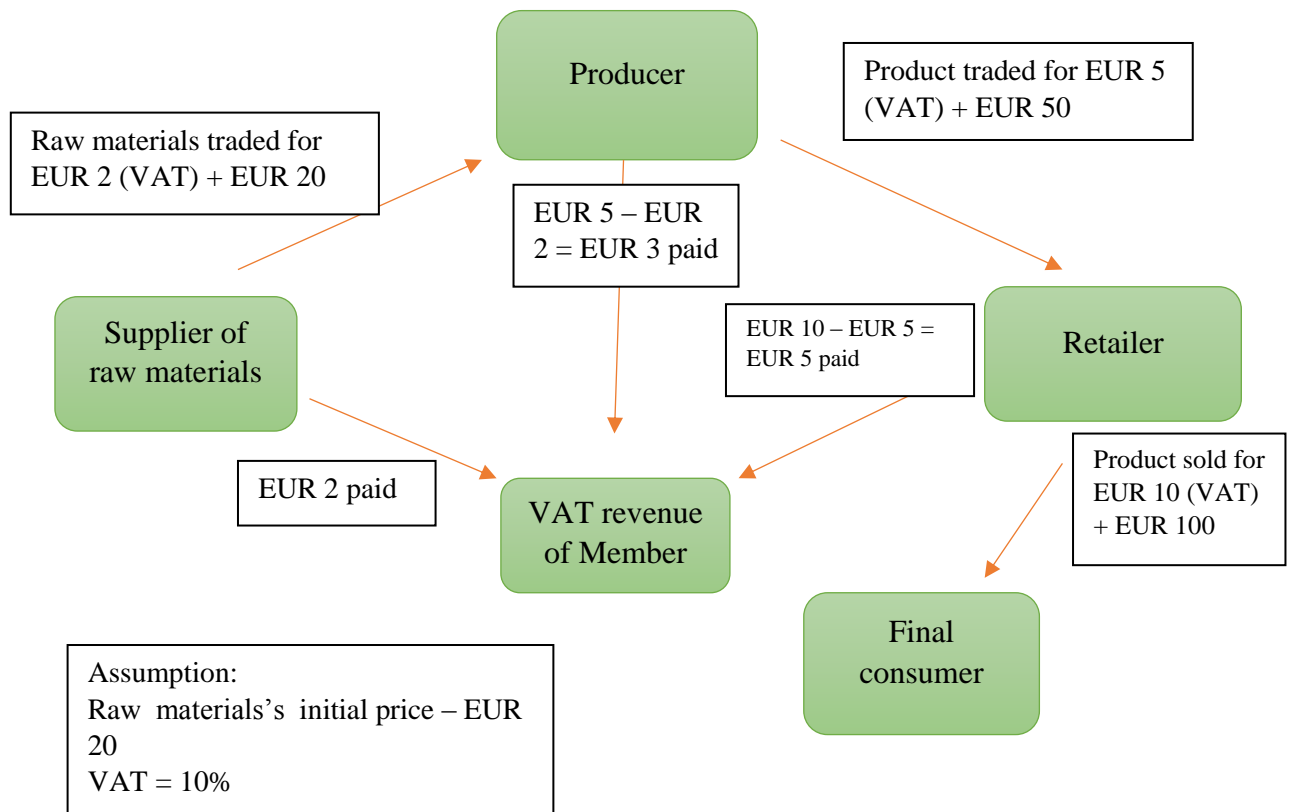


Figure 1

Invoice-based credit will be the reference point method of our study whereas the others were given as additional information. A scheme (Figure 1) illustrates the cycle of the VAT and describes the collecting process of this tax obligation at each level in the supply chain before it arrives the last customer who buys commodities or services. It is clear that the design contains a limited quantity of taxable individuals included in this distribution. The cycle is either longer or even shorter in real life.

Eventually, VAT is a significant source of funds for the national budgets of the Member States. In quantities, the weighted average rate of VAT has a significant amount in each Member State's GDP. Thus, in 1995 this VAT portion was 6.6% of GDP for EU-27, 6.5% of GDP for EU-17 and 6.6% of GDP for EU-25 while in 2010 it was only 7.0% of GDP for EU-27, 6.9% of GDP for EU-17 and 7.0% of GDP for EU-25.⁷ The rate has been almost fixed over these years, concluding that VAT is a significant and valuable source of revenue. At a European Union level, a share of the VAT acquired by the Member States has as ultimate address the European Community's budget. This is one of the main reasons why a constant process of adapting the tax rates and exceptions from taxes exists. Currently, with all the differing percentages the system is fragile to fraud.

⁷ European Parliament Factsheets, Value Added Tax (VAT)

VAT Specific Terminology

It is imperative to understand the common VAT terms in order to get deep insight into the VAT process. By knowing these terms, we can easily learn the explanation of missing trader and of carousel fraud that is one of the most famous illegal cheating act against government tax officials.

A taxable person - is usually an individual person or citizen, corporation, business which provides clients with taxable assets, such as goods and services.⁸ It is true that taxable individuals perform economic activities that refer to the 'misuse of intangible and tangible intangible resources to obtain revenue from that place continually.'⁹ Depending on the Member country, governments do not require VAT payments from some businesses.

Taxable transactions - consist of the supply of services and goods, purchase of assets within the Member States recognised as Intra Community transactions and acceptance of products from foreign countries. The supply of services involves any deal that does not fall into the category of supplying goods.

Lastly, the importation of goods comprises two types of assets - one of them enter the Community and is not in free circulation, whereas second of them are coming from a third province part of the customs area of the Community and is in free distribution. The VAT taxation steps are the fact that tax authorities can charge VAT on the commodities sold by the individual but this taxable person legally can subtract the whole amount of VAT paid on acquisitions or purchases.

The VAT rates differ among the Member States. Yet there is a rule ought to be acknowledged: the reduced rate must be of at least 5%. while a standard rate must be of at least 15%.¹⁰

Zero-rating means that tax authorities do not impose VAT for goods that are transported from foreign countries and the VAT, which paid on these goods, is deductible.

In summary, it is necessary to consider that a taxpayer can deduct or subtract its paid VAT from a transaction solely after it has subjected to VAT in the first place..

⁸ DG TAXUD webpage, General overview of VAT

⁹ Council Directive 2006/112/EC

¹⁰ DG TAXUD webpage, General overview of VAT

Charging tax on the intra-Community transaction activities

The single market, which founded on 01/01/1993, has removed boundary restrictions for intra-Community trade. Suppliers who are obliged to tax VAT allowed to use a zero VAT rate on sales to VAT-registered clients in the different Member States. In general, the VAT obligation must be fulfilled in the Member State where the purchasers consume the goods that sold. If the supply of goods are transferred to a client or directly transferred to the supplier in another Member state¹¹, in this case, it is obligatory to Member State tax authorities to give an exception from VAT obligation on the intra-Community supply of goods. In order to use this exemption, the supplier has to show that the commodities or products that supplied have materially transmitted from the supplying Member State.

For intra-Community VAT goals suppliers who want to be charged to intra-community VAT type must be recognised as a particular VAT identification (ID) and must continually inform tax authorities about the intra-community transferring activities and supplies in a short statement¹² that summarise all economic activities, and that presented to the tax officials of the supplying Member State. An electronic system (VIES) (VAT Information Exchange System) was established by the Member States, the system that contributes exchanging data about VAT purposes registrations of traders and intra-Community supplies.

Tax authorities use recapitulative statements that include the summary of economic activities of businesses, and they enter the information into the electronic VIES system database. It makes this data accessible to the tax officials in the different Member States.

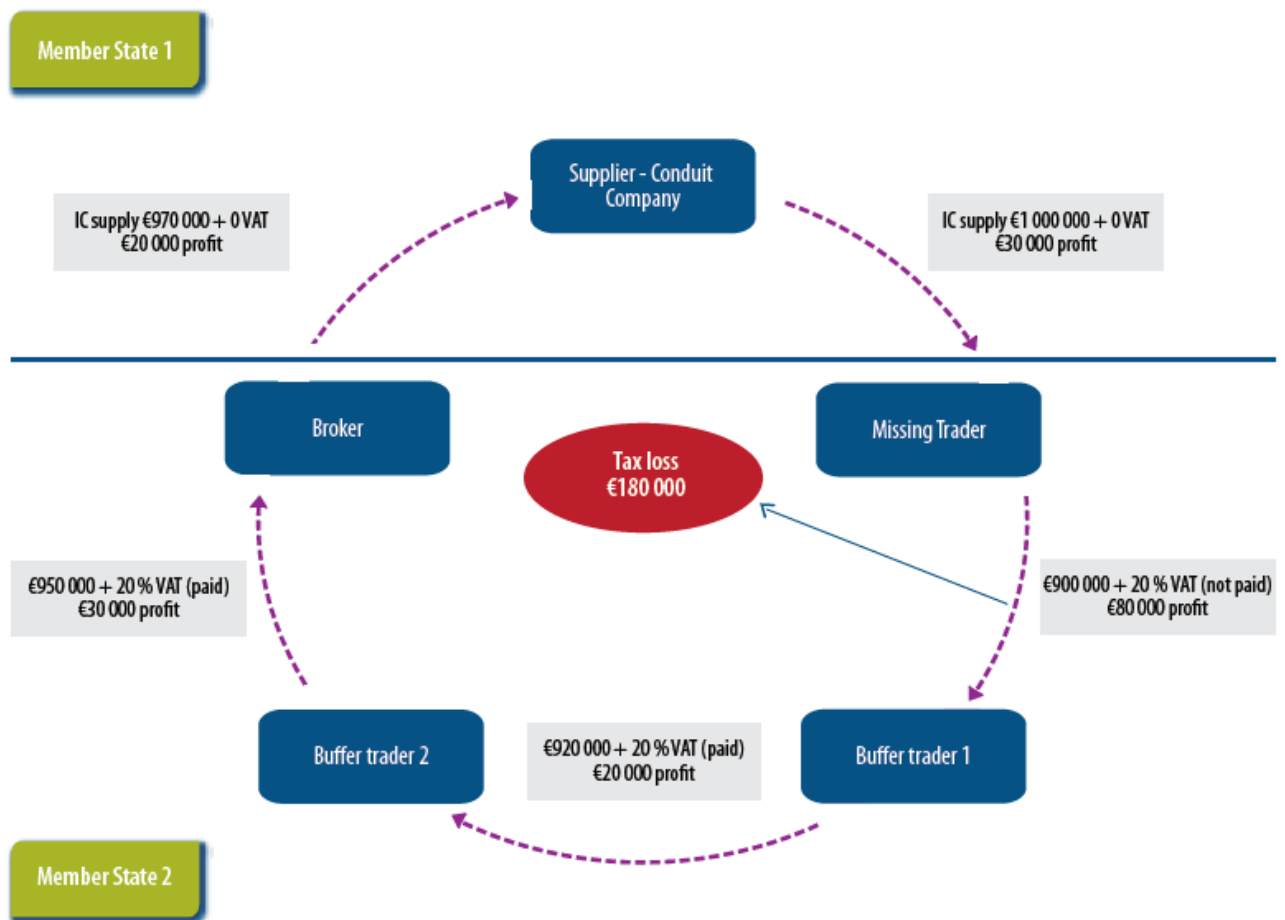
Tax officials must be informed about the intra-Community purchases in the Member State of destination, a taxable event which causes the chargeable VAT in the Member State of the last destination.

¹¹ VAT Directive - OJ L 347, 11.12.2006, p. 1

¹² A statement to be presented by every taxable person, who recognized for VAT purposes and makes intra-Community supplies. The brief statement shall be carried up each month and report the total value of assets supplied to each buyer in different Member States, registered by the identification number of the VAT. Member States may permit this report to be presented periodically (quarterly) when the value of the goods provided does not surpass 50 000 euro.

Evasion from VAT payment on intra-Community transactions

The special VAT system of the intra-Community VAT, which exist between European Union countries, has often been violated under the so-called MTIC fraud. Under MTIC fraud system a supplier, designated as a conduit or channel company, was established in Member State 1 and stores goods (with VAT exemption) to another company, designated as a missing trader and established in Member State 2. This trade transaction between the two-party is VAT-free because of status as an intra-Community supply of goods and resells the same goods in the national market of Member State 2, with lower prices than their competitors. They can do this because, although the sellers charge VAT tax to their clients, it does not pay this amount to the tax authorities; therefore they increase their profit margins due to lower tax obligations. Consequently, the missing traders disappear without any evidence that can prove their crime, and this situation makes the obtaining of tax challenging for the



state where services that are used or goods that are consumed.

Figure 2. A scheme of Carousel

As illustrated on the scheme a client of a broker (in our case: a missing trader) trades or appear as a trader/seller of goods outside of a country, seldom back to the conduit partner company, and require back from its tax officials the VAT tax that gave to the broker (a missing trader). The same transaction may happen circularly and it is therefore acknowledged as "carousel" fraud.

Carousel fraud criminals mainly focus on products that are expensive, such as valuable metals, mobile devices, computer parts, and sometimes compromise intangible items such as gas and electricity, carbon credits, certificates of green energy.¹³

Subsequently, Member States challenge to struggle intra-Community fraud separately. Therefore they must work collaboratively with the tax officials of the other EU Member States and non-EU nations in order to achieve to figure out this problem

The International VAT Regime

Besides the domestic sale transactions, there were also transactions occurring between the borders of the Member States, it became necessary to settle on the taxation policies of such processes. Before 1993, the EU used a temporary approach of charging taxes on the supply of goods in between taxable individuals according to the "destination" policy, intending where the clients consume goods that they purchased. With control of the customs administrations shipped products from another Member state were taxed at the borders and a VAT credit were suggested for the goods enrolling the production cycle. When exporting goods to deliver another state, the VAT would also be refunded while the border officials could verify whether the goods or products indeed left the national borders.

During the formulation of the single market in 1993, the controls at the taxation boundaries were removed and the "origin" system established for taxation. An "origin-based" tax refers to a specific tax rate which is determined based on origin country's tax rate. For example, Tokio is a place where the origin-based sales tax is imposed. So if any company transfer products from Louisiana, where current Sales tax is 4 percent, a customer in Tokio would have to sales tax which is 4% and on the transferred products. Currently, only a few states use this taxation method.

¹³ House of Lords, European Union Committee's 12th Report of Session 2012–13 'The Fight Against Fraud on the EU's Finances', box 4, p. 22

This proposal was not embraced by the Member States as they recognised their VAT rates too different and unique, and there was no proper policy to reallocate the VAT declarations to present the actual use.¹⁴

Therefore the Commission introduced forth the ‘Transitional VAT System’ that admits different taxation systems but holds the controls at the frontiers removed. This transitional policy includes both approaches as it separates the sales to taxable and private individuals. In this system, private persons would meet the tax obligation everywhere in the Member States and could deliver goods to their home country without demanding to pay extra VAT. (specific exemptions employ as for the acquisition of new ways of distance sales and transportation)¹⁵

Taxable individuals still use the destination system and must present the VAT number of their clients that are placed overseas to be suitable for the VAT discount that they are demanding. Consequently, the customs control has changed from the physical control of products and delivered items at the state borders to an accounting control. These individuals are required to include a self-evaluated VAT and involve a credit simultaneously to appear with no VAT obligation or VAT receivable (except for VAT exempt merchants).

This system is motivated by anxieties on the side of the high VAT nations that they would drop their businesses against the low VAT nations.

Right of deducting

General Deduction

Till commodities reach the ultimate clients in each following step of the selling series the products are charged to VAT tax with a deductible amount. VAT is decreased by deducting a certain amount (called as a deductible VAT) from the VAT due in the normal VAT return presented to the tax administrations.

Individual taxpayers or tax chargeable companies that registered as VAT payer add up the whole amount of VAT tax which VAT input suppliers imposed them in EU as an intra-community trade or inside their Member State.

Later these taxpayers sum up the whole amount of VAT tax that they have imposed clients (the amount of the responsibility of supplying delivered goods), netting off the

¹⁴ DG TAXUD webpage, General overview of VAT

¹⁵ DG TAXUD webpage, General overview of VAT

two amount just making a payment of an amount of the difference to the tax officials. When an amount of input VAT amount is excessive, refund option is available but ultimately it is restricted by special obligations. Then officials conducted the right of deduction through periodical VAT return.

If this deduction option is not available for taxpayers, a selling cost of goods will influence to taxpayers. Still, the last consumer should apply this selling expenditure. The taxpayers' deduction right can be performed if a deductible amount becomes chargeable.¹⁶

According to Articles 168 -172 the VAT directive approve whether taxpayers can retrieve a refund and have a right to deduct tax. Articles recognise that these right of taxpayers are equal in practice because both of them are connected with the chance to retrieve input VAT.

Allowed to demand a refund is the tax chargeable person not placed in the EU or placed in any other Member State. A refund may also be demanded when the output VAT is exceeded by input VAT. Respectively, if it does not exist or happen, it will, in fact, appear as a refund.¹⁷

General Conditions

VAT directive gives the deduction right to taxable individual or company when the deductible tax practices as chargeable according to Article 167. In this case, a taxable individual or company must satisfy the requirements to provide their demand for input VAT deduction.

Presented in Article 168 that the goods are employed for transactions that are transactions, a taxable person is allowed to subtract input VAT linked with supplies of services and goods, intra-Community purchasing of assets and importation to those member countries where the transaction agreements occur.

There is a possibility that supplies are obtained from other Member states or seller's own country or from outside the EU. The seller may solely demand input tax deduction when the deduction is associated with goods that used for sale as seller's

¹⁶ van Bael, & Bellis, 2003, p. 208

¹⁷ van Bael, & Bellis, 2003, p. 209

commercial business purposes. Particular output and input transaction must be straightly associated for the taxable person to be credited with VAT deduction.¹⁸

Otherwise, the taxable person is not allowed to deduct the input VAT. Besides this person have to be able to prove that they have satisfied the requirements for deduction.¹⁹

If these terms and conditions are not fulfilled, the taxable person cannot attain the deduction right. As it is obligatory to meet specific requirements to achieve to have the right of deduction into use, according to Article 178, usually this beneficial right is confirmed by statement constructed and created accordingly to the VAT directive. Consequently, If merchants purchase goods from outside their own country within EU, they must present the details of the commercial activities on their VAT returns and retain a duplicate of the statement concerning that acquisition as declared by the VAT Directive. According to Article 179, the taxable merchants subtract this input tax as they subtract other input tax from the total VAT amount charged clients in the period of VAT taxation.

Nonetheless, two requirements must be met in order to have deduction right during a particular tax period.

- 1) A statement or a written agreement equal to a statement approved by a member state must be received by the taxable person
- 2) An occurrence of delivering goods or products²⁰

When the deduction exceeds VAT amount, the member state is able to decide to transfer the surplus to the following period or make a repayment. As introduced in Article 183 of the VAT Directive, the member state has an option to diminish that refund payment amount or a forward transfer when there is an unsubstantial quantity.

Restrictions (Limitations)

As restricted by Article 173, when purchased goods are disclosed in agreement statements with non-deductible and deductible VAT, a taxable person can only deduct the allowable deduction amount of VAT in these transactions. The costs, which are not allowed to deduct, are specified by the Council and the Commission.

¹⁸ Judgement of the Court (Second Chamber) on 8 June 2000 in Case C-98/98, n.d., p. 4210; Judgement of the Court (Fifth Chamber) on 22 February 2001 in Case C-408/98, n.d., p. I-1388

¹⁹ Judgement of the Court (Second Chamber) on 14 February 1985 in Case C-268/83, n.d., p. 665

²⁰ Judgement of the Court (Fifth Chamber) on 29 April 2004 in Case C-152/02, n.d., pp. I-5610 and I-5611

VAT Directive declared those exceptions on Article 176, adding entertainment, recreational costs, luxuries and related expenditures which retain severe business personality shall not be allowed to have a right of VAT deduction.

However, till the principles mentioned above become useful, the member states can keep the prohibitions established in federal legislation. Sometimes some goods are eliminated from deduction system by member states because of specific periodical economic reasons after consultation with VAT committee.

These time-constraint measures were given to member states to make them ready to deal with temporary conditions in the economy, such as economic downturn or any other short-term economic fluctuation.²¹

From Articles 370-396 it is inferred that until the explicit approval of settlements member states can apply some derogations. Joining the EU before or following 1978 has also an effect when determining and employing different rules in this case. Since the extent of tax burden is affected by the restrictions on the deduction right all member states equally and systematically have to espouse these restrictions. The right of using derogations is allowed merely if it is apparently stated in the VAT Directive.²²

Council Regulations on Administrative Cooperation and Combating VAT Fraud

Council Regulation (EC) set out general procedures and principles for regulatory collaboration and data transfer between tax administrations to practice collecting VAT correctly and to resist fraud criminals. According to Article 1, this partnership between Member States' authorities targets:

- Proper VAT assessment
- Control of proper VAT application
- Protection of VAT revenue
- Combating frauds

It is stated in Article 2 that each member states must allocate a particular central contact office as a connection point for partnership with other states and the Commission. In order to share information directly, governments may also designate tax officials and liaison departments whose main function is to inform central liaison office in case of occurrence of the assistance applications that they received. If there is a request received outside of the operational area, it must be sent to the central contact office.

²¹ Judgement of the Court (Fifth Chamber) on 8 January 2002 in Case C-409/99, n.d., p. I-124

²² Judgement of the Court (Fifth Chamber) on 8 January 2002 in Case C-409/99, n.d., p. I-81

Operation of organizational collaboration to combat intra-Community VAT fraud

Since the single market removed border controls on intra-Community sales, Member States depends on the data obtained from the other Member States interested in an intra-Community trade to be able to collect VAT taxes in their area. Member States exchange this information using the regulatory partnership arrangements presented in the EU legislation.

This law lays down the regulatory cooperation as follows:

1. Eurofisc network - a network system for sharing targeted data among Member states about trader suspects and related problems. The primary goal of this network is to support the multilateral partnership in combatting VAT fraud in the different Member States. This network is decentralised and performs as a partnership framework without judicial character.
2. Exchanging the data on requests and information without earlier application using the standard forms supported by the Standing Committee on Administrative Cooperation – SCAC.
3. MLC Controls or Multilateral Controls that handled at the same time in two or more Member States and the attendance of tax executives in the other Member States. These controls admit tax officials to get entrance permission to documentation held or to audit continuing enquiries.
4. Sharing data via the VIES electronic database

Information-exchange networks, multilateral controls, relations and working visits, training and related activities combatting VAT among the Member States - all these activities are supported by Fiscalis programme. This programme's primary aim is to improve the general functioning of the taxation operations or processing collecting tax from businesses and individuals in the internal market by promoting partnership and collaborate assistance among participants, their officials and administrators.

The purpose of the audit was to measure the effectiveness of struggling with VAT in EU.

In order to find it few questions have to be answered:

(1) Are the Member States collaborating efficiently to combat intra-Community VAT fraud? In order to find an answer, we questioned whether there were correct methods or mechanisms for assuring adequate communication of the essential data and administrative cooperation inside the Member States and among the officials of Member States.

(2) Are the means or tools used adequately to eliminate VAT fraud activities in EU and are they enough to solve VAT fraud issues? Answering this question requires to find answers to related questions as follows:

(a) Whether the Commission had made a reliable evaluation of the amount of fraud in this field, and whether it had established appropriate achievement indicators, so that the extent of the problem and the effectiveness of the regulative and control measures, which were employed to defeat it, can be evaluated;

(b) Whether the Commission had established adequate legislative partnership agreements among the Member States thus VAT information could be transferred and shared between tax authorities;

(c) Whether the Commission had provided to establish a regulatory framework in good quality by setting up relevant legislative plans, which are likely to cause a decrease in the amount of VAT fraud in the Member States.

Exchanging information

As Council Regulation provided in Article 10, the requesting authority sends requests for information and administrative inquiries to the body receiving the application making use of standard form. The following must give the information without retardation and at the ultimate three months after the taking date of the application request. If the respective authority already has the date inquired, it is obligatory to send it the ultimate one month after the date of reception.

Without the need for any prior applications, as stated by Article 13 of the Council Regulation, the tax authorities must automatically provide each other with some kinds of information, being in a standard form, must be presented automatically by tax officials without any earlier application when:

- there is a possibility of losing tax revenue of member state governments
- the assumption exists, which suggests that there is a possibility of committing VAT violation or there is a risk that it may occur in a member state

- data from the member state of origin is necessary for the control system of the member state whose authorities will charge tax.

Following to Article 15, other valuable information, which were not provided automatically, have to be shared immediately by the tax authorities. For sharing information, receiving body can be inquired for feedback from other officials. According to Article 1, information should be sent by electronic means as much as possible. In Article 52, it is stated that the provision of data can be rejected if:

- there is a prohibition to collect and use the asked information in the requested member state.
- it is against public policy, or it is vulnerable to use it because of the danger against commercial, professional and industrial private data.
- the extent and the characteristics applications within a particular period from the demanding authority overload the administration;
- the common origins of data have not been consumed by the demanding authority;
- for the reasons in the enactment, the demanding member state cannot present alike information;

In order to transfer valuable data, according to the partnership agreement between data requesting and requested authorities, as provided in Article 28, the Council Regulation presents that bodies of the past may be present at the offices and have entree to get duplicates of documents including the information inquired.

These tax executive can also enrol in regulatory examinations implemented in the inquired member state. However, they cannot manage investigation discussed in the hosting officials. Member states can choose to perform concurrent controls, as stated in Article 29 if this is more suitable in comparison to controls implemented by an individual member state. As stated in Article 31, The Council Regulation sets specific requirements regarding the specific scheme for non-established taxable individuals, that supply non-taxable ones with automated services.

Storing information

The data which is contemporary must be stored in an electronic system by member states for an at least 5 years from the end of the first calendar year in which access to it is permitted. These information types are as follows:

- information about wrong VAT license or identification numbers
- information is given in the summary statements (called as recapitulative) presented by taxable persons recognised for VAT purposes;

- the data on non-established taxable individuals
- data on individuals to whom the VAT identification numbers were given

Cooperating on VAT refunds

Under the Council Regulation's Article number 48, the member state's tax authority address requests for VAT refunds which it gains from tax chargeable individuals found in a different member state to the payment concerned member states' tax officials. After getting the application, tax officials must finish the process electronically earlier than 15 days. The Member States' tax departments of the refund must inform the officials of other member states electronically if they need further electronic coded data on services as well as the nature of the claimants or if they want the applicants to present a representation of their financial activities by applying harmonised codes.

Collaborate assistance with non-EU countries

Providing the support agreements with the non-EU nation in tax problem permit it, following Council Regulation's Article number 50, the tax administration of a member state send the data which received from that state to member states which ask for it as well as to any other member state that may concern or be interested in it. The tax officials of member states can transmit data to non-EU countries if the:

- the non-EU nation in question has allowed co-operating in collecting proof of unusual transactions that resemble to violate VAT enactment.
- the member state from where the data arises permissions.

Collaborating on VAT refunds

Aside from specific exceptions, according to Article 48, it is known that the member state's tax authority send applications for VAT pay-back, it gains from individuals who have a tax obligation and are in other member states to the tax administrations of payment concerned. This process is also implemented less than 15 days electronically after getting request.

The bodies of the member states of payment must also inform other member states' bodies electronically if they want further encrypted data on applicants and their characteristics and services or if they demand the report on taxpayer's business activities by utilising harmonised codes.

VIES

The system used for transferring the data between EU countries and called as VIES has a necessary impact on tracking transactions and cooperating with tax administrations within the Member States.

As the practising of retaining custom controls at internal EU borders ended with establishing single market since 1 January 1993, a brand-new VAT controlling system was presented for Intra-Community trade activities that are chargeable to tax. This change significantly affected businesses by diminishing their legislative burden.

As stated by the new VAT system, within EU when the supplier delivers goods to a taxable individual in another state and who will account for the VAT tax these intra-Community supplies are removed of a VAT tax. A taxable individual (in this case - purchaser) should be presented the chance of a brief insight into the information concerning customers from other states. This information comprises, for instance, VAT identification numbers, name, issue date, address and VAT registration details of its dealers etc. and is collected in an electronic database. This data is controlled by every tax authority.

An electronically automated system has been installed to provide uninterrupted data flow along the internal boundaries, and this system - VIES allows:

- tax authorities to monitor the progress of intra-Community trade and to check whether or not inconsistencies exist
- businesses and corporations instantaneous access to the VAT numbers of good exchanging partners

In each Member State, there is a Central Liaison (CL) Office that has a supervisory and regulatory function on intra-Community trade activities. Through VIES, it is granted instant entrance to the electronic database of different Member States, accessing the VAT registration data of those states. Via VIES, it is provided with immediate access to the VAT registration database of other member states. VIES is of great importance for many reasons. First, it is a tool that allows monitoring the validity of claims with a zero rating in member states. Additionally, it assists to know unreported intra-Community supplied products or materials. Finally, VIES system provides these states with operational verification of VAT registration numbers.²³

In suspicious cases, the efficacy of the clients' VAT number can be verified and checked with the assistance of VIES. Individually member states are required to collect trade data with other member countries from its suppliers within the

²³ VIES and Intrastat Traders Manual, 2011, p. 6

community. As a result, All registered traders who trade with a zero rating to a seller registered for VAT in another Member State are required to submit a VIES application, including the cost of the sale.

Detailed data on the supply of goods within the Community, as well as the above-mentioned applications, must be submitted to the tax authorities of each Member State. Applications of the VIES must be submitted quarterly. If more relevant, larger companies are allowed to do this monthly, and smaller companies are allowed to do per year. However, VIES has a disadvantage. Some months' postponement limits continuous and constant control of different transaction amounts.²⁴

In intra-EU trade, the VAT number is of high importance. If the trader wants to determine for refusal or exception from the VAT, this depends on the validity of the VAT identification number of trader's customer. Hence, it is necessary that the VAT number registry is renewed regularly, accurately and assuredly. Since traders are not correctly notified about the VAT of business associates, they may similarly detect themselves in a situation in which the tax authorities ask them to recover VAT.²⁵

Regarding to this, any bad consequences of misleading information and obsolete data contained in the registers of Member States should be subject to the obligation of the Member State. Timely elimination of inactive VAT numbers of taxpayers who are no longer employed in economic activities, and those who are considered missing, is an indispensable stage in renewing the registries. By doing that, traders will be able to trust these data when deciding whether to do delivery with zero rating.²⁶

Despite the fact that VIES is a useful tool for regulating and managing data on transactions within the Community, it does not work quite well. Since its introduction, inadequate changes have been made. Therefore, the Commission is considering the change VIES to VIES II, that will allow the Member States to improve and strengthen intensive data administration and control transactions.

VIES proved to be ineffective in fighting against fraud with carousels since it requires at least three months after the written agreement - the transaction which made it obvious and available to the Member States. Such a long-term period of time allows fraud with the carousel in such a way that it enables scammers to escape from and avoid sanctions. In addition, the complete system of VIES is based on data presented by taxable persons. Sanction measures to provide incorrect and incomplete data and other violations about the delivery of information now have been inadequate. Instead of the current VIES, the Commission intends to provide a more modern, faster,

²⁴ VIES and Intrastat Traders Manual, 2011, p. 9

²⁵ European Commission, 2007, pp. 9 and 10).

²⁶ European Commission, 2007, p. 10

accurate and efficient information delivery system. Also, the new system should also diminish the expenses of taxpayers.²⁷

²⁷ European Commission, 2004, p. 10).)

TYPES OF VAT FRAUD

VAT fraud is committed thousands of times each day in member states. Tax fraud or discrepancies can take many classes. There are some examples of cases shown below regarding fraudulent taxation problems. Current EU legislation can determine the way in which this practice can be performed at a specified period. Many sorts of these practices were improved after the introduction of the sixth modified EU directive, which entered into force on 1993 January 1st.²⁸

Some examples of VAT fraud - MTIC and Carousel Fraud are described below.

As provided in Commission Regulation's (EC) Article 2 No 1925/2004 of October 29 in 2004, which sets out comprehensive rules and commands and for the implementation of some provisions of Council Regulation (EC) No 1798/2003 on regarding legislative assistance in the field of VAT²⁹ a seller who registers VAT as taxpayer and who, with possible fraudulent purpose, acquires or intends to obtain services and goods without VAT payment and delivering these goods or services with VAT without paying this VAT amount to the national tax authorities, it is recognised as a missing trader.

As its name implies, MTIC fraud comprises two elements: the missing salesman or a trader and the supply within the Community or so-called intra-Community. There are two classes of MTIC - acquisition fraud and carousel fraud.³⁰

Acquisition fraud

Purchase fraud is commodity-based fraud where goods with a nominal zero-rated value for VAT objectives are acquired from a supplier located in another Member State and traded in the Member State of the client for private consumption. The purchaser called the "missing trader", can not afterwards send or pay the VAT that it has imposed on the standard taxable supply to its clients.³¹

The fraudulent purchase method is displayed below in Figure 3. The name "acquisition fraud" typically indicates to the following procedure. Company B, listed as a VAT taxpayer in State B, is involved in fraud as a missing trader. This trader purchases goods from a supplier located in another State A (Both states are the Member States), and then resells these goods, usually to the retail store, either through a retailer or directly.

²⁸ Aronowitz, Laagland, & Paulides, 1996, p. 7

²⁹ Official Journal of the European Union, L 29/14

³⁰ Court judgment (Third Chamber) of 11 May 2006 in C-384/04, n. D., P. I-4222

³¹ What is VAT fraud? Examples of different types of VAT fraud, 2011

After the executive agreement - a transaction, Company B ignores the payment of VAT in respect of its future deliveries. Similarly, it is also believed that fraudulent acquisition is a situation where Company B incorrectly shows itself as an operative business which is VAT-registered, but truly missed the VAT number.³²

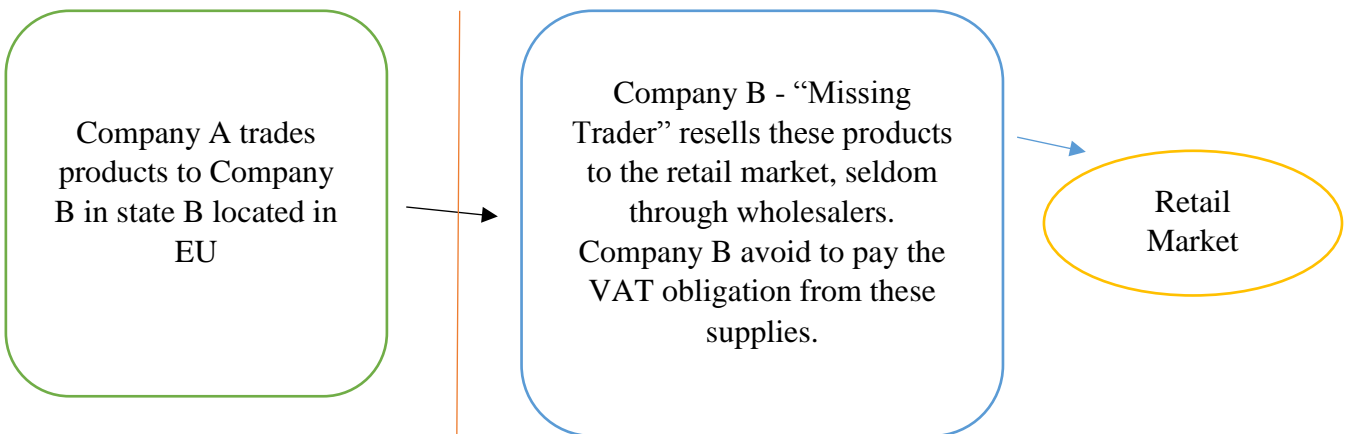


Figure 3. Basic scheme of acquisition fraud

Source: H. Andersson & K. Franzen, *VALUE ADDED TAX. The right to deduct in case of carousel fraud*, 2008, p. 23.

Carousel fraud³³

A carousel fraud is a type of financial cheating associated with improper use of the VAT system, which leads to fraudulent revenue extraction from the treasury of EU. It can include any sort of goods or services with a standard rating. Like in the process of acquisition fraud, goods or services are purchased with a zero rating from the EU, when the acquirer then disappears without taking into account the VAT due on the future supply.

However, goods or services are not available in Member A for using; in this country, these goods and services are resold many times through various companies before final dispatch and shipment, causing a repayment to EU supplier in the Member State A or to the exporter from the tax officials. The above-described process can be happened repeatedly handling the same goods or products. In this case, this process is called Carousel cheating or Carousel fraud.³⁴

According to another explanation, carousel fraud is when "the same goods move inside the Union from one country to another and back repeatedly, without arriving

³² Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. I-4222

³³ Carousel fraud is explained in next chapters in more detail

³⁴ What is VAT fraud? Examples of different types of VAT fraud, 2011

the consumer or last user".³⁵

In contrast to fraudulent acquisition, the strategy of this fraud has the following features. Company A, based in member A, trades the goods to company B or the named as missing or absent trader, based in member state B. Subsequently, the missing trader trades again these goods to buffer company - Company C. Nonetheless, during this process, Company B or the missing trader fails to take VAT into account.³⁶

Company C - a buffer company in this process, may be entirely unsuspecting to its participation in fraud and sell again its goods to different buffer company at a higher price. Only when the goods are ultimately resold to company that recorded as a VAT taxpayer in another Member State, this sort of supply chain is disrupted. In some real carousel fraud practices, this final sale is even committed in member state A by company A. This is a sale of a terminal with a zero -rated due to exportation. Nonetheless, the trader still has the right to input a VAT deduction. The EU supplier attempts to restore the input VAT from the tax officials.³⁷

Afterwards, the amount of payment is sent to the exporting company by the tax officials because of the VAT requirement. This payment is the VAT levied on the sale by the former buffer company - company C. Still, the amount charged as VAT tax payment on Company B is not involved in this payment. Later the fraud may arise again, and the process the VAT payment given to company B or the missing trader is originated from state revenue.

The possibilities includes that may be hijacked missing traders utilise VAT numbers, or they register VAT before disappearing. Thus they hinder authorities' actions includes taking appropriate measures.³⁸

Contra trading

Fraudsters' participation in 2 different sorts of transaction series in the same VAT period for the purpose of preventing authorities from recognising an MTIC fraud forms a new evolutionary form of carousel fraud - a contra-trading fraud. In this fraud process, one chain's output VAT is intended to compensate or balance the input VAT occurred in the other chain.³⁹

³⁵ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. I-4222

³⁶ Opinion of Advocate General Poiares Maduro delivered on 7 December 2005 in Case C-384/04, n.d., p. I-4200

³⁷ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. I-4223

³⁸ Opinion of Advocate General Poiares Maduro delivered on 7 December 2005 in Case C-384/04, n.d., p. I-4201

³⁹ What is VAT fraud? Examples of different types of VAT fraud, 2011

These two sorts of transaction chains are as follows:

- "contra-chains", when the same taxpayer purchases goods from another state and trades them in state A, representing itself as a buyer and creating an output tax obligation from the onward trade in state A

- "Chains of tax losses", when the taxpayer takes on the input tax on purchases in state A and performs zero deliveries of these goods to customers in other states (both states are member states)

"Bogus trader" is an additional way to name missing trader. In the initial stage, missing traders register for VAT legally. Subsequently, they make fraudulent requests for repayments from authorities. These payment claims are received and implemented by tax authorities after these bogus traders miss.⁴⁰

The difference between acquisition fraud and carousel fraud

The principal difference between these two frauds is that in the case of acquisition fraud, taxable individuals are unlikely to participate in organised groups, usually disappear and leave the market. Moreover, in many practices organized criminals usually give financial assistance to the businesses that participated in carousel fraud. Their conventional method is to ensure quick and straightforward incomes, generally for young people who must in return claim to be executive delegates of an organisation that disappears after some operations in the marketplace. This fraud type is known with its missing traders who replaced without any effort and delay.⁴¹

⁴⁰ Cnossen, 2010, p. 53

⁴¹ Needham, 2006, p. 7

CAROUSEL FRAUD

General characteristics and operation

In the UK, the two terms - "MTIC" and "carousel fraud" indicate particular sorts of VAT fraud. In its intention to levy VAT on purchased goods from other states, it uses the zero-rating of deliveries within the Community along with the system called "deferred payment". As provided in the latter, when goods purchased from another Member State cross the border VAT is not collected (because of the removal of fiscal boundaries between the Member States), however, it is obtained in the next periodic VAT refund, as indicated in the legislative changes in 1992.⁴²

As mentioned in Chapter 3, VAT is 21% of the total year-end revenue of member states or 7.5% of their GDP on average for the period 2000-2011⁴³. Its regular rates vary from state to state, beginning from 17% ending to 27%. Of course, its significant cash flow attracts numerous traders who are engaged in trading in the shadow economy. At the first time, carousel fraud occurred in the transactions between Netherlands and Belgium in the 1980s years. " At present, this is a widespread crime, which is difficult to oppose. The estimated calculation of this fraud was GBP 1,12 - 1,9 billion in the UK in 2005 and 2,1 euros in Germany (A tax net full of holes, 2006) Carousel fraud is tended towards trade with highly valuable and low-volume consumer products, especially technical and electronics products. Detection of fraud by the tax administrations normally lags behind, as fraudsters often disappear after they have completed their business activities.⁴⁴

After a successful beginning agreement, carousel fraud can sustain itself financially and also grow and expand. With the accumulation of income, fraudsters in carousels can settle and organise new cheats. As a rule, this is implemented with the contribution of "business loans" from individuals who have already engaged in the chain. This is the main reason that carousel fraud cannot be equalled to any other traditional kinds of crime in which an already-engaged product has a predetermined concrete market for sale. The main goal of the carousel fraud is to deceive the VAT authorities by keeping VAT as long as practicable, placing the goods in circulation several times. This commerce of products is carried out only inside the carousel. Here the volume of a VAT and the value of the products in a subject are proportional; the higher the price of products, the higher the proportion of the VAT that has been stolen. Groups in carousel fraud are not competitors, and to make such a complex constitution prosperous, their collaboration or partnership must be extremely high. A request made in the UK on modern carousel tactics intends that criminal combinations

⁴² Keen, & Smith, 2006, p. 861)

⁴³ CASE & CBP, 2013, p. 11

⁴⁴ Van Brederode, 2008, p. 32

give and borrow money each other when using companies and their goods. This means that these illegal associations support each other and have the experience and means to efficiently participate in fraud.⁴⁵

Simple VAT carousel

One of the most straightforward methods found in the MTIC fraud class is that the trader does not transfer the tax levied on their transactions to the tax officials. Over the preceding few years, the EU has suffered much more devastating practices of this fraud, which do not straight target the Community. Alternately, it is aimed at juridical acts suggested by the Member States in order to promote cross-border trade in the EU. These four factors as follows are in favor of this fraud⁴⁶:

1. The system of deferred payments, which allows you to pay VAT, periodically contributes scammers to have quiet time for their escape or disappearing
2. The rise in goods with low weight and high value, which allows sending high-value goods economically and without problems (hassle-free)
3. In cross-border trade within the Community, the zero rate taxation. This allows not to pay VAT on products acquired by buyers from other member countries, even if they eventually charge VAT on sales, as normal.
4. VAT that has previously been paid to salespeople can be recovered by dispatchers and exporters. As a result, revenue authorities are required to have significant financial hurts after they have reimbursed payments for earlier unreceivable payments.

The identical dispatching of products is periodically sold between corporations that were created specifically to carry out this project. This sort of fraud was called "carousel fraud" because of this circulation of commodities. As a criminal activity, MTIC fraud is pretty straightforward to perform after the shell corporations were created. Eventually, only one opening investment is required to guarantee the constant circulation and with this continuous income. In spite of the fact that MTIC is also being committed to trading from states outside the EU, it is significantly profitable in dealing with a zero-rating occurring in the Community. By the incoming trade, goods enter the EU in certain Member State, although their final address is in different Member State. Once Community Transit controlled them, goods can move without taxation within the boundaries of EU. The origin of these goods becomes anonymous still before arriving intended destination because of their assortment into little and

⁴⁵ Financial Action Task Force, 2007, p. 3

⁴⁶ European Union Committee, 2007, p. 10

many different consignments. As a result, traders do not pay any Common Customs tariff for them.⁴⁷

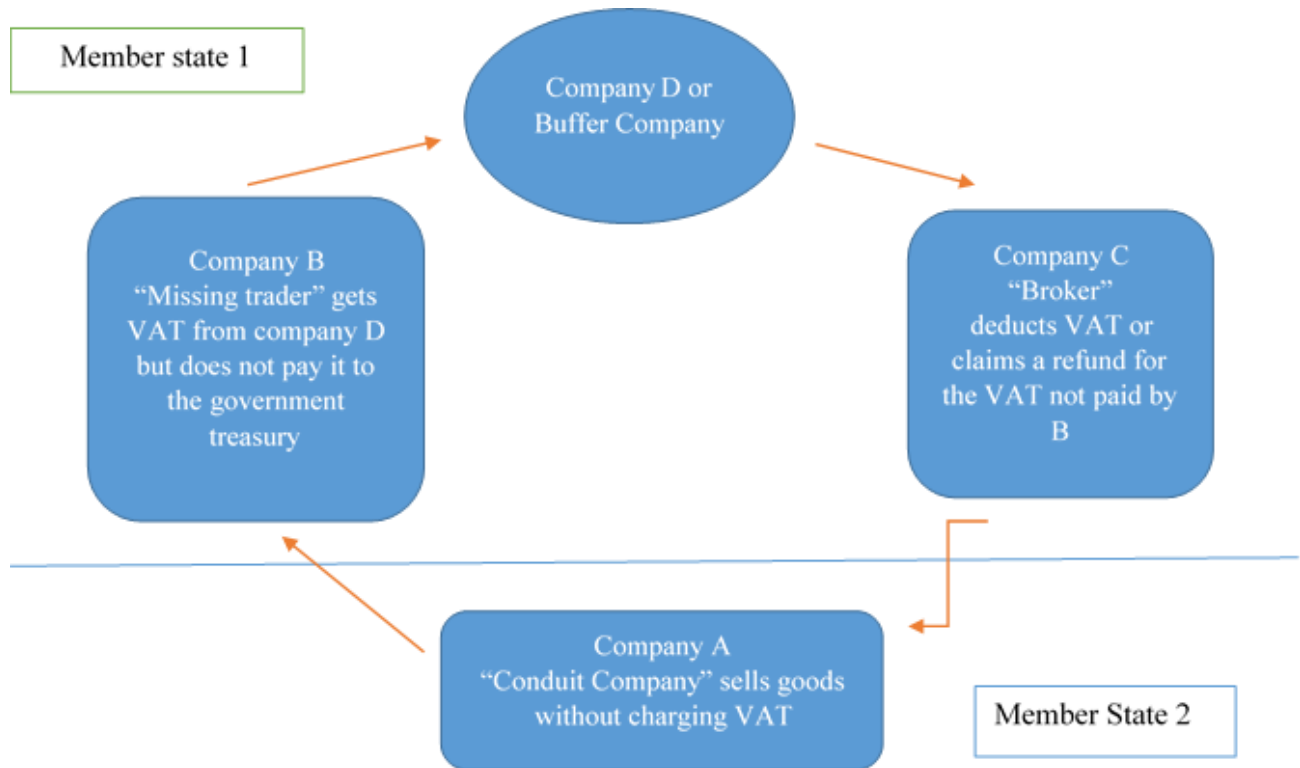


Figure 4. Mechanism of Carousel Fraud⁴⁸

Figure 4 shows an elementary design of carousel fraud, describing how the so-called "conduit or channel company" (A)⁴⁹ provides the "missing trader"(B)⁵⁰, who is in a different state with the exception Intra-Community supply of products. A "missing trader" acquires goods without paying VAT and ultimately contributes a third "broker" company (C)⁵¹ - with a domestic supply (VAT + a price). A missing trader receives VAT on sales to Company C without VAT payment to the Treasury and, therefore,

⁴⁷ Committee of the European Union, 2007, p. 10

⁴⁸ European Commission, Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud, 2004, p. 6.

⁴⁹ A dealer who purchases products from a certain state and directly sells them to another state is named as a "conduit" trader/company (Financial Action Task Force, 2007, p. 25).

⁵⁰ A "missing trader" is a business or a person that assists VAT theft activity, just not taking it into account. It usually follows in the beginning stages of the series and is usually registered as VAT taxpayer at a place of residence. Directors are either nominal directors (who have a right but no real authority) or their titles are fake (Financial Action Task Force, 2007, p. 25).

⁵¹ A "broker" is a vital agent in fraud and appears as an exporter at the final stage of the trade chain. Brokers purchase products from a buffer, and, to obtain a VAT refund, sell products to other countries. Seldom they can be connected in different chains of carousel transactions (Financial Action Task Force, 2007, p. 25)

disappears. Then the refund of VAT on acquisitions from (B) is inquired by the "broker" (C). As a result, the VAT expense paid by C to B takes into account the financial losses of the Treasury. Ultimately, an exempt intra-Community deliver to company A can be announced by company C. Moreover, company A then is able to gain another VAT-free intra-Community supply to company B. This a functioning of the "carousel fraud" model which happens and repeats again and again.⁵²

For distorting or misleading VAT examinations, goods will frequently be shipped from (B) to (C) through intermediary organisations named as "buffers"⁵³. These organisations create a gap between a missing trader and a broker, buying and selling products, and therefore, they take VAT into account, which makes transactions as official⁵⁴. It may be that the buffer does not know about fraud, but usually, it realises that it is involved in an uncommon transaction type (due to the unique nature of the business transaction)⁵⁵

Usually, criminals stop trading solely in the event of a significant interruption. Despite the fact that the goods most frequently physically remain in the same place throughout this process, their ownership will alter many times⁵⁶. In some severe practices, the assets never really existed, although criminals sent and received receipts⁵⁷. In use, these sorts of cheating are established in a complicated way across many states and several organisations in every Member State.⁵⁸

⁵² European Commission, 2004, p. 6

⁵³ A "buffer trader" is another company involved in the chain, whose purpose is buffering and remote relationship between the exporter and the missing trader. If the "missing trader" sales directly to "exporter" - broker, the presence of an "exporter" is threatened; all activities are associated with enterprises without tangible assets and identifications (Financial Action Task Force, 2007, p. 25).

⁵⁴ Financial Action Task Force, 2007, p. 23

⁵⁵ European Commission, 2004, p. 6

⁵⁶ Financial Action Task Force, 2007, p. 23

⁵⁷ Financial Action Task Force, 2007, p. 21

⁵⁸ European Commission, 2004, p. 6

VAT carousel with third-party use

In their desire to succeed defensive efforts against fraud, criminals can be extraordinarily ingenious and intelligent.

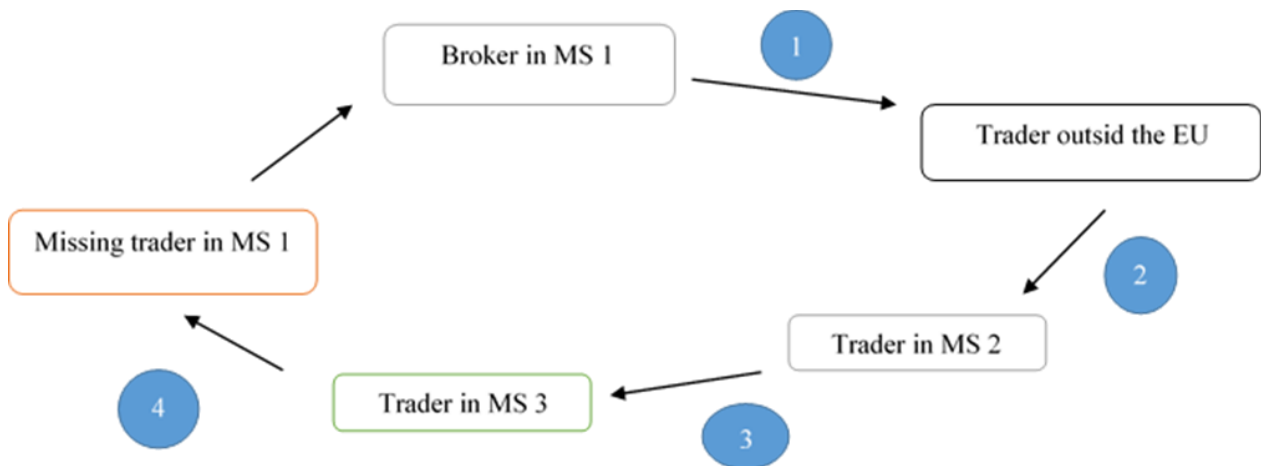


Figure 5 - VAT carousel using a third party⁵⁹

As provided in Figure 5, one way to avoid tracking them is to distribute goods to non-EU states. This implemented by export shipping products from the EU to conduit companies located in customs free zones or export processing zones (EPZ) in non-EU states. In this system, dispatching can pass through many cable conduit companies located in the EPZ of a country outside the EU. Subsequently, they are carried back into the EU, as a rule, to another member state, where again the method of trading over conduit companies located in different member states starts anew. Eventually, the products or goods enter the Member State, where then the VAT is stolen.

The partnership between the non-EU and EU states is seriously deprived of much-needed collaboration and interaction, which enables fraudsters to maintain their projects and makes any prosecution considerably difficult. According to the testimony of the examination of whole carousels, their primary goal is to steal VAT. The analysis showed that the amount of VAT payable from the missing trader matches to the sum of all commercial acquisitions for each company in the carousel. Therefore, it is obvious that this fraud is a planned criminal offence intended to cheat tax system, and is clearly not a way of advanced tax planning.⁶⁰

As provided, the transaction chains work collectively from the beginning. It assumes a 17.5% VAT proportion and implies that at the stage of the trader's missing, there is a price reduction.

⁵⁹ Financial Action Task Force, *Laundering the Proceeds of VAT Carousel Fraud*, 2007, p. 24, Figure 5

⁶⁰ Financial Action Task Force, 2007, p. 23).

	Cost	Sales price	Profit	Input VAT	Output VAT	Net VAT due to customs	Net VAT paid/ (repaid)
Missing trader	110	100	-10	0	17.5	17.5	0
Buffer 1	100	102	2	17.5	17.85	0.35	3,500
Buffer 2	102	104	2	17.85	18.2	0.35	3,500
Buffer 3	104	106	2	18.2	18.55	0.35	3,500
Broker	106	110	4	18.55	0	-18.55	-185,500
Net profit			0				-175,000
Net profit %			0				17.5

Table 1⁶¹ - Profit in a carousel fraud (EUR million)

As shown in 5, the carousel scheme including a non-EU country works as follows:

1. At the completion of the transaction chain in Member State 1 (MS1), the broker exports to a country outside the EU. He has the right to demand the repayment of input VAT from State 1 administration. Scammers are usually exported to non-EU countries because of low import duties or free trade zones.
2. Seldom, in a few hours, cheaters transport goods back to the EU (Member State 2 (MS2) and 3 (MS3)) with State 1, which is indicated as the final stop. According to the directories of the Transit Community, once the goods are returned to the EU, import charges are delayed until the goods reach in their ultimate destination country.
3. In order to hide the identification of the goods, they are sometimes divided up to be traded in various member states by numerous traders.
4. The goods then appear as supplies within the Community and are traded to the missing trader in an EU State 1 without VAT.

Carousel fraud with money laundering

With the help of fraud using a VAT carousel, huge profits are gathered by criminal combinations over time. In the next subsection, we will attempt to explain the nature of this crime, its attitude to money laundering and, eventually, attempt to raise global consciousness on this problem.

This is necessary because carousel fraud promotes funds that money laundering is usually practised in other more or less dangerous and hazardous sorts of evil, such as terrorist acts. The goods flowed inside the carousel, which in most circumstances is "controlled by the mind" or "mind guided". A small profit comes with a transaction

⁶¹ Financial Action Task Force, Laundering the Proceeds of VAT Carousel Fraud, 2007, p. 23, Table 1.

every time the possession of the goods exchanges. This masks the lawless state of the action, adding to the payment of the VAT, subject to reimbursement on the last section of the chain of frauds. The point is that the goods receive their price and value by moving in a flow each time they are traded. If it gets out of hand, prices can rise dramatically. Hence, each product involved in carousel mechanism must be underestimated regarding a price before they are re-circulated, which often occurs in non-EU countries.

The primary purpose of this underestimation or undervaluation is to reduce the import tax due to non-EU countries. This "deficit" is covered by the compensation of VAT payment by a member state. But payment is not usually taken by a missing trader at once. It is here that the "buffer" appears. The payment is directly sent to the EU supplier by a buffer company, and the resting balance is sent to an offshore account which is managed to pay fees of individuals involved in fraud. Those third-party payments are seldom "justified" by accounts for suggested services, such as refunds of loans with excessive interest rates. That reduces the risk of confiscation of the property of the missing trader by the governments and discontinues his demand for a bank account.

As a result, the verification of their identification is unnecessary and hence does not exist.⁶² In some instances, payments are made in instalments. In this case, the element of the VAT is the result of the payment of return. The UK has recognised that the same offshore bank organisations are employed by the overwhelming majority of criminals who are involved in carousel fraud, hence the disabling clearness of transactions in law implementation agencies in the UK. Also, operating accounts in the same bank significantly accelerate transferring money, diminishing the number of errors and working for successful camouflage. Because of the fast advancement of technology, dealers can choose to transfer money online and through guarantee anonymity to the parties participated. Finally, they can participate in fraud with computers, despite the fact that they are far away from trade location.⁶³

Ultimately, significant amounts of money are collected from the EU, and then criminals securely store these amounts on their offshore bank accounts, performing legal transactions. Accordingly, to struggle with money laundering, financial organisations must surrender the requirements of the Financial Action Task Force (from now on: the FATF) for their actions responsibly and clients.⁶⁴

⁶² Financial Action Task force, 2007, p. 4

⁶³ Financial Action Task Force, 2007, p. 4.

⁶⁴ Financial Action Task Force, 2007, p. 8

FATF is an inter-governmental 'policy-performing' organisation that strengthens and supports federal and international strategies to struggle with terrorist financing and money laundering.⁶⁵ The report of 2004-2005 on Typology of financing of money laundering and terrorist financing, published by the FATF, supports this idea and recommends adopting the Alternative Remittance System (from now on: ARS). ARS identifies the transaction as standard if it is not familiar with the fraud profile. Attention is needed to pay to the range of the transaction since it normally does not correspond to the alleged economic activity of the remitter in case of fraud. Therefore, it is useful to get acquainted with the nature of the remitter's business actions. Deals associated with fraud are normally extended and repeated, and the corresponding funds usually pass quickly within the system. To conduct a thorough transaction check, ARS operators involved in electronic payments must perform a correlation between the details of the performer and the details of the final beneficiary.⁶⁶

Countries of choice for depositing money

It was found that carousel fraud and money laundering, as a rule, are prone to specific addresses or destinations⁶⁷ when determining the fraud location. The circumstances influence the determination to choose this addresses or destination⁶⁸ are as follows:⁶⁹

- the chance of "legitimate" investment in business creation projects;
- combination of high-qualified online banking services that allow instantaneous money transfers and are provided with modern financial capacities;
- knowledge and experience in laundering money;
- levels of existing legal trade - this may be employed as a cover for criminal transactions;
- home country of criminals - this may have a big impact on the progress of laundered money;
- close economic and socio-cultural relations with other states of the world;
- a minimum degree of foreign cooperation and administrative parties; and
- insufficiency of official equivalence for extradition and legal aid.

In some practices, the money is returned to the state in which the fraud began. Although it has not been achievable to obtain full information on how this is performed, the project indicates that it is achieved through the use of false receipts from the service sector, poorly designed loans or real estate investments. Nonetheless,

⁶⁵ Financial Action Task Force, 2011

⁶⁶ Financial Action Task Force, 2005, p. 25

⁶⁷ The report does not involve the list of states covered by the applications because of the low reply rate which would give inexact and inaccurate results (Financial Action Task Force, 2007, p. 9)

⁶⁸ Not all of those factors are relevant to all countries (Financial Action Task Force, 2007, p. 9).

⁶⁹ Financial Action Task Force, 2007, p. 10

it is not straightforward to support such a hypothesis, as there is no physical existence of these goods. Still, there have been invalid practices in which VAT money obtained from carousel fraud activity in the United Kingdom has been reinvested in the UK real estate market.⁷⁰

Correlation to other crime

Interconnection with organised criminal gangs

Criminal gangs must be great well prepared to be able to launder large amounts without disruption. The states and its commercial institutions may be dramatically troubled by their growth and enlargement. Because VAT carousel fraud is able to generate substantial earnings with an essentially non-threatening risk of practice, it brings criminals involved in extra traditional forms of severe settled crime. According to the evidence in the United Kingdom, huge amounts of money, which has resulted in an increase in crime, was connected with carousel fraud. In the United Kingdom, many violent equipped robberies have been perpetrated in the many assumptions of the transportation forwarder. Goods destined for the fraudulent use of carousel were stolen in these accidents.

In addition, there was several examples in which fraudsters have seized and "stolen" their own products. Subsequently, they made misleading insurance requirements and used funds to fund more carousel fraud crimes. Because carousel fraud generates huge sums of money, extortion methods are used by different criminal groups to extract money.⁷¹

Financing other crimes

It has been shown that carousel fraud is seldom funded by other kinds of organised crime. In Spain, for instance, VAT carousel fraud was deemed "financially supported" by some criminal groups which required a share of the profit. Electronic instalments of VAT carousel fraud can be addressed to countries of origin where they can be used to buy medicines. With the money they receive in exchange, they support other criminals participated in VAT carousel fraud, e.g. forwarders and "buffer" companies. It is essential to have the expertise and experience of how carousel fraud is originally financially rooted by those criminal associates. The more serious international collaboration of companies and their partnership in committing carousel fraud needs

⁷⁰ Financial Action Task Force, 2007, p.10

⁷¹ Financial Action Task Force, 2007, p.11

to be founded and supported to recognise and fortunately target its real origins of revenue.⁷²

Case law

There are different types of carousel fraud schemes. A full analysis of three ECJ practises has been completed. Findings contribute to explain how these criminal systems work. In the cases examined, various carousel fraud configurations taken from real circumstances are satisfied. The analysis comprises engaging in carousel fraud, unknowingly and intentionally, with the features described here. Regarding taxpayers who are ignorant of or have no reason to consider that they were participating in cheating in the Optigen case, the ECJ observed their VAT deduction right. In the FTI case⁷³ conditions in which taxpayers may be collectively and separately responsible for VAT in carousel fraud were taken into perspective.

The results of the investigation of those three circumstances suggest a reliable overview of the problems associated with the treatment of the right of VAT deduction cases in which taxpayers were knowingly or unknowingly engaged in carousel fraud. Still, the determinations reached in these cases may also create new interpretive challenges in concluding whether or not a company participated in a carousel scheme.

The FTI case

Background

In this example, 53 dealers in the mobile phone and processors and their commerce organisation, the FTI - Federation of Technology Industries, were faced with the tax administrations and the Attorney General. This provision performed by the Commission and was created to oppose the fraudulent use of the VAT system and its relevance to Community law. Specifically, national regulations and state laws are the rules whose main purpose was prevention from and combat against carousel fraud and MTIC. The FTI examined whether provisions are compatible with Community laws. As expected by national law, the taxpayer must, when appealing for a refund, be able to present proof regarding the VAT in question. Additionally, the tax authorities are allowed to require security to be given by the taxable person when they make a VAT credit.⁷⁴

⁷² Financial Action Task Force, 2007, pp. 11-12

⁷³ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. -4210

⁷⁴ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. I-4213 - I-4217

Moreover, these controls may also be used in requiring several obligations of dealers who were knowledgeable of or had any ground to conclude that complete or partial VAT of the supply in question can be linked to non-payment.⁷⁵

Due to different types of fraud, the UK government experiences financial damages of more than GBP 1.5 billion on a yearly basis. Dealers who knew or had reason to consider that complete or part of the VAT on supply would not be given are, as provided on United Kingdom law, joint and several liability. The principal basis for adopting such national enactment was to make an effort against MTIC fraud. Still, according to the FTI, this enactment did not comply with the legislation of the VAT Directive, because it does not permit the implementation of such actions by the Member States. The FTI's complaint was appraised by The Court of Appeal appraised and the court rejected the procedure. In the end, the ECJ was summoned to give an introductory ruling.⁷⁶

Community legislation

When taxable individuals perform a taxable supply of goods it is obligatory for them to pay VAT. A taxable individual located in a Member State other than a state where the VAT is chargeable may make a taxable supply of goods. In this example, the Member State may designate the recipient of the supply as responsible for payment under Article 194 of the VAT Directive. In some situations, payment of VAT may become a liability of the receiver of the supply of goods, but only when particular criteria are satisfied. Nonetheless, Member States are entitled to make exemptions to this requirement in circumstances in which the individual liable for VAT is a tax representative accordance with the definition of Article 204 of the VAT Directive. Whenever an intra-Community purchase of goods is taxable, under Article 200 of the VAT Directive, VAT is obligatory for the taxpayer getting the goods in question. Unusually, Member States also have the right to charge the payment of VAT on individuals other than the taxpayer stated above. The primary goal was to determine and evaluate the presence of coherence and competence between national and Community legislation following Article 205 of the VAT Directive.

Question Referred

As a conclusion of this case, the ECJ was commanded to explain whether the Community law does not exclude enactment if it is an evaluation of several and joint

⁷⁵ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., p. I-4225

⁷⁶ Judgement of the Court (Third Chamber) on 11 May 2006 in Case C-384/04, n.d., pp. I-4218 - I-4223

liability of taxpayers because both the actual liable person any another taxable individual can be together recognized as such. The extra topic requiring explanation was whether to examine transactions in which dealers were informed of fraud activity and those in which they were not, ought to be treated adversely.

Findings of the ECJ

As stated in the ECJ, Member States may utilise Community legislation whereby joint and several responsibilities can be imposed on a taxpayer, with the exemptions of a person who is actually accountable for paying VAT. Since the legislation on the obligations (several and joint) of the taxpayer conforms to the policies of proportionality, Member States can accept it.

The principle of proportionality directs the Member States to do no further than what is undoubtedly essential to achieve their goals. Following national law, responsibility can be attached to the taxpayer in circumstances where this taxpayer understands or has reason to consider that all or portion of the VAT on the supply will not be refunded. If the price of the supplied products was lower than the lowest anticipated value of the open market or below the value of any earlier offer of the same commodity, then the taxpayer must have grounds for doubting fraud. Such assumptions are legally permitted. However, they can not be performed in such a way as to discourage or even prevent the taxable person from proving the reverse of the tax officials and, therefore, automatically strengthen the rights of the state treasury. The right of legitimate, fraudulent and honest sales ought not to be examined, and dealers who participate in them should be able to rely on legislation and regulations of the juridical system, not being able to be mistakenly accused of obligations for making VAT payment.⁷⁷

Judgment

A taxpayer who has been provided with the products and who was informed or had any grounds to suppose that all or portion of the VAT on the related offer or any preceding or following proposal will be unpaid may be charged with several and joint liabilities together with the individual, who is actually liable for the payment of VAT. Under the Community legislation, Member States are allowed to take such actions presented that they are favour of the general principles of law, particularly of the legal certainty and the proportionality principles.⁷⁸

⁷⁷ Decision of the Court. (Third Chamber) 11 May 2006 in C-384/04, par. I-4227 - I-4229).

⁷⁸ Court decision (Third Chamber) on 11 May 2006 in the case of C-384/04, nd, pp. I-4229

Conclusions

The Member States are allowed to set up legislation that makes a taxpayer who has been provided with the supply of goods severally and jointly with VAT payable concurrently with the person really responsible. However, solely when the taxpayer was recognized or had a basis to understand that all or portion of the VAT in the subject would not be funded, such enactment could be applied. Moreover, the proportionality principles or legal certainty ought to be observed. The legal certainty requires an anticipated and direct application of Community standards for those who should depend on them.⁷⁹ Holding the proportionality principle, as explained in Article 5 of the VAT Directive, the Member State is not permitted to exceed what is required to achieve the goal when taking measures. However, in this example, it was not possible to solve the puzzle of determining what precisely is needed for a taxable person, because it has grounds to be informed of their engagement in fraud with carousels. National courts may face significant problems in attempting to establish responsibility for the payment of VAT without properly given guidance and instructions,

The Optigen case Background

The joint case among Bond House Systems Ltd, Optigen Ltd and Fulcrum Electronics Ltd brought an action against the tax administration, which rejected to repay VAT on the purchase by companies of CPU - computer processing units in the United Kingdom. Afterwards sold abroad to a different member state.⁸⁰

The businesses have acquired processors from companies established in the United Kingdom. Then, they traded to companies established in another Member State. Each of these companies demanded input VAT balance of a different volume. The associated transactions set out to be related to a supply chain, which engaged in a carousel fraud. In this chain, a defaulting trader⁸¹ included. The final decision concluded that the applicants did not know and could not understand that these commercial transactions were involved in carousel fraud.⁸²

⁷⁹ Opinion of Advocate General Poiares Maduro delivered on 7 December 2005 in Case C-384/04, n.d., p. I-4205

⁸⁰ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-483 and I-515

⁸¹ A 'defaulting trader' is a trader that acquires a liability for VAT without actually discharging his liability with the tax authorities; instead, he disappears. The defaulting trader may also use a VAT number of another company (Joined cases C-354/03, C-355/03 & C-484/03, p. I-483).

⁸² Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-506 and I-507

Optigen and Fulcrum Electronics

Fulcrum Electronics and Optigen were involved in trading computer chips. They bought chips from British companies and sold them to customers in another member state. None of them (sellers) had any purpose to engage in the fraud but their transactions occurred in the carousel scheme. Nonetheless, both of them did not know and had no basis to suspect that they were engaged in fraud. Despite this, the tax administrations rejected the application for a refund of VAT because the transactions were not committed in the framework of economic activity and were not adequate in the economic essence. According to them, the acquisitions were not supplies destined for business projects, and it was not intended that they would be used for these objectives.⁸³ An application of two companies was listed against the refusal of the tax authority to pay VAT.⁸⁴

Optigen demanded the input VAT refund of £ 7 million. Fulcrum Electronics's demand for repayment in June was 7.2 million pounds sterling and 4 million pounds sterling next month. Eventually, the decision made by the tax administrations rejected Optigen's claim for refund and partially refused Fulcrum Electronics's request. The refusal declared that the acquisitions made by companies have no economic essence and are not part of any business activity. Afterwards, they filed an application against the determination to the VAT and Duties Tribunal in London. None of the companies examined was involved in fraud and had no basis to suspect that they were included in it. They were both normal buyers in the transaction process and did not sell with the agent using the missing trader and the missed VAT number.⁸⁵

Bond House Systems

Bond House Systems (BHS) is an organisation that mainly deals with computer elements. It was included in Wales and England. The main function was buying processors from dealers from the UK who registered for VAT and then resold them to businesses located in other member countries and registered for VAT. In May 2002, BHS performed 51 CPU transactions, all of which were made to customers in other member countries, accounting for about 99% of the total turnover in May. Suppliers in the UK acquired the CPU with fair market rates in all transactions. BHS paid vendors a determined price with VAT and subsequently resold the processors to customers in different member countries. Customers bought processors at a slightly higher price than BHS. The rates of supplies were zero, and the VAT refund for May

⁸³ Opinion of Advocate General Poiares Maduro delivered on 16 February 2005 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-488

⁸⁴ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-508

⁸⁵ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-506 - I-510

2002 was returned by Bond House. Subsequently, the business demanded the repayment of the VAT amount, which it gave to its supplier. The return of the declared input VAT for 27 out of 51 acquisitions was rejected by the tax administrations. At the end, an application against this decision was made by BHS.⁸⁶

The input VAT refund of 16.3 million GBP was required. Still, since the transactions were parts of the supply chain with the participation of the default trader, only 2.7 million pounds sterling reclaim was allowed in favour of Bond House, which was accompanied by the company's request to VAT and Manchester Duties Tribunal.⁸⁷

Any charges of VAT fraud against BHS were withdrawn because the company did not know about this fraud. In addition, it was concluded that Bond House does not act negligently and that he does not associate in business with fraudulent dealers. The officials confirmed the legality of all transactions with BHS, that is, through transactions, actual money and goods were transacted.⁸⁸

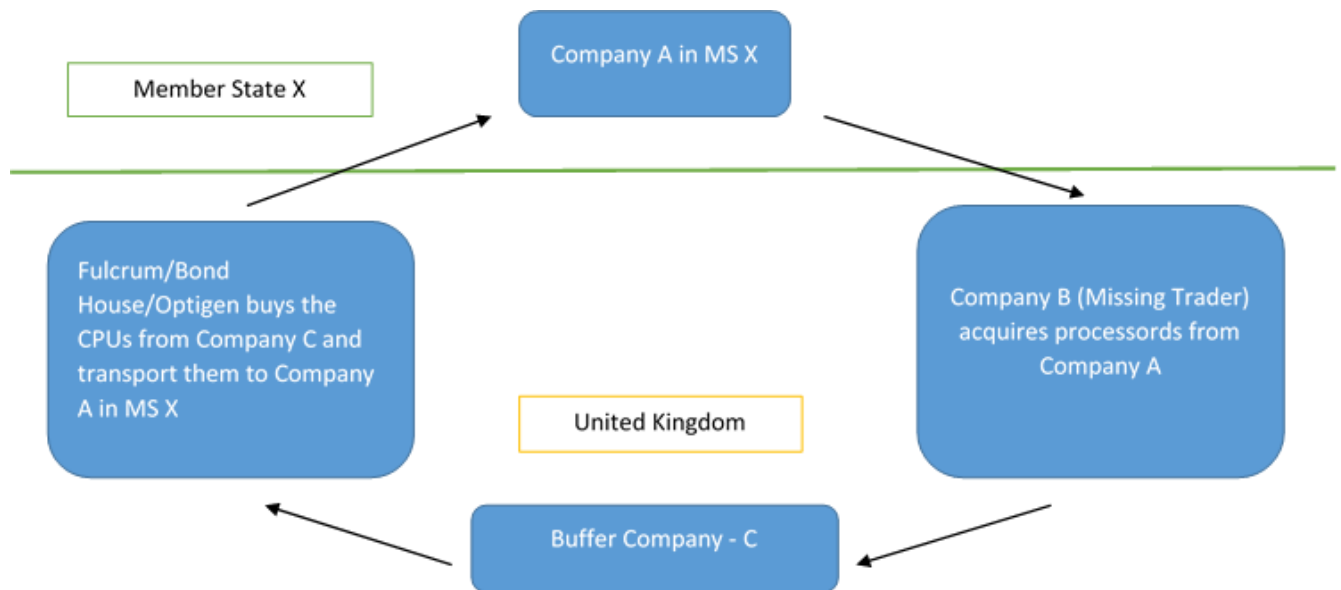


Figure 6. The Optigen carousel scheme⁸⁹

Question referred

The National Court considered whether the relevant transactions, deliveries of goods and the taxable person are compatible with the VAT Directive. Although they were

⁸⁶ Opinion of Advocate General Poiares Maduro delivered on 16 February 2005 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-489 and I-509

⁸⁷ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-506 and I-507

⁸⁸ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-511

⁸⁹ H. Andersson & K. Franzen, *VALUE ADDED TAX. The right to deduct in case of carousel fraud*, 2008, p. 20.

engaged in the supply chain, in which past and subsequent transactions turned out to be fraudulent, the transactions themselves were not, but without a trader associated with a reliable transaction, being aware of or having any way to know that the chain was involved in fraud. Furthermore, the national court also investigated that can in such specific situations traders limit their advantage of VAT deduction?⁹⁰

Two phases of the Optigen case are necessary. First, the ECJ made a decision in cases in which a transaction engaged in a supply chain in which past and subsequent transactions were fraudulent represents the delivery of goods carried by the taxable person and business activities as defined by the VAT Directive. Second, concerning such cases, the European Court concluded the issue of restrictions on the right of VAT deduction.

Moreover, Fulcrum and Optigen requested that the decision on whether a merchant should to or not have the right to get a loan for VAT payments should be based on actual transaction and its aim, and not past and next transactions, undiscovered to the trader. In compliance with UK law, the merchant's right to get a loan for paying VAT amount will be determined for all transaction activities performed in the supply chain. Every transaction made in the supply chain that was involved in the fraud are outside the extent of VAT Directive. As a result, legal dealers who unintentionally engage in these sort of transactions are not subject to VAT Directive. According to tax administrations, the trader's right to get a loan for VAT payments should be based on economic activities in which the dealer was a real participant. Any fraudulent actions in the supply chain that the dealer does not realise should not impact the judgment concerning his eligibility for a loan. Thus, excluding the taxable supply will be contrary to VAT Directive.⁹¹

Findings of the ECJ

According to the conclusions of the ECJ's investigation of the notion of economic activity, the extent of the economic activity is quite broad. In terminological expressions, the term "economic activity" indicates something of an actual nature and should thus be considered solely by itself, to the exclusion of its intention or its consequence.⁹²

⁹⁰ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-515 and I-516

⁹¹ judgment of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-516 and I-517

⁹² Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-519; Judgement of the Court on 12 September 2000 in Case C-260/98, n.d., p. I-6572

Similarly, the names "taxable person" - (a subject) and "supply of goods" - (delivery) are also both objective and employed despite their intention or the consequence of the transactions to which they concern.⁹³

In according with the ECJ, the transaction intention of the taxable person is not assumed to be investigated by the tax administrations because it would show that it is contrary to the objectives of the VAT system. VAT system's goals provide legal certainty and help the application to the VAT⁹⁴. Moreover, under the standard VAT system, the intention of the dealer in other past or prospective fraudulent activities hidden to the taxable person is also not examined. Therefore, transactions must be assessed and judged separately. Additionally, circumstances before and later the transaction must not be allowed to modify the nature of the transaction.⁹⁵

Judgment

In accordance with the requirements of the VAT Directive, non-fraudulent activities create a supply of goods or services, taxable individuals performing as such, plus business activities. The intention of the dealer in the connection with the performance is inappropriate. Circumstances in which the taxable individual was ignorant that the activities were part of an illegal supply chain and were headed or followed by an unlawful transaction, the right of the taxable individual to subtract input VAT cannot be limited. As the Court of Justice clearly states, the right of deduction is an essential part of the VAT system and ought not to be limited. The mere fact that VAT on a previous or subsequent trade of goods has not been given to the officials should not be a sufficient reason to impact the right of input VAT deduction.⁹⁶

Conclusions

A taxable person ought to be able to legally claim the right to subtract input VAT in situations in which they did not understand or could not comprehend that the previous or subsequent transactions in the chain were illegal and they were engaged in fraud. The VAT deduction right of the dealer should not be questioned if dealer used all practicable measures to avoid the participation of transactions in carousel fraud.⁹⁷

⁹³ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-519

⁹⁴ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-520; Judgement of the Court (Fifth Chamber) on 6 April 1995 in Case C-4/94, n.d., p. I-1010

⁹⁵ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-520

⁹⁶ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-521 and I-522

⁹⁷ Judgement of the Court (Third Chamber) on 12 January 2006 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., p. I-517

A key component of the VAT system is that each transaction in the supply chain must be analysed separately and that VAT must be collected on respectively. That said, past or future circumstances can not influence the nature of the business. Following the principle of judicial certainty and the impartiality of the VAT system, each transaction should be dealt with separately.⁹⁸

Still, some questions remain unresolved because the ECJ has solely assessed the deduction right of VAT in cases in which dealers were not knowledgeable of participation in fraud and did not take into account circumstances in which dealers knew or should have recognised it.

⁹⁸ Opinion of Advocate General Poiares Maduro delivered on 16 February 2005 in Joined cases C-354/03, C-355/03, & C-484/03, n.d., pp. I-493 and I-494

SOLUTIONS CAPABLE OF REDUCING A VAT FRAUD

Several recommendations for measures to oppose VAT fraud have already been submitted to the Commission. These proposals are essentially concentrated on modifications to the current tax system, the installation of a final VAT system, a general fee for the return and other possible solutions in the fight and prevention of fraud or tax evasion.

The main principles adopted and embraced by the EU are, above all, fair opposition, the formation of a Common Market and the prohibition of measures that can somehow prevent an unlimited and free movement of services, funds, people and goods. Because those policies must be followed and carefully observed, the process of developing measures to fight against VAT fraud successfully is quite a challenge.⁹⁹

In addition, those rules should also comply with the VAT principles stated below and defined in the First VAT Directive¹⁰⁰:

- impartiality concerning the size and length of the transaction chain;
- neutrality about the origin of goods and services;
- creation of a unified VAT system;
- proportionality in relation to the price of products and services; and
- the non-aggregate system that serves as the foundation for fees: the input tax is deducted from the output tax.

Therefore, it is obvious that an uncomplicated tax system reduces the costs of compliance with tax laws for companies. In addition, such a system is comparatively economical, creating fewer failures and reducing the extent for fraud.¹⁰¹ OECD reported that the tax officials of OECD nations are ready to take on the difficulties of globalisation in the affairs of their citizens. Among other problems, the OECD points to improving the efficiency of tax administrations, reducing tax requirements for companies and minimising the dangers of fraud or tax evasion¹⁰². It is worrying that fraud can be ultimately reduced, while administrative tax settlement levied on taxpayers remain unchanged and do not rise. Therefore, it is imperative to find and maintain a proper balance between the consideration of tax fraud and the basic

⁹⁹ International VAT Association, 2007, pp. 13 and 14

¹⁰⁰ International VAT Association, 2007, p. 14

¹⁰¹ International Association of VAT, 2007, p. 14

¹⁰² OECD, 2005, p. 120

principles of VAT concerning proportionality, legal expectations and legal protection.¹⁰³

As provided by the Commission, any changes to the current VAT system should meet the following obligations¹⁰⁴:

- Notable reduction in opportunities for fraud
- lack of significant latest threats and prospects of fraud;
- Lack of additional regulatory costs and burdens;
- Tax impartiality; and
- Equal performance of both national and foreign executives in the Member State.

When assessing the advantages and disadvantages of each decision on solutions considered in the thesis, the preliminary conditions set forth by the Commission are stated.

The "reverse charge" mechanism

Concerning the delivery of goods and services inside EU, VAT is normally collected by the supplier. Following the "reverse charge" mechanism, the subject responsible for VAT is the buyer and requirement any evidence about this deal to the tax officials is the obligation of the supplier or service provider. According to reverse charging system, VAT is only imposed on the final, retail level of the trade chain.¹⁰⁵

Under Article 17 of the VAT Directive, the VAT deduction right VAT applies when a recipient is a taxpayer who, on VAT refunds, takes into account the amount of VAT payable under the reverse payment mechanism. However, the recipient can also select to take it into account as an input VAT with the same VAT refund. In such circumstances, the taxable person is not obliged to pay VAT, and payment cannot be required. While in a system where there is no application of reverse charge, the supplier collects VAT from the buyer and is responsible and liable for its payment. This appeals if the products and services in a subject are not grouped as one of the listings:

- supply with a reverse payment,
- intra-community supply or supply outside the EU

¹⁰³ International VAT Association, 2007, pp. 14 and 15

¹⁰⁴ European Commission, 2006b, p. 9

¹⁰⁵ International VAT Association, 2007, p. 22

Following Articles 194-197 of the VAT Directive, this mechanism is applied, and its use is allowed in certain situations. For instance, if the service provider is situated in another Member State, reverse payment is admitted. Another case: if the supplier delivers goods susceptible to fraud. Such kind of item in the Directive grants autonomy to the Member States when determining whether to implement the mechanism in these circumstances, provided that the criteria are satisfied.

Since the system for tracking a taxpayer placed outside the Member State in subject is more complicated, using a reverse payment mechanism in such circumstances allows a much more flexible and straightforward gathering of VAT because it noticeably diminishes their possibilities of tax evasion. Many Member States have favorably employed a common reverse acquisition system for dealing with taxpayers established elsewhere.¹⁰⁶

Without such a system external suppliers providing services in nations where they are not founded should register for VAT objectives and meet all VAT obligations in that member state. In order to avoid such a regulatory duty for foreign suppliers and to guarantee VAT accounting, the reverse payment mechanism provides (or sometimes claims) a registered client VAT to take into account the tax on income obtained from external dealers. However, the mechanism does not employ in all jurisdictions, and when it is performed, the rules may vary in different member states.¹⁰⁷

As an outcome of their particular structure, some economic sectors have revealed to be considerably more prone to the fraudulent violation and more challenging to supervise and keep under control than others. Supplies resulting from those areas of the economy are subject to an optional treatment of the reverse charge method. A real case of such practice happened in the construction industry, in which the mechanism supported to prevent a try to avoid a substantial amount of tax; the main transaction partners planned to deduct the VAT that the subcontractors had nevermore made payment for. Another instance is transferring of greenhouse gas emission allowances.¹⁰⁸

Under Article 27 of the VAT Directive, Member States can make special decrease that will enable them to be exempt from the VAT Directive. With the purpose of minimising the possibility of tax evasion and making tax collection more easy to handle, these exceptions would appeal to supplies or deliveries that can comply with the criteria of reverse charge mechanism. In order to obtain a derogation, the Member

¹⁰⁶ Ludviksson, 2012, p. 7

¹⁰⁷ OECD, 2011, p. 5

¹⁰⁸ European Commission, 2005, p. 8

State must initially apply to the Commission, and if the application satisfies the requirements, the Council will either accept or reject the demand of the State.

This generalised mechanism allows receiving VAT and the obligation for accounting for the acquired tax, which should be focused on one stage of the complete chain of activities. It is not probable to require input VAT without liability for paying VAT on supply. Such a measure functionally excludes the possibility of committing fraud and, therefore, guarantees the absence of VAT losses made by the repayments of VAT or input VAT. As a consequence of VAT fraud, Germany's yearly damage in 2005 was determined at 18 billion euros, which was almost 11% of the annual VAT issue.

These estimates called for thorough and immediate effort to decrease existing levels of VAT fraud. Additionally, although Germany ultimately conducted comprehensive studies on this issue, no satisfactory solutions were determined. The implementation and proper treatment of the reverse payment system in the Member States possess so far confirmed successful and effective. In its appeal for a mechanism in 2005, Austria referred to the positive results of the case in the field of construction, designating that this was a powerful and decisive factor in deciding whether or not to implement it. In 2006, Austria, the United Kingdom and Germany applied to the Commission for permission to present a mechanism of reverse charge in their law. This mechanism will apply to almost all national transactions between taxpayers in above-mentioned Member States. The UK tried to apply it to certain goods, which have been revealed to be associated with a high level of tax evasion by the state, especially in the field of mobile phone technology, similar computer devices and microchips while Germany and Austria proposed to use a recharge mechanism for all wholesale purchases surpassing a certain amount. In Germany, this method will be united with one of two control models: "R-Check" or "Cross-checking".¹⁰⁹

The Commission recognised and evaluated requests from Germany and Austria as happening too common and inadequately specified. As a result, derogation applications for both states were rejected. The Commission argued that the treatment of derogations would not solely create extra challenges and confusion for the tax administration and taxpayers but also enhance risks of tax evasion. On the other hand, the Council did approve UK's derogation demand.¹¹⁰

A necessary element of the VAT system is fractionated payment. It works as a foundation for the system's three significant features:¹¹¹

- advance payment of VAT receipts; States can assemble a consumption tax until the

¹⁰⁹ International VAT Association, 2007, p. 22

¹¹⁰ European Commission, 2006d, p. 6

¹¹¹ International VAT Association, 2007, p. 23):

economic chain is completed;

- self-control of the tax; Every participating member in the economic chain must receive documentation from the previous party. These reports are proofs of transaction activity and enable to examine how the tax is created through the chain;
- safety related to the acquisition of VAT receipts; In the example of tax evasion generated by the operator in a chain, the state solely misses the VAT amount equal to the VAT of the taxpayer evading return. Still, the full amount of the tax on products and services will be missed if the tax is focused only on one part of the economic chain.

As stated by International VAT Association, the use of the reverse payment mechanism is advantageous for the coming reasons (2007, p. 23):

- increase in acquisitions. It was calculated that in Germany, for instance, an extra EUR 3.8 billion could be collected, presented that this mechanism is coupled with another control method of "R-check";
- 25% reduction in VAT failures caused by bankruptcy of companies, as declared by Germany;
- given the fact that it does not require any requests for refunds, thus it does not distinguish between companies that levy taxes and companies with zero ratings for VAT payments. In addition, it also provides immediate VAT recovery without prior financing need;
- the proper and accurate use of this mechanism in other segments of the industry, such as the construction business, has been proved as very useful both in Germany and Austria.

The disadvantages of the RC mechanism are set out in the Austrian Commission's decision and Germany's request for a derogation and include the following¹¹²:

- Greater burden on companies - in the event of non-payment of a VAT, the RC mechanism requires that financial risk due to this behaviour should be transferred from the Treasury to organizations. The decision on whether to impose a customer with VAT by an evaluation of their validity depends on the company, which finally becomes the bearer of financial risks. Nonetheless, such actions are against to the Lisbon objectives, as they overload the organisation with excessive obligation and fiscal costs;
- VAT diffusion- in Member States, most of the VAT (about 80%) is given to no higher than 10% of the taxpayers as a whole. As a consequence of such (dis) proportionality, a particular amount of income from VAT is ensured, and therefore revenue authorities are not expected to create a severe system of control for

¹¹² European Commission, 2006d, pp. 2 and 3

accumulating and obtaining funds;

- New and superior types of fraud. The introduction of a generalised RC mechanism is likely to cause new structures of fraudulent behaviour. For instance, the final connections of the supply chain are likely to vanish if additionally burdened by responsibility for a tax refund. Also, the RC system should not be recognised as an answer to the so-called informal "black sales". When VAT is paid at the end point of the supply chain, the motivation to purchase these black supply items will grow with the taxpayer who must be answerable for the full amount of VAT and not solely for the fractionated part;
- Increased tension in the tax authorities - with the use of an RC mechanism, the number of officials of the supervisory bodies working in the tax administrations should significantly increase. Such a measure is needed since the tax debt is distributed over a larger number of taxpayers, which automatically requires extra surveillance and control;
- Opening and investment costs for the creation and establishment of a new regulatory system can be very notable;
- Threshold suggested by Austria, UK and Germany will not be able to stop fraud. Exceeding the recommended thresholds will use the RC mechanism, which is mandatory;
- In the circumstance of loss of optional payment in steps (fractional VAT payment), the installation of new additional duties and obligations for taxable persons is inescapable to ensure undisturbed and continuous collection of tax revenues;
- Monitoring and verification of the status of customers, and the purpose of their purchase will be necessary - the RC mechanism can be applied solely if the clients are respectively VAT registered businesses;
- Submitting the reports to the authorities periodically - the trader's client's register must be given to the tax authorities regularly - monthly or quarterly;
- Constant supervision of all current members in the transaction chain - there is a risk that in certain circumstances not all businesses in the chain will be checked instantly. Precise control of connections in the transaction chain reduces the risk of fraud;
- The hijacking of the VAT license number is still probable;
- Some goods that are free of taxes may eventually end up in another Member State.

As already suggested, the retail step of the supply chain yet continues to have a risk of fraudulent activities, regardless of the multiple benefits of an RC system. Because of the violation of the principle of fractionated payment, this level in the chain produces desirable circumstances for financial fraud including more taxes.¹¹³

¹¹³ European Commission, 2009, p. 2

Modifying of "transition" system

The "transitional" taxation policy in the country of destination has proved to be the most relevant federal agreement since the removal of financial barriers in 1993, although during these years it had to experience several changes.

Currently, the focus is on determining whether its extra improvement can efficiently fight and stop VAT fraud. The latest measures to prevent fraud taken by the Member States are stated below:¹¹⁴

- targeted utilisation of the RC system, still solely for particular sectors of the economy;
- in associated transactions using "normal value" as the foundation for assessing taxes;
- in transactions including taxpayers located outside the taxation state, the use of an RC system;
- charging joint and several obligations on any taxpayer who is aware or had cause to conclude that all or some of the VAT payable would not ultimately be paid.

One of the objectives of the measures noted above is to help the Member States more adequately deal with fraud by strengthening combat capabilities. Also, these measures comply with the legislation adopted by the European Court, especially in the FTI decision and the case of Optigen¹¹⁵

Supporting and improving the transition system to combat fraud can be helpful for the below-mentioned reasons¹¹⁶:

- the sovereignty of Member States in the compliance of measures and VAT rates may continue unchanged;
- in the state of consumption, products and services, as a rule, are subject to taxation;
- in the destination country system corresponds to the territorial authority of the tax officials responsible for fiscal receipts; and
- a significant decline in the formal procedures earlier required for products passing borders; VAT rates and rules concerning the introduction of input tax do not require harmonisation.

Despite further development, the adjusted transition system can be defined by the following weaknesses¹¹⁷:

¹¹⁴ International VAT Association, 2007, p. 19

¹¹⁵ International VAT Association, 2007, p. 19

¹¹⁶ International VAT Association, 2007, p. 20

¹¹⁷ International Association of VAT, 2007, p. 20

- A decrease in the economic achievement of European companies. Member countries are gradually taking new measures, and the administrative costs of businesses have experienced significant growth. Companies are also financially hindered by high operation expenses on the intra-community market because of various charges such as costs of registration in each country, etc. This has a negative impact on employment, company performance, customer prices and some other factors that, in general, influence the international competitiveness of market;
- Instead of simplifying it, additional development solely increases the uncertainty of the system. This contradicts the Lisbon Agenda, the global policy on the VAT application established by the OECD, the principles of the first VAT directive and the policy of the anti-fraud policy of Commission;
- The common principles of Community legislation are incompatible with the measures that are necessary to combat fraud adequately. Also, unrecorded taxpayers are subject to non-standard statutory treatment accordingly to tax obligations;
- Some responsibilities that must be performed by the tax officials are assigned to taxable individuals. Despite the fact that taxable persons are influenced by anti-fraud policies, this should not occur because of the assumption of fraud on the basis of fiscal receipts that have not been revealed responsible;
- Because intra-public operations are still being an exception, there is an opportunity for manoeuvre for carousel fraud.

Charging tax on intra-Community transactions

The probability of obtaining and supplying goods and certain services that are not taxed inside the EU states seems to be the main weakness of the transition system, since it allows fraudulent claims for VAT refunds because of a hole in the VAT chain originated by the zero rating of intra-community shipping. Generally, this is one of the principal characteristics of carousel fraud. A report published by the Institute for Fiscal Studies in Great Britain recommends that by eliminating the main reason of missing trader fraud, a more effective long-term tactic can be accomplished. Such a suggestion would be more appropriate and useful than a combination of resource-intensive coercive measures and specifically targeted adjustments that solely produce short-term solutions instead of solving major issues. Furthermore, the Institute strongly suggests that the taxation of supplies within the community in the countries of origin ought to be reassessed, because, in its opinion, it was released too quickly in 1993, accompanying the removal of fiscal boundaries.¹¹⁸

¹¹⁸ European Commission, 2007) 177

The proposed strategy does not apply to the country of origin system. Still, it takes financial incentives for carousel fraud, appealing VAT to cross-border sales. This tax can be implemented at a charge of 10% for one EU or a rate authorised by the collecting state¹¹⁹.

As suggested by the International Association of VAT (2007, p. 27), the benefits of taxation of intra-community activities noted below:

- partially restore the tax charging system at all stages of production, provision of services and delivery processes;
- restricting financial earnings from carousel fraud by removing tax scheme with the zero-rate for shipments within the EU;
- setting expenses and costs;
- elimination of the requirement for certain declarations because of the taxation of supplies within the EU and, as a result, the reduction of liability and regulatory burden on businesses.

In addition to those listed above, the International Association of VAT also names weaknesses:

- Reintroduction of financial limits, an action that is likely to be met with disapproval from organisations, especially at the initial stage;
- an obstacle to the movement of funds for companies that can pay VAT before they can return/compensate it.

A frightening degree of fraud puts the Member States under intense pressure to act instantly and intervene by taking the best probable means to solve this problem. Conditions should be carefully studied, and all possible resolutions, regardless of their potential non-traditional nature, are adequately assessed. It has already been decided that by implementing a segmented and disorderly adjustment without proper consistency, the contemporary, transitional system is unlikely to produce long-term and practical solutions to problems associated with fraud. What appears to meet the obligations and standards of the basic principles of legal certainty, proportionality and uniformity is the postponement of the zero-rated assessment of intra-community supplies while maintaining the basic notions of a fractionated payment system. Other types of fraud can be the consequence of inadequate VAT settlement imposed by the supplier; in the event that this tax is ultimately not paid, fraudulent abuses, such as fallacious input VAT subtractions or deliberate bankruptcies may appear.¹²⁰

¹¹⁹ International VAT Association, 2007, p. 27

¹²⁰ International VAT Association, 2007, p. 28

“R-check”

Germany introduced the "R-check" system to ensure the stream of information in the tax authorities in respect of internal business activities between taxpayers associated with the RC mechanism and that Germany was attempting for a derogation. With a RC mechanism, the economic transactions of the chain must be taxed immediately, at the retail stage. It can only be implemented between taxpayers when the recipient has the advantage to 100% deduct VAT amount. Through the R-check, the supplier can check the status of the customer promptly using a reliable computerised method. This is performed by verifying the validity of the customer's address, name and "R-number". Also, the dealer through "R-return" must constantly and promptly transfer all "reverse charge" sales to taxation authorities.

In return, the following should be indicated (International VAT Association, 2007, p. 34):

- an invoice or account number;
- date of invoicing.
- VAT number of the dealer;
- R-number of the customer;

The advantages of the R-check system are below-mentioned¹²¹:

- "R-check" is necessary when using the RC mechanism to verify the exemption of a transaction from the quality of the customer;
- It gives announcements in real time about the legality of the customer's R-number.

Disadvantages of "R-check" (International Association of VAT, 2007, page 35):

- being a really limited system, since it is useful in preventing solely one type of fraud, the provision of a mistaken R or VAT number;
- Increase the expense of companies' agreement with companies as a consequence of special returns on transactions concerning mainly SMEs;
- The primary cost of 2 billion Euro;
- 5 billion operating expenses for tax administrations;
- Operating expenses of 200 million Euros for German corporations annually.

The R-check rejects to process unopened transactions and will not deal with a risk of number hijacking. The system will need notable changes in the contemporary VAT system with considerably significant costs for states and organisations.¹²²

¹²¹ International VAT Association, 2007, pp. 34 and 35

¹²² International Association of VAT, 2007, p. 35

RTvat

RTvat demands fundamental procedural adjustments. Firstly, the supplier's VAT obligation moves on the date it collects payment from its clients, and the client's right to deduct the changes of the input tax on the time of payment of its supplier. There is no change in the supplier's obligation. The change is a tax collection that is automatically attached to the arrangement of the customer transaction. Secondly, following Article 402 of the VAT Directive, that provides that the final VAT system in the EU will be origin-based, the recommended RTvat form is a tax system that is origin-based. However, it can be a system that is destination-based. The procedural change is the most distinctive characteristic of RTvat. As part of RTvat, this is just the VAT-exclusive price which suppliers obtain for their goods supplied, as the amount of VAT is deducted from the customer's payment in an automatic way and electronically sent to the tax authorities by the bank of supplier, making it necessary for the transaction to be completed via Electronic Funds Transfer (hereinafter: EFT). Having received it from the supplier's bank, the tax officials can return the tax on deductions to the client via EFT on the same day.

The payment system used by RTvat for collecting VAT is very alike to the industry of the credit card payment system. Furthermore, when end-users make returns to retailers on credit or debit cards, smartphones or other "plastic money", VAT is automatically written off and sent directly to revenue authorities. Assuming that each member state accepts the RTvat system, each state will be connected to a network of 28 identical servers utilised as centres for transferring and exchanging of funds between them. A separate server, held and managed by each member state, will process all of its intra-community and internal transactions. It is practically improbable to avoid fraud with traders within RTvat since no VAT collected from the client is ever conducted (on behalf of the government) by the company. In addition to retail transactions for which the client make payments in cash, and not by credit cards and other types of plastic money, the supplier is not able to go avoiding with VAT in hand (Ainsworth, 2011b, p. 8).

If the RTvat system was centred on the destination, and the bank split up client's payments, it would perform more efficiently. The tax officials of a Member State will not have to return VAT to clients located in another Member State. In the circumstance of cross-border shipments, the RTvat utilisation based on the destination will demand suppliers to know the VAT applicable in the clients' member states. This should not create any problems and, in cases where it is not clear whether the supply of products is standard or zero-rated in the destination State, in the relationship of

B2B , the supplier can merely charge the standard rate, because the customer can subtract the VAT amount in any circumstance. As a weakness of the principle of destination, businesses may need to file multiple VAT records in several member states. However, they ought not to submit VAT declarations on transactions made through certain bank payment channels and prepared by tax authorities.¹²³

In spite of the fact that RTvat is theoretically applicable everywhere in the EU, transactions with low cost and transactions taking into account the margin scheme should be excluded from the mandatory system. The originality, uniformity and efficiency of RTvat would have made it exceptional if it had stopped at this stage. In addition to effectively limiting the loss of trader, RTvat also successfully combats other kinds of fraud, such as fraud of suppression. However, RTvat's plan goes further. Instead of relying on the appropriate receipts as the basis for the separation of payments, the RTvat system receives the needed data from the vendor's business records, which means that a vendor always receives payment for a sale, a portion of its business records is checked and audited. This technology was improved to conserve electronic cash registration records from the fraud of suppression and assure the safe transfer of critical tax data to officials for remote verification. It can be applied (B2B and B2C) to provide the authorities with a real-time database necessary to close the VAT gap in fields other than MTIC fraud.¹²⁴

¹²³ (Ainsworth, 2011b, p. 9).

¹²⁴ (Ainsworth, 2011a, pp. 9 and 10).

Final remarks

Fraud within the EU started off as the importation of gold crossed the borders of Luxembourg. This gold was then traded (inclusive of VAT) in different member states before its sellers would disappear. As from one January 2000, the RC mechanism is also functioned to such supplies. However, a fraud occurred with a missing trader (for example, digitised CO2 emissions permits or VoIP services) is sharply superior to gold smuggling. The technological advancement allows fraudsters to move quickly, making the increase of fraud nearly unlimited. Compliance efforts should be just as fast. Despite the fact that VLN is not able to cover the whole EU economy, from the above options, it can give solutions to problems of missing trader fraud in specific sectors. D-VAT certification cannot stop missing trader fraud, although it influences in a positive manner to the compliance with VAT. Additionally, the use of CSP is quite expensive, especially for SMEs. Thus, RTvat is the single solution for efficiently preventing missing trader fraud and limiting other fraudulent activities (for instance, fraud of suppression). This prevents the risk of fees for tax administrations while preserving all the security mechanisms of a reliable VAT system. In the RTvat system, transactions are handled through banks, a payment method that has already become a popular phenomenon in B2B and B2C sales. However, when VAT obligations rise, and the VAT can be deducted needs a change. Such a turn should generally impact the economy. Traditional checks will remain to be needed in the future to deal with complex VAT evasion schemes. Nevertheless, the more reliable the basic VAT system, the more time investigators and examiners can apply to closing other gaps in the system.¹²⁵

¹²⁵ Ainsworth, 2011b, p. 160

CONCLUSION

It has been shown that over the past 40 years the existing invoice-based system in the EU has been effective in the collection of tax revenue. The next is its progress in Europe, a VAT system of fractionated payment has been adopted by more than 130 countries worldwide. Still, the enlargement of VAT evasion in the EU has begun to affect the balance of current accounts and international trade statistics of states and, therefore, requires well-coordinated and strong-minded strategy. Although it provides some advantages, the current system does not require changes to reverse the current direction.¹²⁶

It was discovered that not less than 100 euros are lost annually because a tax system is not working as it should. From the analysis of potential resolutions for resisting VAT fraud, especially with the carousel fraud, it becomes clear that one solution is not enough to solve it. In the short term, some practical and pragmatic operations should be implemented. The fundamental policies of VAT should continue unchanged when trying to change the system to efficiently deal with fraud.

The "rules of the game", which are fair for legitimate companies, should be maintained and the effectiveness of the tax authorities, including the reward system, must continuously be improved, together with technological solutions. Actions practised solely at the level of a Member State can lead to conflict analysis, legal uncertainty and higher costs for businesses, and hence they need to be regulated at the EU level.

The enormous VAT losses in the EU are well known, and recent data from Commission confirm that merely 55% of potential VAT returns are achieved. Implementing the collection in real time in all member states, this indicator can be significantly changed in a positive manner, and the extra income received for the tax authorities and budgets will significantly reduce the current severity problems of an economy of many countries.¹²⁷

Given the digital solutions to this challenge, RTvat is the unique solution that can tackle with missing traders and limit some other sorts of fraud. Despite technical characteristics that need further developments, RTvat is by far the most effective, promising and practical solution for providing a reliable VAT system. Currently, there are no alternative solutions that can stop all forms of fraud, closing the VAT hole in the taxation system and blocking VAT evasion. In the future, it will be essential to continue the application of traditional audit to solve complicated VAT avoidance schemes.¹²⁸

¹²⁶ International Association of VAT, 2007, p. 43

¹²⁷ Williams, 2011

¹²⁸ Ainsworth, 2011b, p. 160

While tax evasion and tax evasion in the human mind is perceived as something "cool", and as long as tax rates persist extraordinarily high or even rise, there will always be a notable tax gap. Fraudsters will always find loopholes in brand-new laws, policies or technology.

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