

Brussels, 31 May 2006

EU coherent strategy against fiscal fraud – Frequently Asked Questions

(see also [IP/06/697](#))

What does this Communication for a strategy against tax fraud exactly cover?

This Communication presents a whole range of pragmatic and realistic actions that could be taken against tax fraud. However, it is essential that this would be done in a coordinated and integrated manner. This Communication covers direct and indirect taxes but clearly the fight against VAT carousel fraud is a major issue within that Communication.

This Communication should serve as a basis for a broad discussion with Member States and stakeholders on a number of issues, for instance on reinforcing cooperation between Member States, increasing cooperation with third countries or on the need to modify the current community VAT legislation.

Why do we need a European action to combat tax fraud?

Tax fraud is a global phenomenon. Fraudsters are ahead of many companies and of tax administrations in terms of globalisation. In the context of the internal market, in particular, fraudsters take advantage of the four freedoms to move their activities very rapidly in order to escape from the reach of tax administrations that remain organised at a national level.

The free circulation of goods and services within the internal market but also the globalisation of the economy makes it practically impossible for a Member State to act individually against tax fraud. In order to address this phenomenon, there is a pressing need to define a coordinated action at EU level.

What are the Commission's suggestions?

The Commission proposes to reinforce the existing cooperation tools between the Member States as well as to introduce innovative measures if necessary in view of the development of an EU strategy against tax fraud.

The Commission believes that exchange of information could be improved by taking advantage of new developments in information technologies. In this context, declaration obligations could be re-examined with a view to fighting against fiscal fraud.

Moreover, the Commission considers that cooperation with third countries is essential in order to fight fraud. It is important to have a global approach, common to all taxes as well as to the entire EU in order to be effective.

Finally, solutions involving some legislative changes in the common VAT (see below: more extensive use of reverse charge) and excise duty system should be examined with an open mind.

What are the existing community tools to combat fraud? Why do we need to improve them?

Combating fraud is for a large part a Member State's competence. In order to assist Member States in this task, tools for administrative cooperation between Member States are available at EU level.

These tools are organised around each sector of taxation. Indeed VAT, excise duties and direct taxes all have their legal tools, committees, procedures for exchanging information and to some extent their own informatics system.

These tools, despite the efforts already deployed in the last years, need to be further improved and complemented. Moreover, it is necessary to ensure that Member States make more efficient use of the existing instruments.

They should be developed in a way that would allow a much more coherent approach to tackling tax fraud. Only a rapid and well targeted exchange of information and action at European level can assist Member States in their efforts to fight the rapidly adapting tax fraudsters.

What could be the expected impact of a coherent strategy?

At this stage it is very difficult to define the potential impact of a new coherent strategy on the level of reduction of the fiscal fraud. The intention of the Commission is to launch an in-depth debate at political level with Member States and stakeholders, in which all possible alternatives would be discussed with an open mind in order to find the most efficient and pragmatic way to fight tax fraud at European level.

How much support does the Commission expect from the Member States?

Several Member States consider that the fight against fiscal fraud is a priority. In addition, many Member States recognise that this fight against fiscal fraud is a problem that cannot be solved at national level. Some Member States have already quite innovative ideas about the fight against tax fraud, therefore the Commission is convinced that most Member States will be prepared to participate actively in the debate and hopefully to contribute to the definition of the new strategy.

Do we have figures on the amount of tax fraud in Europe?

Unfortunately, the Commission has no detailed figures on the level of tax fraud. Mainly because very few Member States make figures available. However, in the economic literature, estimates of tax fraud of 2 to 2.5% of GDP are mentioned. This would represent about 200 to 250 billion Euro at EU level.

On the VAT fraud, estimates of up to 10% of losses in VAT receipts are often quoted.

In order to have a clearer picture the Commission is about to launch an in-depth study on the amount of VAT fraud and different methods to assess it and gather comparable figures for all member States.

The Commission is only aware of more detailed figures which have been public in Germany and the UK. Germany has recently estimated the overall losses in VAT receipts at 17 billions € per year. This figure consists not only of losses due to carousel fraud but covers also losses due to black economy, deduction tax fraud and insolvencies. The so-called "VAT-gap", meaning the difference between the theoretical VAT receipts and the actual VAT receipts.

In the UK the VAT gap is estimated at 13,5 % of the VAT receipts, the revenue losses due to carousel fraud are estimated between €1,5 billion and €3 billion a year. This represents about 1.5% to 2.5% of the total UK VAT receipts.

On the excise fraud, Member States estimated in 1998 that **for alcohol** only, fraud amounted up to €1,5 billion yearly, which was approximately 8% of the total excise duties receipts on alcoholic beverages.

On the excise fraud related to tobacco, national EU customs authorities seized in 2004 more than 41 million packets of counterfeit cigarettes. Nowadays the market share of illegal cigarettes is equivalent to approximately 9% of the total excise duty receipts on tobacco products.

How does VAT carousel fraud work?

On internal supplies, a supplier charges VAT to his customer. His supplier pays this VAT to the Treasury. The customer, where it is a business, can reclaim this VAT from the Treasury. It is the final consumer who bears the VAT charge since he can not reclaim the VAT from the Treasury.

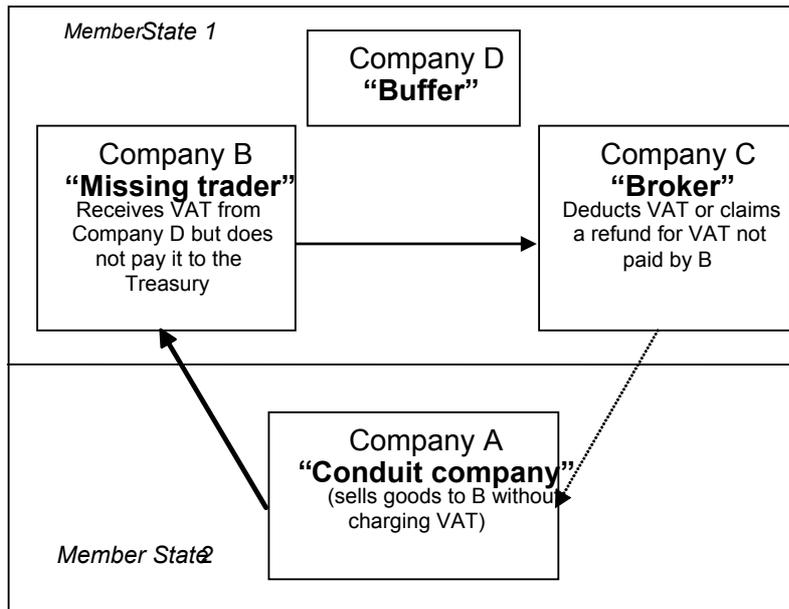
However, the rules are different for supplies to business clients in other Member States. The supplier does not charge VAT and the goods circulate VAT free.

The fraud mechanism works as follows. A company (B) acquires goods in another Member State without having to pay VAT to his supplier (A). Subsequently it makes a domestic supply for which it charges VAT to his customer (C). However, the company (B) does not pay the VAT to the Treasury and disappears. The customer (C) claims a refund of the VAT paid to the company (B). Consequently, the financial loss is for the Treasury which has to refund VAT to the customer (C) which it never collected from the supplier (B).

Subsequently, Company C may declare an exempt intra-community supply to Company (A) and, in its turn, (A) may make an exempt intra-community supply to (B) and the fraud pattern resumes, thus explaining the term "Carousel fraud".

The main elements are the fact that there has been an intra-Community transaction and a trader charging VAT to his customer but not paying it to the Treasury and "going missing".

This is a very simplistic description of the fraud, which in reality is much more complex, involving a series of transactions with intermediary companies (D) in order to hide the fraudulent character of it.



What is the so called VAT reverse charge mechanism?

The reverse charge mechanism can only be applied to supplies to business clients. It allows the supplier of goods or services to not charge VAT to his customer. The supplier does not pay the VAT to the Treasury and it is the customer to do it. This customer can subsequently deduct this amount of self invoiced VAT, when the goods or services are used for business purposes.

What's the Commission's position on the use of the reverse charge system as a tool to tackle VAT fraud?

A small number of Member States have advocated for a more extensive use of the reverse charge system in view of reducing VAT fraud. However, making a more extensive use of the reverse charge requires a change in the existing VAT legislation.

As it supports the objective of combating fraud, the Commission is examining the need for such a step with an open mind at this stage. It has notably to be analysed whether such a change provides for a clear reduction of fraud opportunities and does not create new opportunities for fraud. Furthermore, it may not lead to a disproportionate administrative burden for businesses and tax administrations and a neutral and non-discriminatory treatment of all operators would have to be ensured.

Why could the definitive VAT system (taxation at origin) reduce VAT fraud?

The so-called "definitive VAT system" is based on the taxation of goods and services in the Member State of origin.

An origin system would have many advantages; it would be simple for businesses and less vulnerable to fraud. Under such a system goods would not circulate tax free within the Community. It would certainly bring a solution to carousel fraud, although it would not be able to eliminate all kind of fraud (black economy).

A system of taxation at origin requires, however, a much higher degree of harmonisation of the taxation system and of the VAT rates compared to the current destination based VAT system, in order to avoid delocalisation of businesses.

It is obvious that there is currently not the political will amongst Member States to make such fundamental changes to the VAT system. Furthermore, it is to be reminded that such changes require adoption by unanimity.