“Modernization of the Value Added Tax System in the European Union”


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Chapter 1. Introduction.

1. Introduction to the topic.

The VAT system of the European Union takes its origin from 1967. “Since then, VAT has been introduced in around 140 countries worldwide”. However, the real harmonization started in 1977, when the Sixth Directive was issued, which established the uniform basis of assessment. In 2006, the Sixth Directive was reviewed, as a result of which the legal framework for the contemporary EU VAT system was established.

The system, which exists now, is considered to be a transitional, interim one. This transitional system was created in 1991 “in order to achieve the removal of border controls for tax purposes inside the Community from 1.1.1993”. Notwithstanding the fact that the system established, on the one hand is to be characterized as one which is more or less stable and efficient, on the other hand, through the years of its application different sorts of problems have arisen. Among these problems, there could be mentioned complexity of the current EU VAT system, functioning of the system not in line (or not completely in line) with the internal market of the EU, susceptibility of the system to fraud, functioning of the system not in line with the

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2 OECD, Consumption Tax Trends 2008, VAT/ GST and excise rates, trends and administrative issues, p. 23 (Citation: Green Paper of 1 December 2010 “On the future of VAT – Towards a simpler, more robust and efficient VAT system”, COM(2010) 695., P. 3)


changes in technology and economic environment. Also the issue of substituting “origin principle” of current EU VAT system to the future-oriented “destination principle” of EU VAT is on the agenda. In general, according to scientists’ opinion, there are more than 20 problematic issues in the current EU VAT system. Scholars say, “Reforming EU VAT has become inevitable and urgent”.

2. Motivation of the research question.

Taking into account all mentioned above, the research question of this Master Thesis will be: What could be the possible solutions to tackle EU VAT fraud, which are effective on the one hand and make the VAT administrative burden lower or keep it at the same level on the other hand?

3. Short explanation of the interrelationship that exists between the area of international business taxation on the one hand and the selected discipline in the area of law on the other.

There is a strong interrelationship between international business tax law as a scientific discipline and the legal regulation of VAT. European VAT system plays a considerable role in comparison with VAT systems all over the world. What is more, in comparison with the other areas of European taxation, the VAT area is

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11 Michel Aujean et. al. Op. cit. P. 16; Charles Jennings. The EU VAT System – Time for a New Approach? // International VAT Monitor, 2010, Volume 21, No. 4; Stephen Dale, Helene Percie du Sert, Christine Sonneleitner. European VAT system fights for survival. // International Tax Review. July/ August 2002. P. 35-36. Nevertheless, yet in 2004 European Commission believed that it is possible to solve some of the problems of the current VAT system (such as VAT fraud) within the system (therefore, without the necessity of its reform). For example, the European Commission in one of its reports supposed that the problem of EU VAT fraud could be solved by means of improvement VAT control mechanisms (and at the same time not reforming the whole EU VAT system). In general, the EU Commission in 2004 was very reluctant to reform the EU VAT system as a whole, and even calls reforming VAT system itself “hazardous” The EU Commission says that this approach “involves more risks and uncertainties than it offers solutions”. See: Commission of the European Communities. Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud. Brussels, 16.4.2004, COM (2004) 260. P. 3-4; 19.
deemed the most harmonized\textsuperscript{12}. VAT is crucial for the European Union, because it is the main instrument for economic and fiscal policy, and in theory, it should contribute both to economic growth, support budget consolidation and improve competitiveness of Member States\textsuperscript{13}. “By 2008 VAT receipts accounted for 21.4\% of the national tax revenues of EU Member States (including social security contributions), a rise of 12\% since 1995\textsuperscript{14}.”

4. **Limitations to the research.**

Due to the fact that it is not possible to cover all (or even the majority) of the VAT problems mentioned, the research will be limited to only very certain of them. In this research I would like to focus on two important and closely related problems of the current EU VAT system: 1) **EU VAT fraud** (mainly the “carousel” or, in other words, the “missing trader” fraud); and 2) **administrative simplification** of the current EU VAT system. It is important to mention that these problems are crucial from both public law and private businesses prospective. Here, one should take into account the fact that if one is trying to create a fraud-proof VAT system, it could be very likely that it might be rather complicated in the practical application, and vice versa, in simplifying the VAT system the possibility of the system being more susceptible to VAT fraud should be taken into account. Therefore, in current research the I will focus on finding a balance between the resistance of the reformed EU VAT system to fraud on the one hand, and its administrative simplicity on the other hand.

5. **Short description of the main findings (‘sneak preview of the results’).**

In this Master Thesis, I will try to find possible solution(s) to VAT fraud, and will also try to find out what can be the possible ways to make current EU VAT system more administratively simple. However, it is important to say that I will focus on finding a “harmonized solution”, in other words I will try to find out, to what extent fraud-proof EU VAT system can be administratively simple.

6. **Discussion of the academic and societal/practical relevance.**

The topic chosen has very high academic, societal and practical relevance. As an example, it could be said, that the European Commission, when it was publishing the Green Paper on the Future of VAT, in one of its parts (part 6. “Have your say”) mentioned that “the purpose of this Green Paper is to trigger and

\textsuperscript{12} However, the European Commission in its Communication on the future of VAT mentions that the EU VAT system is “fragmented into 27 national VAT systems, which constitutes the main obstacle to efficient intra-EU trade and thus prevents citizens from reaping benefits of a genuine single market”. What is more, the Commission points out that “internationally active business consider that the price they actually pay for this lack of harmonization comes in form of complexity, extra compliance costs and legal uncertainty”. // Communication of 6 December 2011 from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market, COM(2011) 851. P. 3.

\textsuperscript{13} For more information on this matter, see Michel Aujean et. al. *Op. cit.* P. 16.

encourage public debate on the future of EU VAT system\textsuperscript{15}. After collecting and considering all the opinions provided, the European Commission promised to issue at the end of 2011 a Communication\textsuperscript{16} “identifying those priority areas in which further action at EU level would be appropriate\textsuperscript{17}”. Even after issuing this Communication, some additional initiatives, based on it, were allowed\textsuperscript{18}. Also it is important to mention that another important international player – OECD, issued “International VAT/ GST guidelines\textsuperscript{19}” that are called “invitation for comments”, therefore, everyone, including private persons and businesses, public agencies are supposed to assess them and to comment on the Guidelines. Therefore, the topic chosen has crucial theoretical and practical relevance.

7. \textbf{Standard outline of the Master Thesis.}

This Master Thesis will be structured as follows: after the introduction and the description of normative framework in the subsequent chapter, there will be third chapter, which will be dedicated to VAT fraud. First of all, in this chapter the notion of VAT fraud will be discussed, as well as the types of fraud within the VAT system of the EU. Much attention will be paid to VAT “carousel”/ “missing trader” fraud as the most “famous” type of VAT fraud in the EU. After that, based on the analysis of scientific literature, I will try to propose possible solutions to tackle VAT fraud in the EU. The most popular solutions, such as reverse charge mechanism, split payment model and EUROFISC will be analyzed and tested against the Normative Framework in accordance to all criteria mentioned except administrative simplicity. The fourth chapter will be the following one, and it will be dedicated to administrative simplification of the current EU VAT system. In accordance with its title, this chapter will be fully dedicated to the analysis of the possible solutions to VAT fraud from the prospective of simplicity of EU VAT system and the administrative burden for businesses and for tax administrations. First of all, in this chapter I will talk about the current status of compliance costs in the EU. Also, within this chapter I will discuss the measures analyzed in the previous chapter (reverse charge mechanism, split payment model, EUROFISC) from a point of view of administrative simplification: 1) for businesses; 2) for tax administrations. In the last part of the fourth chapter, based on the previous analysis, I will try to find out, which of the measures to combat VAT fraud (analyzed in the third chapter) are the most suitable from the administrative simplicity point of view. A conclusion will complete this research in chapter 5.


\textsuperscript{16} Communication of 6 December 2011 from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market, COM(2011) 851.

\textsuperscript{17} Ibid.

\textsuperscript{18} “Subsequent initiatives following that Communication, will be based on thorough impact assessments”// Green Paper of 1 December 2010 “On the future of VAT – Towards a simpler, more robust and efficient VAT system”, COM(2010) 695. P. 22.

8. Motivation for the research method applied and the description of the research method.

A traditional legal method will be used in this Master Thesis. Due to the fact that there is a high level of harmonization in the area of VAT in the European Union, the methodology allows to use to a large extent the EU legislation concerning VAT as well as the EU Commission initiatives for the modernization of EU VAT system. In addition, the initiatives of some international organizations (OECD International VAT/GST Guidelines) concerning EU VAT modernization will be used. In the second, third and fourth chapter I will use descriptive, analytical and teleological methods of research.
Chapter 2. Development of the normative framework.

Due to the fact that current EU VAT system is now facing a lot of difficulties (as it was explained above), the normative framework for this Master Thesis will be:

1. Simplicity of EU VAT system;
2. Extended robustness of EU VAT system;
3. Efficiency of EU VAT system;
4. EU VAT system which is tailored to the single market;
5. Neutrality of the EU VAT system;
6. Flexibility of the EU VAT system;
7. Legal certainty of the EU VAT legislation.

These characteristics are mentioned in the European Commission’s Green Paper on the Future of VAT\textsuperscript{20}, Communication of European Commission on the Future of VAT\textsuperscript{21}, OECD International VAT/ GST Guidelines\textsuperscript{22} and in the scientific literature\textsuperscript{23}. This developing of the normative framework will be based on the sources, mentioned in the previous sentence. The two initiatives of the European Commission mentioned contain the basic ideas about how the current EU VAT system should be modified and what are the principles of its modification. The distinguishing of the principles mentioned above is very relevant primarily from the theoretical point of view. From the practical prospective, this strict distinguishing is less relevant, because these principles/ criteria are closely connected with each other and improvement of one criterion may “automatically” improve the other criteria\textsuperscript{24}.

According to OECD International VAT/ GST Guidelines, (in respect to the taxation of services and intangibles), the following principles must be insured\textsuperscript{25}:

1) International neutrality must be maintained.
2) Compliance for businesses involved in these supplies must be kept as simple as possible.
3) Clarity and certainty must be provided for both businesses and tax administration.
4) The costs involved in compliance and administering the tax must be minimal.


\textsuperscript{21} Communication of 6 December 2011 from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market, COM(2011) 851.

\textsuperscript{22} OECD International VAT/ GST Guidelines, Consolidated Version, April 2014, Committee on Fiscal Affairs, Working Party No 9 on Consumption Taxes.


\textsuperscript{24} See, for example, Communication of 6 December 2011 from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market, COM (2011) 851. P. 6.

5) Barriers to fraud and other abuses must be sufficiently robust.

These criteria basically cover the most crucial weak points of the current EU VAT system. However, because of the fact that in my thesis I am dealing with the measures to tackle EU VAT fraud and the administrative simplicity, I will talk more in detail about two of them: extended robustness of the current EU VAT system and simplicity of the current EU VAT system.

1. **Extended robustness of the EU VAT system.**

*Extended robustness* of EU VAT system for the purposes of this research shall mean that the system is enough fraud-proof. In respect to the principle of robustness and fraud-proof of the future EU VAT system, the EU Commission relies on the “modern methods of collecting and monitoring of VAT, which should maximize the revenues actually collected and limit fraud and avoidance as far as possible”\(^{26}\). The EU Commission points out that many studies concerning EU VAT fraud have been made from its side\(^ {27}\) (not taking into account the academic literature on this matter). According the EU Commission, “the success of any anti-fraud measure depends directly on the administrative capacity of national tax authorities”\(^ {28}\). Therefore, in my opinion, creating a robust and fraud-proof EU VAT system in this aspect is closely connected with creating an efficient EU VAT system. In accordance with the EU Commission, for the purposes of creating a robust and fraud-proof EU VAT system, there should be “enhanced relationships between Member States and businesses and their VAT procedures”\(^ {29}\). EU Commission considers that “strengthening cooperation with third countries with a view of exchanging information in the field of indirect taxation”\(^ {30}\) could also help to create a more robust and fraud-proof EU VAT system\(^ {31}\). Within the

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\(^{30}\) Ibid. See also on this matter: Kenneth R. Petrini, Robert H. Green, Elvin T. Hedgpeth, Emily A. Parker, Robert Adams. *Inter-Governmental Cooperation and Information Sharing – Where Are We Now?* // The Tax Magazine. Vol. 85, Issue 6 (June 2007), P. 43-54.

\(^{31}\) However, within the means how to make the system more robust and fraud-proof, the EU Commission enumerates also activities, which should be referred to the other parts of improvement of the current EU VAT system. For example, “easing compliance for business”; in my opinion, should obviously be a constituent part of the principle of simplification of the current EU VAT system. In its Communication on the future of VAT the EU Commission points out itself that “these priority topics are closely interlinked: a simpler VAT system for domestic combined with intra-EU transactions makes compliance easier and therefore contributes to its robustness” // Communication of 6 December 2011 from the Commission to the European Parliament, the Council and the
scope of measures directed straight to making EU VAT system more robust and fraud-proof. EU Commission mentions “an intensified, automated and rapid exchange of the information between national tax administrations32”. This measure, in my opinion, could also apply to creation of the EU VAT system tailored to the single market. Among the other initiatives of the EU Commission to combat EU VAT fraud and hence, create a more robust and fraud-proof system, there could be mentioned “setting up an EU cross-border audit team, consisting of experts of the national tax authorities to facilitate and improve multilateral controls33”. According to scholars, this will not increase compliance costs for businesses34.

2. Simplicity of the EU VAT system.

Simplicity of the EU VAT system for the purposes of this research shall mean that it should be easy (at least not very complicated) for the taxpayers to pay VAT and to fulfill all the administrative requirements which are connected with such a payment. In one of its Communications, dedicated to combatting fraud, the EU Commission points out that “the simplification of the fiscal environment is a key element in context of realizing the Lisbon objectives35”. In its Communication on the future of VAT, the EU Commission figures out that the simplification of the future EU VAT system should include at least two aspects: “1) simplification of the EU VAT legislation; 2) simplification of the so-called tax administration issues36”. The first aspect, in accordance with the European Commission’s Communication on the Future of EU VAT, should imply the creation of EU VAT Code as a primary normative expression of the principle of simplicity in the EU VAT system. The second aspect should mean that “a taxable person should only deal with the tax authorities of a single Member State37”. In addition, the simplicity of the EU VAT system should include low compliance costs for businesses. There is a point of view in literature, according to which, “compliance costs for businesses will even be reduced if the VAT authorities work together more closely and agree on a common approach to administrative efficiency, acceptance of results of inspections and smoother compliance obligations38”. I will provide more detailed information about the current status of compliance costs in the chapter 4 of this Master Thesis.

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32 Ibid.
34 Ibid.
37 Ibid. P. 5.
Chapter 3. VAT fraud in the European Union.

In chapter 2 (Normative Framework) I discussed the two principles: extended robustness of the EU VAT system and the simplicity of the EU VAT system, and in this chapter I will talk about EU VAT fraud and the solutions to it. Namely, the most attention in this chapter will be paid to VAT “carousel”/ missing trader fraud in the European Union, however VAT fraud in general as well as its types will be considered as well. It is important to mention that in this chapter, the solutions to deal with VAT fraud in the EU will be presented and analyzed in general, and in the fourth chapter, these solutions will be considered through the prism of administrative simplicity for both businesses and tax authorities.

1. The notion of fraud in respect to a Value Added Tax.

Most of the modern dictionaries contain the definition of fraud. For instance, Oxford dictionary defines fraud as “wrongful or criminal deception intended to result in financial or personal gain”39. Collins dictionary says that fraud is “deliberate deception, trickery or cheating intended to get an advantage”40. Fraud in most of the countries is considered as a criminal activity. For example, article 150 of the Criminal Code of Russian Federation provides another, legal definition of fraud: “Fraud is theft or obtaining the right to possess someone else’s property by means of deception or malpractice”. Even though the definitions of fraud (including the legislative definitions) in different countries may vary considerably, there are some common features, which characterize fraud as a criminal activity. In my opinion, the key characterizing elements of fraud are: 1) deliberate; 2) (criminal) deception; 3) in order to get financial or personal gain.

Fraud as a social event and a criminal activity could happen in different areas of life. In other words, different social relationships could serve as a “basis” for fraud. In this Master Thesis fraud will be analyzed in one particular sphere of life – tax relationships between the taxpayer and the tax administrations in the European Union. Within the tax relationships in general, fraud in only one part of them will be considered, fraud in indirect taxes, namely in VAT.

The definition of tax fraud can have certain specifics in comparison with the definition of fraud in general. Scientists define tax fraud as “deliberate omission to provide information, or to provide it in time or correctly, with the aim of either non-payment or underpayment of tax debts to the tax authorities, or recovery or overrecovery of tax claims from the tax authorities”42. Taking into account the particularities of tax legal relationships, fraud in tax area in all possible cases may not become “automatically” a criminal offence. This means that if tax fraud or VAT fraud does not fulfill the criteria, set out in criminal legislation43, from the public order point of view, there will be no fraud as a criminal offence, but there will be fraud as a tax offence, which means that the violators of the legislation will not be subject to criminal

43 General criterion of public danger of the activity, or, for instance, more specific criterion of a certain threshold of the amount of money illegally obtained as a result of fraud. (The difference depends on the criminal legislation of a particular country).
liability. However, I consider that the fraud as a social event, in general, should be qualified as a criminal activity, because sometimes fraudsters can avoid criminal liability just because certain legislative criteria were not fulfilled. Therefore, the normal course of events should be that the tax investigation in respect to the fraud should be followed by the criminal investigation. What is more, the more effective the tax investigation is (which means that it can both detect and stop the fraud), the sooner the criminal investigation against fraudsters will start.

VAT fraud in general has a big influence on the European Union’s economy. For example, the European Commission says, “some Member States have estimated losses caused by VAT fraud as up to 10% of net VAT receipts”. According to the statistics presented by some European private companies, “every year roughly 100 billion Euros are lost due to VAT fraud in the European Union”. According to other estimates, the losses from VAT fraud vary from 20 billion Euros to 35 billion Euros per year for all Member States.

2. **Types of VAT fraud in the European Union**

There are several types of VAT fraud in the European Union to be distinguished. They could be structured in accordance with the level (scope) of fraud. Thus, there are: 1) “domestic” VAT fraud; 2) “intra-Community” VAT fraud; 3) “international” VAT fraud. Among the **domestic** types of fraud there could be mentioned:

- Use of goods and services for private purposes despite the fact that VAT has been deducted, in part or in full, in respect of their acquisition.
- Supplies of goods or services “without VAT invoices” and, consequently, without payment of VAT. According to scientists, this type of fraud is the most effective when the customer is not entitled to deduct input VAT.
- Non or underreporting of tax debts.

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48 For additional information concerning different types of VAT fraud in the EU, see, for example, Silvia Fedeli, Francesco Forte. *EU VAT Frauds*. // European Journal of Law and Economics. 31:143-166. 30 December 2009. P. 147-148.


50 Ibid.

51 Ibid.

52 Ibid.
• Deliberate non-registration for VAT purposes of genuine individuals and businesses, whose turnover is above the registration threshold (“shadow economy fraud\textsuperscript{53}’’)
• Understating their sales by genuine businesses or false inflating their claims for VAT on purchases (“suppression fraud\textsuperscript{54}”)
• Purchasing taxable goods, after that selling them (often at inflated prices), and subsequently going insolvent without paying their VAT liabilities (“insolvency fraud\textsuperscript{55}’’)
• “Bogus trader fraud”. “Fraudsters register for VAT, make false claims for repayments (paid out by the VAT office!) and then abscond\textsuperscript{56}’’.

Among the types of fraud on “\textit{intra-Community}”\textsuperscript{57} level there could be distinguished:

• Non-declaration of intra-Community acquisitions of goods\textsuperscript{58}
• “Carousel” fraud/ MTIC (Missing trader intra-Community) fraud\textsuperscript{59}
• Miscategorization of domestic supplies as (zero-rated) intra-Community supplies of goods\textsuperscript{60}

There is at least one type of fraud which can be both domestic and “intra-Community” one. This is setting up chain of transactions channeled through “phantom companies”, i.e. companies that disappear into thin air by the time their VAT liabilities are due\textsuperscript{61}. This type of fraud has some common elements with the “carousel”/ MTIC fraud.

There is also at least one example of \textit{international} VAT fraud\textsuperscript{62}. It is miscategorization of domestic supplies of goods as exports\textsuperscript{63}.

\textsuperscript{54} Ibid.
\textsuperscript{55} Ibid.
\textsuperscript{56} Ibid.
\textsuperscript{58} Ibid.
\textsuperscript{60} Ibid.
\textsuperscript{61} Ibid.
\textsuperscript{62} For the purposes of this research, the term “international VAT fraud” should mean VAT fraud, taking place in the trade between the third countries and the EU.
There are also some types of fraud, which could happen on all three levels: domestic, intra-Community and international. Among these “general” types of VAT fraud, the European Commission distinguishes:

- False VAT returns\(^{64}\).
- Unauthorized VAT deductions\(^{65}\).

Also, if choosing as a criterion for categorization the sector of economy, which involves VAT fraud, probably one of the most well-known types of VAT fraud in the EU (along with the “carousel” fraud), is VAT fraud with emission allowances trading\(^{66}\).

3. VAT “carousel” fraud/ VAT missing trader fraud as the most “popular” type of the VAT fraud in the EU.

Certain scientists consider this types of fraud as the most “avoided” one among the other types of VAT fraud\(^{67}\). However, from the grammatical correctness point of view, of course, not the fraud is avoided, but the payment of tax (VAT) is avoided.

The general description of the mechanism MTIC/ “carousel” fraud is that it occurs “when a registered trader imports commodities from a supplier in another EU member country, invoices and collects VAT at home, but fails to remit the tax to the home authorities. By the time the tax authorities have detected the fraud, the company has already disappeared\(^{68}\).” The scientists point out the two key features used in the mechanism of “carousel” fraud, which are: 1) the VAT zero-rating on exports; 2) the system of deferred payment for VAT on imports, adopted in the EU since the removal of fiscal frontiers in 1992\(^{69}\). The second feature can be considered as the part of a VAT transitional regime, which, as it was already mentioned above, according to some scientists’ opinion, could be itself the first reason for the massive fraud in the EU\(^{70}\).

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\(^{65}\) Ibid.


\(^{69}\) Ibid.

4. EU VAT “carousel” fraud scheme.

The *scheme of work of the carousel fraud* is explained by the European Commission, as well as in the scientific literature.

First of all, it is essential to mention, that the “carousel” fraud as an illegal scheme has the intra-Community *supplies of goods* as the basis for its functioning. The European Commission found out in its Report in 2004 that “most cases of carousel fraud involve high value goods which are easy to transport such as computer components and mobile phones”. However, according to the EU Commission, “around 40 different sectors” of business connected with intra-Community supplies of goods, “have been identified so far”.

As the scientists point out, “for the purpose of making fraud profitable, the goods must be valuable, easily transportable, subject to standard VAT rate, easily absorbed by the market, and, preferably, their market prices must be volatile due to frequent introduction of new models, for example electronic devices, mobile telephones, automobiles, parts and components for those products etc.”. What is more, as the authors mention, “in some types of the industry, it is practically impossible for businesses to determine where the goods in question are physically located or at what stage of processing they are at the time of “supply”. The authors consider, that there could be situations with the types of goods mentioned, that “at the end of chain of supplies, goods are delivered to the same person who initially supplied them to the third party, which does not necessarily mean, of course, that the “carousel” fraud takes place.

Hence, from the mentioned above I can conclude, that **several types of goods** (at least, 40 varieties, as mentioned by the European Commission), will be **a priori very vulnerable to the VAT “carousel” fraud** due to:

- The natural characteristics of the goods themselves.
- The characteristics of the process of production of those goods.
- The characteristics of the process of supplying/ transportation of those goods.

This fact, along with the characteristics of the transitional regime of the European VAT system (see above), constitute, in my opinion, the **second important reason of the EU VAT “carousel” fraud**.

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72 Ibid.
75 Ibid.
76 Ibid.
77 Ibid.
The fraud scheme itself, according to the EU Commission, is as follows: “A so-called “conduit” company (A), makes an exempt intra-community supply of goods to a “missing trader” (B) in another Member State. This company (B) acquires goods without paying VAT and subsequently makes a domestic supply to a third company (C), called the “broker”. The “missing trader collects VAT on its sales to the “broker”, but does not pay the VAT to the Treasury and disappears. The “broker” (C) claims a refund of the VAT on its purchases from B. Consequently, the financial loss to the Treasury equals the VAT paid by C to 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 EU Commission in its report also provides an illustration of the scheme of “carousel fraud”.

![Diagram of the fraud scheme]

Picture 179.

The EU Commission points out, “the “buffer” could be unaware of the fraud but in most cases he is conscious that he is involved in an irregular type of transaction (because of the unusual nature of the commercial transaction)."

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79 Ibid.

Some scientists point out that the mechanism of VAT “carousel” fraud could be even more complicated, depending on the fact, how sophisticated the fraudsters are\textsuperscript{81}.

5. **Possible solutions to combat VAT fraud in the EU: different approaches.**

In this sub-part of the chapter three, the most popular solutions to combat VAT fraud in the EU will be presented and analyzed in general. However, in the fourth chapter, these solutions will be analyzed from the point of view of administrative simplification, both for businesses and for tax authorities.

In this sub-part of the chapter three I will deal with the initiatives, proposed by the European Government (European Commission), due to the fact that they are most systematized, however I will also deal with the initiatives, proposed in the academic literature by scholars.

Even though a massive fraud in the area of VAT in the European Union was detected already in the middle of nineties (soon after the introduction the so-called “transitional” regime for the European VAT system), the European Commission started to take it into consideration more or less substantially only in the beginning of the two thousandths, when the Commission’s Report and the Council’s Recommendations were issued. However, one cannot say that in the nineties there were no initiatives at all to combat the EU VAT fraud. E.g., in 1994, the VIES (VAT Information Exchange System) was introduced\textsuperscript{82}.

Nevertheless, already in two thousandths, the European Commission had to introduce VIES-II\textsuperscript{83}, because, according to the Commission, VIES “has proved itself to be an inadequate tool in the fight against carousel fraud, not because of the slowness of the system itself, but because of the length of time that elapses before information on intra-community acquisitions becomes available to Member States\textsuperscript{84}”. Another reason was the “incompleteness of VIES data\textsuperscript{85}”. In the first initiatives of the European Commission to combat VAT

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\textsuperscript{83} It was a revision of VIES and extended it on services.


\textsuperscript{85} Ibid.
fraud (including the report of 2004) there were also some scattered measures proposed, such as *coordinated mutual assistance and exchange of information and greater use of administrative cooperation*.\(^{86}\)

From the point of view of historical development of the EU VAT anti-fraud legislation, in my opinion, there is a clear trend that in the nineties the European government was willing to tackle VAT fraud only by means of closing the “loopholes” in the EU VAT legislation. However, already in 2004, in its Report to the Council and the European Parliament, the European Commission took an intermediate position. On the one hand, as it was already mentioned above, the EU Commission was still quite reluctant to reform the EU VAT system itself, and acknowledged this reform as containing many risks, on the other hand, it made some suggestions concerning “*adapting VAT system itself*”.\(^{87}\)

For the purposes of current research I will focus only on three possible solutions, which could be considered as the most popular in modern times: the reverse charge mechanism, the split payment model and the EUROFISC. I choose these three solutions to combat EU VAT fraud because these solutions are the most promoted by the European Commission. The first one deals with the change of the EU VAT system as such (reverse charge mechanism); the second one changes the mechanism of payment the VAT (split payment model); at the same time the third one is just a form of exchange of information.

**a. Reverse charge mechanism.**

Under a reverse charge mechanism, the liability to pay VAT is shifted from the seller to the buyer.\(^{88}\) In other words, “the person liable for the payment of the VAT on the particular transaction is the recipient/buyer”.\(^{89}\) “The supplier/service provider would be solely responsible for indicating the transaction to the Revenue service”.\(^{90}\) The reverse charge mechanism displaces the legal VAT payer to the country of destination, therefore it can be considered as a solution to EU VAT fraud under the destination principle.\(^{91}\) The scheme of reverse charge mechanism is presented below.

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87 Ibid. P. 15.


90 Ibid. P. 22.


The rationale of the reverse charge mechanism is that it is used to tax certain imported goods or services that are otherwise difficult to tax. The EU VAT Directive currently allows a reverse charge for some designated supplies in articles 194-199. “Art. 199 VAT Directive 2006/112/EC stipulates an exhaustive list of supplies, which Member States may subject to the reverse-charge mechanism, such as the supply of construction work.” Furthermore, “Art. 199a VAT Directive provides for a list of supplies, which – until 30 June 2015 – may for a minimum period of two years be made subject to the reverse-charge mechanism as well.” “Art. 199a VAT Directive will be amended by one of the new directives in light of the context: Member States will be allowed to...”

97 Ibid.
provide for a reverse-charge mechanism on certain supplies, which are prone to fraud, such as mobile phones, certain telecommunication services and the supply of game consoles, laptops or tablets. In respect to the experience of the particular EU Member States concerning the application of the reverse charge mechanism, it can be said that the United Kingdom “requested in 2006 (and received in 2007) authorization from the Council for a targeted reverse charge for certain products” (such as mobile telephones and computer chips). However, approximately at the same time Austria and Germany requested for authorization of a more general reverse charge mechanism, which was rejected. Nevertheless, “recently, these countries and Italy received authorizations from the Council (2010/710/EU) to introduce a reverse charge for the trade in mobile telephones and integrated circuit devices”. It is important to underline that, in accordance with the Council, the above mentioned changes in EU VAT Directive should not be interpreted “in a way a move towards a general reverse charge system”. The Council considers “VAT with reverse charge for all business to business transactions and standard VAT at the final stage unacceptable as a far reaching solution.”

The reverse charge mechanism served as a basis for a proposal of the European Commission called “Quick Reaction Mechanism”. It is aimed to enabling the Member States of the European Union to combat and prevent VAT fraud more efficiently. It was introduced in form of a proposal of the European Commission to amend the existing EU VAT Directive. As a result of the reform several new articles were added to the current EU VAT Directive. In its substance Quick Reaction Mechanism “gives the Member States possibility to apply the reverse charge mechanism to specific supplies for a short period of time under an accelerated procedure”. The approximate procedure of the functioning of the Quick Reaction Mechanism is demonstrated in the picture below.
Basically, the Quick Reaction Mechanism constitutes a form of authorization of the Member States by the European Union to apply the reverse charge mechanism “in order to combat sudden and massive forms of fraud in the field of VAT which could lead to considerable and irreparable financial losses108”.

In the scientific literature there are different opinions concerning the degree of efficiency of reverse charge mechanism as a measure to combat EU VAT fraud.

First of all, most of the scientists acknowledge that the reverse charge mechanism will eliminate EU VAT fraud as such, because “the supplier no longer acts as tax collector, does not receive any VAT payments from its customers, and cannot steal the VAT109”. However, in applying a reverse charge mechanism for intra-Community supplies one should bear in mind that its application will “create a strong tendency to

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108 Ibid. P. 95.
fraud by the last supplier, the retail sector\textsuperscript{110}, as well as “the abuse and hijacking of VAT-identification numbers, the creation of fake invoices, the replication of MITC patterns on the domestic scene, and black market activity\textsuperscript{111}”. What is more, the scientists say, “the retail sector is not always able to resist this (fraud) temptation in difficult times\textsuperscript{112}”. At the same time, some scientists assert that notwithstanding the fact of the risk of fraud in retail business, this sort of business is “easy to control, retailers are visible\textsuperscript{113}”. In addition to that, many scientists consider that with the introduction of targeted reverse charge mechanism for specific goods or services could create a situation, when the VAT fraud will migrate/ mutate to the other sectors of economy or to other goods or services\textsuperscript{114}.

Among the advantages of reverse charge mechanism there could be mentioned\textsuperscript{115}:

- “Increased receipts of the States. Germany estimates it would have additional revenues of 3.8 billion euros if this method were to be combined with the “R-check” control method\textsuperscript{116},
- “According to Germany, a 25% reduction of VAT losses due to the insolvency of companies\textsuperscript{117},
- “Allows the immediate VAT recovery (no pre-financing) and avoids the VAT refund discrimination between zero-rated businesses and tax-collecting business, since there would be no refund requests required\textsuperscript{118}.

Many scientists consider that the reverse charge has more disadvantages than advantages. For example, some scientists say, “the reverse charge regime for all business to business transactions creates heavy discriminations\textsuperscript{119}”. Scientists point out that “the real problem for the reverse charge system as applied on intra community imports is the interruption of the VAT chain, due to the fact that exporters and importers have different VAT codes and are under different VAT administrations\textsuperscript{120}”. As a fundamental shortcoming of the current reverse charge system in the EU it can be considered the fact that it breaks the existing


\textsuperscript{112} Ibid. P. 213.

\textsuperscript{113} Gabriel Biris. \textit{EU VAT legislation, an invitation to fraud}. Presentation for TTN conference Rome 2013, 20th September 2013, Rome, Italy.


\textsuperscript{116} Ibid.

\textsuperscript{117} Ibid.

\textsuperscript{118} Ibid.


\textsuperscript{120} Ibid. P. 156.
mechanism of fractioned payment\textsuperscript{121}. International VAT association considers that “Moving away from today’s fractionated payment system to a sales-tax approach based on the “reverse-charge” mechanism would multiply the potential sources of tax evasion in the EU\textsuperscript{122}.

It is important to mention that sometimes the reverse charge itself can be a cause for a massive VAT fraud in the European Union. For example, International VAT Association says, “Europe is witnessing a rise in fraud using reverse charge mechanism applied to cross-border supplies of services\textsuperscript{123}”. This is because of the fact that “by virtue of their intangible nature, services are more difficult to track, and do not require the same level of VAT reporting as supplies of goods\textsuperscript{124}”. According to International VAT Association, “the fraud industry has developed new strategies to “mask” their fraudulent activities, by actively exploiting the reverse charge mechanism to cross-border supplies of services\textsuperscript{125}” (see picture 4).

In accordance with International VAT Association, “If the principle of applying the reverse-charge mechanism is extended to other services, as currently proposed by the Commission, it will not only expand opportunities for MTIC fraud in services themselves, but also expand the opportunities for arranging fraud-masking operations similar to the model set out above\textsuperscript{127}”.

\textsuperscript{122} Ibid. P. 4.
\textsuperscript{123} Ibid. P. 5.
\textsuperscript{124} Ibid. P. 7.
\textsuperscript{125} Ibid. P. 8.
\textsuperscript{126} Ibid.
\textsuperscript{127} Ibid. P. 10.
There are also other shortcomings and disadvantages of the reverse charge system, which will be listed below:

1) **Diffusion of VAT.** In accordance with the “‘rule of thumb” in all Member States is that 80% of VAT is paid by less than 10% of taxable persons128.”

2) **New forms of fraud** (as it was already mentioned above) and increase of the amount of the so called “black supplies” (black market)129.

3) “**Significant initial costs of set up and operation of the new systems”**130.

4) “**Hijacking of VAT identification numbers will not be eliminated”**131.

5) There is a risk that “‘tax free” goods may end up in other Member States”132.

Even though some countries (for example, the UK) apply the reverse charge mechanism for certain supplies, in other words, they apply a “targeted” reverse charge mechanism, the International VAT Association acknowledges the potential risks connected to it. “Perhaps one of the greatest risks of a general reverse-charge system to be implemented within a specific jurisdiction, is the possibility that the fraud would be exported to other Member states who did not have this provision in place. This creates unknown levels of risk which would need in our view to be considered very seriously133”.

International VAT Association, referring to Institute for Fiscal Studies (UK) concludes that “extended reverse charging may provide temporary relief but do not address the underlying problem134”.

Therefore, my conclusion is that even though the reverse charge method combats EU VAT fraud completely (especially “carousel” fraud), for certain types of supplies – goods (such as mobile telephones and computer chips), in general it can lead to the movement of EU VAT fraud to the other areas. What is more, sometimes the reverse charge mechanism can be a cause of the VAT fraud itself (see picture 4 above). In addition to that, the reverse charge mechanism breaks some fundamental principles of the current transitional EU VAT system (for instance, the principle of fractioned payment), and therefore, for example, the generalized reverse charge mechanism could be deemed to be not very consistent with the current state of affairs in the area of indirect taxation in the European Union. Furthermore, it causes some other risks that affect different aspects of the European VAT system. Hence, from the prospective of efficiency, basing on the evidence, the reverse charge mechanism has proven to be not a very suitable (at least, not the best) solution to combat EU VAT fraud. As it was mentioned above, the reverse charge mechanism from the prospective of administrative costs will be analyzed in the subsequent (fourth) chapter.

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129 Ibid.

130 Ibid.

131 Ibid.

132 Ibid. P. 25.

133 Ibid.

b. **Split payment method.**

The split payment model is an alternative model to combat EU VAT fraud, proposed by the European Commission. The Communication of the European Commission contains the legal definition of the split payment method. According to Commission, it is a model, “in which the purchaser pays VAT to a blocked VAT bank account with the tax authorities’ bank, which can also be used by the supplier for paying VAT to his suppliers’ blocked VAT bank account.” However, in my opinion, this definition seems to be not very clear for understanding, therefore, I will prefer the definition, which explains why split payment model was called in this way. According to this definition of split payment model, “the total amount paid by the customer is to be split by the bank into the amount of VAT to be remitted to the tax authorities and the net amount to be paid to the supplier.” There is also another definition of split payment model, which, together with the definitions cited above, creates a comprehensive view on what the split payment model is. In accordance with this definition, “under the split-payment model, customers must transfer the VAT element of the total price to their supplier’s blocked bank account. The suppliers can only use the balance of that “VAT account” for remitting VAT to the tax authorities or for paying VAT to their suppliers, who must also have a VAT account.

Apart from the traditional split payment model, in the literature it is distinguished the so-called conditional split-payment method, in accordance to which, “if the supplier is not compliant, the customer must pay part of the invoice directly to the tax authorities.” In my opinion, this is a rather radical variety of split payment model, which, inter alia will be difficult to apply in practice.

In the scientific literature there is no unanimous opinion concerning the efficiency of the split payment model. For example, PricewaterhouseCoopers (PWC) in its report of 2010 suggested that split payment model could be a good solution to combat EU missing-trader fraud. Some scientists acknowledge an advantage of the split payment model that “at an early stage in the VAT collection process, the tax is physically transferred to a blocked account with the tax authorities’ bank. It allows the tax authorities to

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137 Ibid. P. 142.

138 Ibid. P. 239.

139 Ibid. P. 239.

monitor and block funds in the VAT accounts and prevent fraudulent businesses from embezzling amounts of VAT that they have received from their customers\textsuperscript{141}.

However, the intention of the European Commission to apply split payment model faced a negative reaction from businesses and tax practitioners\textsuperscript{142}. In addition, some scientists point out that “The feasibility of split payment model, as a rather complicated model is doubtful\textsuperscript{143}”. They say that it will be “probably ineffective in preventing missing-trader and suppression fraud\textsuperscript{144}”.

In my opinion, at the moment there is not enough relevant data on the feasibility and efficiency of the split payment model in combating EU VAT fraud. (That is why several years ago the European Commission has launched a study concerning the feasibility and efficiency of the split payment model as a means to combat EU VAT fraud, and at the same time is collecting the opinions of all stakeholders concerning its application\textsuperscript{145}). As for me, I will agree with the opinion of Fabrizio Borselli who says that “a “split-payment” model for enterprises operating cross-border could be implemented quickly, thereby creating a short-term impediment to existing fraud schemes\textsuperscript{146}”. The suitability of the split payment method from the prospective of administrative simplification will be analyzed in the subsequent (fourth) chapter of this thesis.

c. EUROFISC.

First of all, it is important to mention that EUROFISC as a measure to combat EU VAT fraud is a part of more generalized notion and more generalized measure – exchange of information. In my opinion, for the proper countering EU VAT fraud there should be build a system of exchange of information structured in different levels. According to my viewpoint, there should be: 1) exchange of information between the taxpayer and the tax authorities; 2) exchange of information between the EU Member States (between the tax authorities of the EU Member States); 3) exchange of information between the tax authorities of EU Member States and the European Commission; 4) exchange of information between the tax authorities of the EU Member States and the tax authorities of the third countries. However, taking into account the fact


\textsuperscript{143} Kenneth Vyncke, Axel Cordewener, Luc de Broe. Towards a Simpler, More Robust and Efficient VAT System by levying VAT at EU level. // International VAT Monitor. July/ August 2011. P. 244.

\textsuperscript{144} Ibid.


that the exchange of information is a rather broad measure to combat EU VAT fraud, in my thesis I will focus on the EUROFISC as the most “popular” part of the general exchange of information measure.

First of all, the Netherlands and France proposed a legislative initiative of stimulating of the international exchange of the information through the EUROFISC network. After that, the European Commission got interested in this approach in its Communication in 2008\(^\text{147}\). In 2010, the EU Council agreed\(^\text{148}\) on a recast of Regulation 1798/2003 on administrative cooperation in the field of VAT\(^\text{149}\). Subsequently, in 2010 the EU Council issued a Regulation\(^\text{150}\), which applies from 1 January 2012\(^\text{151}\). However, EUROFISC started its operational work on 7 and 8 February 2011\(^\text{152}\). The Regulation established a network for the swift exchange of targeted information between Member States\(^\text{153}\). According to scientists, “this is a decentralized network for the exchange of information on VAT fraud between the Member States whose functioning would be organized by agreement of the participating Member States, with the support of the Commission\(^\text{154}\)”. The EUROFISC has no legal personality\(^\text{155}\). In accordance with the scholars, “the network provides for a multilateral early warning mechanism as well as coordination of data exchange and the work of liaison officials in acting upon warnings received\(^\text{156}\)”. From a technical point of view, EUROFISC is a “shared electronic platform managed by the EU Commission, which allows real-time monitoring of information flows among different countries\(^\text{157}\)”. It is important to underline that “the Commission provides EUROFISC with technical and logistical support but has no access to the information that is exchanged through this network\(^\text{158}\)”. The scientists point out that the EUROFISC is based on the following principles: “1) the freedom of each Member State to participate in any of the network’s tasks; 2) active participation of the Member States in the exchange of information; 3) confidentiality of information exchanged\(^\text{159}\)”.


\(^{152}\) Ibid.


\(^{154}\) Ibid.


\(^{157}\) Ibid.


It is also important to mention that “EUROFISC network is not only a means of cooperation between the tax authorities of different Member States, but also means for cooperation between anti-fraud specialists in the various Member States.\textsuperscript{160}

The Regulation of the EU Council, which introduced EUROFISC, inter alia, specifies: “the cases in which Member States have to exchange information spontaneously; the procedures for providing feedback on such information; the situations in which Member States must conduct multilateral controls and share electronic databases on taxpayers and risk analysis; the conditions under which the authorities assist in the protection of VAT revenue in all the Member States. It also prohibits a refusal to provide information on a taxable person on the grounds that the data are held by banks and financial institutions.\textsuperscript{161}

In respect to the efficiency of EUROFISC as a means to combat EU VAT fraud, again (the same as for split payment model) there is no consistent opinion of the scientists in this matter. Those who “vote” in favor of it, argue, “If Member States would make full use of its potential, EUROFISC could play a crucial role in the process of restoring the proportionality of the EU VAT system.\textsuperscript{162} They add, “If necessary, the ECJ could push Member States into the right direction.\textsuperscript{163} They point out that “the tax authorities now have a legal basis for providing to each other specific information on abnormal situations or abnormal behaviour of businesses.\textsuperscript{164} The other scholars argue, “EUROFISC should be a great aid in setting up a risk analysis system at EU level by pooling the experience of the individual countries’ tax authorities.\textsuperscript{165} In my opinion, the fact that the Member States participate in the network on a voluntary basis,\textsuperscript{166} could also be considered as advantage of this measure to combat EU VAT fraud.

However, these and the other researchers acknowledge some shortcomings of the current EUROFISC system. For instance, they specify that the fact that “only when Member States suspect fraud can the related information be shared with other Member States on a voluntary basis represents a “highly subjective approach and the criteria for sharing information lack clarity and will undoubtedly vary from Member State to Member State.\textsuperscript{167} The other scientists indicate that EUROFISC “has so far failed to emerge as a meaningful platform for fiscal cooperation. Despite an annual reporting requirement, the deliberations of
EUROFISC remain secret. Transparency on EUROFISC is a necessary step to improving its effectiveness\textsuperscript{169}.

To conclude this part of the chapter 3, in my opinion, it is important to underline that EUROFISC “will not stop the fraud as such. Cooperation leaves the ‘driver’ of carousel untouched: deduction without payment\textsuperscript{170}”. However, scientists say that EUROFISC as a measure of “administrative cooperation may lead to an earlier detection of carousel fraud\textsuperscript{171}”. According to my viewpoint, basing on the analysis of the evidence, despite of some of its shortcomings, the EUROFISC has proven to be quite an effective measure to combat EU VAT fraud, even though it does not eliminate the fraud as such, but leads to its early detection. The suitability of the EUROFISC as a measure to combat EU VAT fraud from the prospective of administrative simplicity will be analyzed in the subsequent (fourth) chapter of this Master Thesis.


\textsuperscript{171} Ibid.
Chapter 4. Administrative simplification and measures to combat fraud in the VAT system of the European Union.

In chapter 2 (Normative Framework) I discussed the two principles of EU VAT system – extended robustness and simplicity, and in this chapter I will talk about the solutions to EU VAT fraud from the prospective of administrative simplicity. First of all, in this chapter I will address the current situation with the compliance burdens for businesses in the European Union. After that, the three selected measures to combat EU VAT fraud (reverse charge mechanism, split payment model and EUROFISC) will be analyzed from the prospective of the level of administrative burden: 1) for businesses; 2) for tax authorities.

1. Current status of the compliance costs in the EU.

The scientists indicate that the main difficulty in measuring the compliance costs for businesses is that there is no objective criteria, in accordance to which the compliance costs for businesses, except the “subjective” opinion of the businesses themselves172. In the recent years, several surveys took place (organized both by the European Commission and the private organizations, such as PWC), which were measuring the compliance burdens based on the estimations of respondents173 (businesses). The tax survey of 2004 held by the European Commission “shows that entrepreneurs that develop VAT activities abroad through a subsidiary, branch or permanent establishment not to experience bigger problems than they do in the country of their main establishment174”. However, “when VAT activities abroad take place without a subsidiary, branch or permanent establishment being present most businesses experience more and tougher problems than in their own country175”. Another survey identifies different reason for compliance burdens for businesses: “the diverse implementation of the EU VAT at a national level makes VAT compliance very burdensome and it is a source of legal uncertainty for businesses with cross-border activities176”. 

In 2010 PWC held a comprehensive report in respect to the VAT compliance. It “encompasses 183 countries and shows that it takes businesses an average 125 hours to comply with VAT: 82 hours are spent on preparation, 24 hours on filing, and 19 hours on payment177”. It specifies that “in EU countries businesses spend on average 73 hours to comply178”. Also it indicates that “in Finland the time spent is lowest (22

173 Ibid.
178 Ibid.
hours) and in Bulgaria the highest (288 hours)\textsuperscript{179}. Furthermore, it says that “in countries that allow online filing and payment compliance is reduced by 41 hours\textsuperscript{180}. Moreover, it adds that “when countries require taxable persons to submit invoices or other additional documents with their VAT return the compliance time is doubled\textsuperscript{181}. In addition to that, it asserts, “it generally takes less time to comply with VAT in the developed world than in the developing countries\textsuperscript{182}” and that “VAT compliance tends to be more time-consuming in countries where indirect taxes are not administered by the same tax authority that deals with corporate income tax\textsuperscript{183}. Apart from that, the report says “on average, it takes longer to comply with VAT than it takes to comply with corporate income tax\textsuperscript{184}”. In addition, the report reveals, “administrative procedures vary and can significantly impact the compliance burden\textsuperscript{185}. The report also demonstrates, that “in high income economies it tends to take less time to comply\textsuperscript{186}.

Basing on the evidence shown in the reports, I can make a preliminary conclusion in respect to the current level of VAT compliance, that the countries which are more developed, have higher income and which use modern means of technological progress (such as electronic invoicing etc.) in general have lower level of VAT compliance costs. In this sense, EU is a perfect example of a region, where the VAT compliance costs are even lower than in average in the world\textsuperscript{187}. Nevertheless, as it was already mentioned above, subjectively the businesses even in the EU assess their VAT compliance burden as high. Therefore, for the purposes of finding a solution for EU VAT fraud it is crucial to take into account administrative burdens considerations (both for businesses and for tax administrations). Further, the solutions presented and analyzed in the third chapter of this thesis will be assessed from the prospective of administrative simplicity for businesses and for tax authorities.

2. **Reverse charge mechanism.**

The evidence in the reports says that the application of generalized reverse charge mechanism will create “a greater degree of complexity for businesses”, due to the fact that the businesses will have to “operate both within the reverse charge mechanism and outside it\textsuperscript{188}”. Especially, in accordance with the House of


\textsuperscript{180} Ibid.

\textsuperscript{181} Ibid.


\textsuperscript{183} Ibid.

\textsuperscript{184} Ibid. P. 6.

\textsuperscript{185} Ibid. P. 9.

\textsuperscript{186} Ibid. P. 7.

\textsuperscript{187} See: PWC, The impact of VAT compliance on business, September 2010, \url{http://www.pwc.com/gx/en/tax/pdf/impact-of-vat.pdf}. Figure 7, P. 8.

Lords (UK), “if transactions arise that require the reverse charge to be declared in Output VAT, they will be administratively time-consuming and will require someone with a higher level of experience to process these transactions than would normally be the case with ordinary transactions, thus increasing costs\textsuperscript{189}.

The scholars argue that the reverse charge mechanism “would put a heavy burden on suppliers who would first have to verify that their customers are registered persons qualifying for application of the reverse charge\textsuperscript{190}.”

In addition to that, Sijbren Cnossen asserts, basing on the arguments of the European Commission, “the proper enforcement of reverse charging would largely depend on the level of the additional reporting obligations that would have to be imposed, particularly the detailed monthly listings of transactions subject to reverse charging as well as transactions subject to the normal VAT\textsuperscript{191}”. According to Cnossen, “the Commission seems to believe that the costs of reverse charging would exceed the benefits\textsuperscript{192}”. Below there will be presented a chart, in which the approximate additional reporting obligations of the supplier and the purchaser are demonstrated in case of use of reverse charge mechanism.

\begin{tabular}{|c|c|c|c|}
\hline
Supplier & No Additional Reporting Obligations & Global Listing: VAT Number of Supplier + Global Value of Purchases & Transaction-Based Listing: VAT Number of Supplier + Amount of Each Transaction \\
\hline
No additional reporting obligations & Normal audit; no verification of transactions & & \\
\hline
Global listing: VAT number of purchaser + global value of supplies & Rudimentary cross-check; indication of mismatch but not source & Cross-check; indication of source of mismatch & \\
\hline
Transaction-based listing: VAT number of purchaser + amount of each transaction & Rudimentary cross-check & Full cross-check; indication of mismatch & Exhaustive cross-checking; clear indication of mismatch \\
\hline
\end{tabular}

\textit{Table 1. Additional Reporting Obligations under Reverse Charging}

\textit{Picture 5}\textsuperscript{193}.

In addition to that, International VAT Association argues that the compliance burden for businesses is one of the main shortcomings of the proposal for the application of the reverse charge mechanism (both the

\textsuperscript{189} Ibid. P. 103.


\textsuperscript{191} Ibid.

\textsuperscript{192} Ibid.

\textsuperscript{193} Ibid.
generalized one and the targeted one). In conformance with the Association, “under the reverse charge system, the financial risk arising from the non-payment of VAT is transferred from the Treasury to businesses. It is the latter that bears the risk when deciding whether or not to charge VAT based on validating the status of their customer as a genuine taxable person. Such shift of responsibility from the tax administration to business with potential costs for business runs counter to the “Lisbon” objectives\(^{194}\). Also, the International VAT Association indicates that “Each business would have to keep two invoicing systems (B2B and B2C) or organize a flexible invoicing system to be adapted for billing VAT-registered businesses or non-registered businesses or even private persons and, as the case may be, to deal with any subsequent changes to the status of the customer\(^{195}\). What is more, “each business would have to provide periodically (monthly or quarterly) a list of his registered customers and file it with the tax authorities\(^{196}\). On top of that, the application of the reverse charge mechanism will lead to the increased burden for tax administrations. International VAT Association says, “Tax administrations would have to significantly increase the number of control officials to deal with the greater risk arising from the tax debt being spread over a larger number of taxable persons\(^{197}\). Furthermore, “The loss of fractioned payments of the VAT under the current situation should mean the introduction of additional obligations (for tax administrations) to assure that the tax, which is normally paid in stages, is not put at risk\(^{198}\). Furthermore, in accordance with the International VAT Association, from the point of view of tax administrations, “the risk that some transactions are not declared at one point in the chain transaction, and consequently subsequent transactions, is not eliminated and all the parties in a chain transaction must continue to be controlled\(^{199}\). Consequently, basing on the evidence cited above, according to my viewpoint, the reverse charge mechanism is not a proper solution to combat EU VAT fraud, because: 1) it is not consistent with the current EU VAT system; 2) it is not efficient (has many disadvantages and implies many (hidden) risks); 3) it is administrative burdensome a) for businesses; b) for tax administrations.

3. **Split payment model.**

As it was already mentioned above, there is no much evidence in the official documents and the scientific literature in respect to the feasibility of split payment model both from the prospective of efficiency of application and from the prospective of administrative burden for businesses and for tax administrations. This is why the European Commission is currently studying the feasibility of the application of this model and is collecting the opinions of all the stakeholders.

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\(^{195}\) Ibid. P. 24.

\(^{196}\) Ibid.

\(^{197}\) Ibid.

\(^{198}\) Ibid.

\(^{199}\) Ibid.
However, some scholars express an opinion, that among the other disadvantages of the split payment model, “it requires considerable investments by both businesses and tax authorities”\(^{200}\). From this statement, I can make a preliminary conclusion, that taking into account the fact that it is not a very well explored model, it can at least to a certain extent increase the administrative burden for businesses and for tax administrations. Therefore, in my opinion, even though the split payment model could be considered as quite an efficient model (it eliminates EU VAT fraud as such) (but still the impact of the split payment model should be explored further), in my opinion, it is not quite feasible solution from the perspective of administrative burden for businesses and tax administrations.

4. EUROFISC.

It is important to say, that due to the fact that EUROFISC is a relatively new measure to combat EU VAT fraud, there is currently not enough scientific research on the matter of its suitability from the administrative burden point of view. However, some scientists indicate that one of the principles, on which EUROFISC is based, is that it does not impose additional burden on businesses\(^{201}\). Also, in my opinion, the fact that the participation in the EUROFISC network is voluntary\(^{202}\) (for the Member States) should influence on the decrease of administrative burden for Member States (tax administrations). Of course, one should bear in mind, that the creation of EUROFISC as an international platform for exchange of information required some initial efforts from the European authorities (especially, the European Commission). What is more, it will require some additional efforts from the side of tax administrations of all the participating Member States. In general, in my opinion, EUROFISC as a part of more general measures of exchange of information, seems to me quite a suitable solution to prevent EU VAT fraud.

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\(^{201}\) See, for example, Fabrizio Borselli. *Op. Cit.* P. 28.

Chapter 5. Conclusion.

To make a preliminary conclusion in respect to the reverse charge mechanism as a means to combat EU VAT fraud, I can say that even though it eliminates EU VAT fraud as such (because when this mechanism is applied, as it was already mentioned above, there is no money left for fraudsters), this mechanism has considerable shortcomings from the prospective of the efficiency of its application. For instance, sometimes, the application of this mechanism is the cause of the fraud schemes, involving this mechanism, for example, with the supplies of services. In addition to that, the application of this mechanism increases considerably the administrative burden both for businesses and for tax administrations. Taking into account the fact that, basing on the surveys concerning EU VAT compliance costs, the EU businesses assess their compliance burden as high, in my opinion, it is impermissible to make the compliance costs even higher than they are now. In addition to that, the reverse charge mechanism is contrary to some fundamental principles of the current transitional EU VAT system (such as the principle of fractioned payment). That is why the European Commission is quite reluctant in applying the generalized reverse charge mechanism (because its application will mean a fundamental change of the existing EU VAT system. At the same time, the European Commission encourages all sort of initiatives of targeted reverse charge mechanism (for instance, European Commission’s Quick Reaction Mechanism). However, one should bear in mind that the reverse charge mechanism can be applied successfully as a means to combat EU VAT fraud only in case of fundamental revision or even abolishing the current EU VAT system, which is very unlikely to happen. Another possible condition of the successful application of the reverse charge mechanism as a means to combat EU VAT fraud is the change of the structure of the European Union as an economic and monetary union of politically independent states. In other words, if the Member States will give up their sovereignty and the VAT will be levied on a centralized EU level (which would imply that the European Union would become one single state), in my opinion, in this case the generalized reverse charge could be applied successfully. However, the scenario described above is very unlikely to happen.

In respect to the split payment model, I can say that, in my opinion, it is quite an artificial solution which was designed especially for the purposes to combat EU VAT fraud. As it was already mentioned above, the nature and the impact of the split payment method are not very well studied now. However, already in this moment it is obvious, that this solution to EU VAT fraud will influence on the efficiency and the compliance costs (especially for businesses) in a way that it will interfere in (and to certain extent break) the normal course of civil turnover. As it was considered above, the variety of split payment method called “conditional split payment method” (according to which the purchaser should divide his payment to the supplier into two parts: the amount of VAT, which he should directly pay to tax administration, and the net price, which he pays to the supplier), in my opinion, completely destroys the normal course of civil turnover. However, here it is important to bear in mind, that in general, as a solution to combat EU VAT fraud, the split payment model is more acceptable measure than, for example, the reverse charge mechanism, which has a lot more weak points and disadvantages, which makes it inapplicable (or applicable to a very low extent) in practice.
In regards to the EUROFISC, it is crucial to say that this is a solution, which does not combat EU VAT fraud as such, but at least helps to prevent EU VAT fraud. It is very important that this information exchange platform is created on a voluntary basis (the participation of the Member States in the program is voluntary). What is more, it does not create any sort of additional administrative burden for businesses (and in this way, leaves the administrative burden for businesses at the same level). However, of course, the creation of such a platform required some initial efforts from the side of the European Commission and probably the Member States. Nevertheless, in my opinion, this is a case of minor importance, because, as far as I am concerned, there will be much less efforts required to maintain this platform in order during the course of its functioning.

To conclude, I would like to say that from three solutions, analyzed in this Master Thesis, in my opinion, the most suitable solution to combat EU VAT fraud both from the prospective of efficiency and the prospective of administrative burden for businesses and tax administrations is EUROFISC, even though it does not combat EU VAT fraud as such, but only helps to prevent/ detect it to certain extent. On the “second place” in the “rating of applicability” of analyzed solutions, I would put split payment model. The last place in this “rating” would occupy the reverse charge mechanism, which, in my opinion, in current state of affairs (transitional EU VAT system) has a very limited applicability.

However, if we look at the solutions to EU VAT fraud from both prospectives (extended robustness and administrative simplicity), in my opinion, it is important to pay attention to split payment model. Even though its feasibility is not tested very well at the moment, and also taking into account the possible administrative burden for businesses, bearing in mind that there are no ideal solutions, in my opinion, we should accept that solution.
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