



**MASTER'S THESIS**

**CAROUSEL FRAUD IN LIGHT OF CURRENT AND FUTURE  
LEGISLATIVE SOLUTIONS**

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## **List of Abbreviations**

<b>AEO</b>	Authorized Economic Operator
<b>B2B</b>	Business to Business
<b>B2C</b>	Business to Customer
<b>CFE</b>	Confédération Fiscale Européenne
<b>CTP</b>	Certified Taxable Person
<b>EC</b>	European Commission
<b>ECOFIN</b>	Economic and Financial Affairs Council
<b>EU</b>	European Union
<b>GRCM</b>	Generalized Reverse Charge Mechanism
<b>HMRC</b>	Her Majesty's Revenue and Customs
<b>MOSS</b>	Mini One Stop Shop
<b>MTIC</b>	Missing Trader Intra-Community Fraud
<b>OSS</b>	One Stop Shop
<b>RCM</b>	Reverse Charge Mechanism
<b>SMEs</b>	Small and Medium-sized Enterprises
<b>TBE services</b>	Telecommunications, Broadcasting and Electronic Services
<b>TNA</b>	Transaction Network Analysis
<b>UEAPME</b>	European Association of Craft, Small and Medium-sized Enterprises
<b>UK</b>	United Kingdom
<b>VAT</b>	Value Added Tax
<b>VAT Directive</b>	Council Directive 2006/112/EC of the November 2006 on the common system of Value Added Tax
<b>VIES</b>	VAT Information Exchange System
<b>QRM</b>	Quick Reaction Mechanism

## 1. Introduction

“Value added tax, also known as a VAT, is an indirect tax, which represents a general tax on consumption. Applied more or less to all goods and services that are bought and sold for use or consumption across Europe, it represents a significant source of income not only for the Member States but also for the European Union as a whole.”<sup>1</sup> With that being said it is no surprise that each Member State gives great importance to the collection of VAT and in case of discrepancies between the amount of tax that was supposed to be collected and the amount that was actually collected (VAT gap) tries to detect what caused such a disparity so it can efficiently tackle this burning issue at the source.

Although it is difficult to precisely account for each factor in the final VAT gap, such as bankruptcy of the taxpayer, tax incentives, inefficiency of the tax administration and so forth, there is a common position on the level of the European Union that the most significant and harmful source of the VAT gap can be attributed to different types of fraud, with carousel fraud being the hardest to contend with. The European Commission calculated that VAT fraud caused damage in the amount of €50 billion<sup>2</sup> each year. So what kind of fraud is the European Commission referring to?

Before a detailed explanation of what carousel fraud really is and how the fraudsters operate, it is necessary to mention the fact that the ultimate goal of the European Union is the establishment of a single, commercially neutral market, where goods and services could move freely from one Member State to other, consequently ensuring stable and persistent growth of the European economy. In order to achieve this aim, starting from January 1993, the EU removed fiscal frontiers for the internal commerce between the Member States.<sup>3</sup> The practical implication of this move is that in the case of cross-border supply of goods or services from a supplier situated in Member State A (hereinafter: supplier A) to another supplier situated in Member State B (hereinafter: supplier B), supplier A will not be charged for VAT since his supply of goods is going to be treated as an “export”. Supplier B will also be relieved from the burden of VAT upon the “importation” of the same goods or services.

This non-taxation on the “export” and subsequently on the “import” of the same product is a specific mechanism based on the destination principle, i.e. it is considered that VAT should be levied in the country where the consumption takes place, since VAT is a tax on consumption.

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<sup>1</sup> “What is VAT?”, [https://ec.europa.eu/taxation\\_customs/business/vat/what-is-vat\\_en](https://ec.europa.eu/taxation_customs/business/vat/what-is-vat_en).

<sup>2</sup> “European Commission proposes far-reaching reform of the EU VAT system”, [http://europa.eu/rapid/press-release\\_IP-17-3443\\_en.htm](http://europa.eu/rapid/press-release_IP-17-3443_en.htm), (October 4, 2017).

<sup>3</sup> European Commission, *Internal market, From crisis to Opportunity: Putting Citizens and Companies on the Path to Prosperity* (Luxembourg: Publications office of the European Union, 2014), 4.

“The intention of zero rates is to safeguard the principle of taxation in the country of destination.”<sup>4</sup> This mechanism surely precipitated the process of European economic integration but also left certain loopholes which have been extensively abused since 1993. The scheme which briefly outlined the operating system of European intra-Community supply has not been altered in more than 20 years, enabling taxpayers to collect VAT unlawfully. Namely, current regulation allows the registered taxpayer to “import” goods from a supplier situated in another Member State without having to pay VAT upon “importation”, sell those goods further while simultaneously invoicing and collecting VAT in his own country, without remitting the tax to the tax authorities. By the time the tax authorities detect the fraud, the company has already disappeared. This type of fraud is known as missing trader intra-Community fraud (MTIC). In the case of repeated fraud, it is called carousel fraud.

“By realizing what a hazardous effect carousel fraud has on the European economy, the European Commission proposed on 4 October 2017 a set of measures and principles which are supposed to reduce the possibility of fraud to a minimum and would also set the fundamental principles or cornerstones for a definitive VAT regime.”<sup>5</sup> Another, more detailed *proposal* was presented on 25 May 2018 and should serve as guidance for the Member States in what they should expect and how they should prepare for the upcoming changes following the introduction of new legal institutes into the VAT system. Professionals in tax circles are generally supportive of the Commission’s efforts to establish a permanent VAT regime together with the proposed measures. However, they expressed skepticism in regards to timing, especially taking into account that Member States will have to unanimously agree on the application of tools like One Stop Shop, which could lead to difficult and long lasting political negotiations.<sup>6</sup> Moreover, further suspicion was raised whether the proposal will lead to simpler rules for SMEs or tackle overall VAT fraud.<sup>7</sup>

### **1.1. Benchmark**

Value added tax is one of the most important sources of EU financing and with its ever growing portion in the EU budget, it does not come as a surprise that the European Commission is putting significant effort to close all the loopholes of the existing system, which enable the erosion of the amount of VAT Member States collect. However, despite many efforts to redesign the VAT system during the past 10 years, the VAT system is unable to keep pace with the challenges of today’s global, digital and mobile economy and widespread, cross-border VAT fraud causing significant budgetary damage. Namely, despite significant efforts,

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<sup>4</sup> Ben Terra, *The place of supply in European VAT* (the Netherlands: Kluwer Law Interantional, 2016), 9.

<sup>5</sup> “Single VAT Area”, [https://ec.europa.eu/taxation\\_customs/business/vat/action-plan-vat/single-vat-area\\_en](https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat/single-vat-area_en).

<sup>6</sup> “European Commission Proposes Far-reaching Reform of the EU VAT System: a Single EU VAT Area”, <https://meijburg.com/news/european-commission-proposes-far-reaching-reform-of-the-eu-vat-system-a-single-eu-vat-area>, (October 6, 2017).

<sup>7</sup> “SMEs Say No to Commission Approach for Definitive VAT System”, <https://www.eubusiness.com/Members/UEAPME/single-vat>, (March 6, 2018).

businesses are still confronted with complex VAT rules, resulting in unacceptable administrative burdens, domestic and intra-Community transactions are treated differently for VAT purposes, and the way in which VAT rules apply in practice diverges across the European Union, which has the effect that VAT is an obstacle to the functioning of the internal market.<sup>8</sup> As the technological and economic environment has changed and continues to change rapidly, the EU VAT system has not been able to keep up with this evolution and a reform of the current VAT system is necessary to maximize revenue collection and to end the susceptibility of the system to fraud.<sup>9</sup>

This incentivized the European Commission to start a more determined fight against such negative trends and to create system which would be more robust, simpler and from the perspective of this Master's thesis most importantly - **fraud resilient**.

Namely, a system based on increased trust and cooperation between tax administrations.<sup>10</sup>

“Therefore, the European Commission adopted the new proposal to fundamentally change the current VAT system by taxing sales of goods from one EU country to another in the same way as goods are sold within individual Member States, consequently creating a new and definitive VAT system for the EU.”<sup>11</sup> Proposed measures should be appropriate tools to reduce the possibility of carousel fraud to a minimum, along with establishing a level playing field.

Along with the measures which should prevent or, more accurately, reduce the possibility of VAT fraud occurrence, the European Commission introduced several instruments which should facilitate the reduction of administrative costs for businesses and enhance the level of certainty for their economic operations. Certified taxable person and One Stop Shop are considered as the most important instruments and will be dealt with in detail later on.

Therefore, this thesis will try to answer the following question:

**To what extent will the solutions proposed by the European Commission in October 2017 be able to close all the loopholes of the current VAT system and make it fraud resilient?**

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<sup>8</sup> Kenneth Vyncke, Axel Cordewener and Luc De Broe, “Towards a Simpler, more Robust and Efficient VAT System by Levying VAT at EU Level”, *International VAT Monitor*, (July/August 2011): 242.

<sup>9</sup> *Ibid.*

<sup>10</sup> “Questions and Answers on VAT Reform in the EU”, [http://europa.eu/rapid/press-release\\_MEMO-17-3444\\_en.htm](http://europa.eu/rapid/press-release_MEMO-17-3444_en.htm), (October 4, 2017).

<sup>11</sup> “European Commission proposes far-reaching reform of the EU VAT system”, [http://europa.eu/rapid/press-release\\_IP-17-3443\\_en.htm](http://europa.eu/rapid/press-release_IP-17-3443_en.htm), (October 4, 2017).

Additionally, the thesis will also evaluate to which extent the current VAT system could be labeled as robust and simple, as well as what are the main drawbacks of the existing regulation that should be amended in order to achieve the goals set by the European Commission in its proposal from 4 October 2017.<sup>12</sup>

## **1.2. Method and Material**

A legal-dogmatic approach was applied to provide a comprehensive insight into carousel fraud, its sources, measures to combat it and the new proposal regarding the improved ways to tackle this unwanted, widespread phenomenon. The main idea of the thesis was to assess current regulation regarding carousel fraud and the recent proposal of the European Commission by using relevant academic literature, legal articles, EU official commentaries and reports. The majority of the literature used can be found on the leading tax online platforms such as KluwerLawOnline, IBFD and EUR-Lex. During the writing of the Master's thesis, various texts in English and Croatian were taken into consideration.

## **1.3. Motivation of the Subject**

Carousel fraud has been a serious fiscal problem for the European Union for quite some time. By causing a significant financial problem for both Member States' treasuries and the EU treasury to an estimated amount of €50 billion annually, it is a "hot potato" for European VAT policy makers. "Being aware that the existent system of VAT collection does not present an adequate solution for today's commerce, especially in the case of the supply of goods and services among businesses registered in different Member States, the European Commission is trying to find an optimal solution that would be in line with type of VAT system the Commission wants to establish: simple, efficient, neutral, robust and fraud-proof."<sup>13</sup>

However, new rules often incur significant compliance costs which, up to now, proved to be burdensome for the businesses operating on European soil, so extra caution is necessary when proposing new solutions. Furthermore, under the assumption that the new measures prove to have a positive effect – reducing carousel fraud to acceptable levels, the question arises, at what cost?

Therefore, this thesis will try to answer the question to what extent the current system is able to successfully combat carousel fraud and what are the main loopholes that need to be closed. Furthermore, it will try to examine the strengths and weaknesses of the European Commission's October 2017 proposal and how the proposed measures would influence business compliance costs. Finally, it will try to give an answer to which

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<sup>12</sup> Ibid.

<sup>13</sup> Communication 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, final.



path the EU should take in order to ultimately establish a permanent VAT system, which would be, as noted previously, simple, efficient and, most importantly – fraud-proof.

#### **1.4. Outline**

As it will be touched upon later on, there are many types of VAT fraud but due to the page limitation, this thesis will focus exclusively on carousel fraud because of its magnitude and its significant impact on the European budget. Nonetheless, in order to achieve a better understanding of the topic, a short overview of the leading operating principles of VAT will be presented, along with existing tools for combating fraud. For the most part, this thesis will, however, focus on the Commission’s recent proposal aimed at devising an optimal legal frame which would successfully combat carousel fraud. It is important to stress that this thesis was completed on 15 June 2018, therefore, no later publications or amendments of the proposal of the European Commission were taken into account.

## 2. Tax Fraud

### 2.1. Principle of Neutrality as One of the Main VAT Principles

As noted earlier, the European Union aimed to establish a system which would be based on the principle of fiscal neutrality. “The objective of the principle has to be inferred from the preamble of the first VAT Directive stating that establishing a common market in which there is a healthy competition and whose characteristics are similar to those of a domestic market presupposes, inter alia, turnover taxes that will not distort conditions of competition or hinder of free movement of goods and services.”<sup>14</sup>

“It is clear that the principle of fiscal neutrality is strongly connected with the objective of the common market and the fundamental rights protected by the *Treaty on the functioning of the European Union*<sup>15</sup> and therefore, only a neutrally applied turnover tax can avoid distortion of competition, free movement of goods and services within the common market.”<sup>16</sup> “In that sense, Article 138 of the Council Directive on the common system of value added tax (VAT Directive) prescribes that Member States shall exempt the supply of goods dispatched or transported to a destination outside their respective territory but within the Community, by or on behalf of the vendor or the person acquiring the goods, for another taxable person, or for a non-taxable legal person acting as such in a Member State other than that in which dispatch or transport of the goods began.”<sup>17</sup> In other words, cross-border supplies within the EU leave the country of the initial supplier tax-free. Article 140 of the VAT Directive is on the other hand, prescribing exemptions on the importation of goods, i.e. it prescribes that goods and services which are being “imported” from other Member States shall also enter the territory of that other Member State VAT free.<sup>18</sup> This is the so called *external neutrality*<sup>19</sup>, which ensures that import-export transactions do not receive worse fiscal treatment than domestic, internal transactions. Apart from external neutrality, internal neutrality is also one of the fundamental principles underpinning the system of VAT.

“Namely, *internal neutrality*<sup>20</sup>, in a domestic situation, is achieved at the level of the taxable person by granting the right to deduction on the VAT paid to the supplier; thus, under this scenario, VAT is strictly a matter of cash flow until it is recovered by the latter (e.g. the beneficiary of the goods or service traded), as input VAT will be deducted and recovered from the state budget.”<sup>21</sup> In other words, internal neutrality is

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<sup>14</sup> Claus Bohn Jespersen, *Intermediation of Insurance and Financial Services in European VAT* (Netherlands: Kluwer Law International, 2011), 75.

<sup>15</sup> See Treaty on the Functioning of the European Union, especially part three - Union Policies and Internal Actions, Title I and Title II of the Treaty

<sup>16</sup> C. Bohn Jespersen, *Intermediation of Insurance and Financial Services in European VAT*, 75.

<sup>17</sup> Article 138 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

<sup>18</sup> Article 140 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

<sup>19</sup> To read more about the external neutrality please consult: Ben Terra, and Julie Kajus, *A guide to the European VAT Directives* (Amsterdam: IBFD, 2004)

<sup>20</sup> To read more about the internal neutrality please consult: Michael Lang, Peter Melz and Elenor Kristoffersson, *Value Added Tax and Direct Taxation: Similarities and Differences* (Amsterdam: IBFD, 2009)

<sup>21</sup> Raffaele Petrucci and Karoline Spies, *Tax Policy Challenges in the 21<sup>st</sup> Century* (Vienna: International Tax Law, 2014), 123.

ensured through the right of the deduction of input VAT throughout the supply chain, given to the businesses, leaving only the final consumer with the VAT burden that needs to be settled.

## 2.2. Carousel Fraud

Even though the concept of external neutrality has sound reasoning behind it and an aim which it is trying to secure, its shortcomings made it an easy target for fraudsters around the globe who are, by using a special kind of fraud scheme, causing considerable financial damage for the European Union. An important characteristic of carousel fraud is that it is happening extremely fast so it is hard to detect in real time and prosecution causes severe problems for the tax administration. Probably the most significant problem is the fact that it is possible to recover the money to the treasury only in a small number of cases.

“Since major VAT fraud firstly emerged over twenty years ago, it was spread predominantly across Western Europe, but with the fifth enlargement of the European Union in 2004 including Cyprus, Estonia, Lithuania, Poland, Czech Republic, Slovakia, Hungary following Bulgaria and Romania in 2007, it spread to the east as organized gangs have sought new regimes that did not have a lot of experience in the field of such fraudulent activities, which made them extra vulnerable.”<sup>22</sup>

The principle scheme of VAT fraud is applicable to any Member State with fraudsters operating as follows: company A, the so-called “conduit company” (A) makes a zero-rated intra-Community supply of goods to a “missing trader” (B) in another Member State. This company (B) acquires the goods without paying acquisition VAT and, subsequently, makes a domestic supply to a third company (C), called the “broker”. The “missing trader” collects the VAT on the supply to the “broker”, but does not pay the VAT to the tax authorities, and disappears. “The “broker” (C) claims a refund of the VAT on its purchases from B.”<sup>23</sup> Consequently, the financial loss to the treasury equals the VAT paid by C to B. Subsequently, C may declare a zero-rated intra-Community supply to A and A may make a zero-rated intra-Community supply to B, so the fraud pattern repeats. If the fraud circle is not repeated, it is called a missing trader intra-Community fraud (MTIC), and if the fraud circle repeats, it is called a carousel fraud.

Goods which are especially suitable for conducting the fraud are high value goods, of small volume and easy to transport such as mobile phones, gold and microchips. Over the time, fraudsters turned their attention to intangible property, such as software, licensing, gas and electricity, emission trading, which is obviously much harder to keep track of.

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<sup>22</sup> “5 EU Countries Demand Anti-VAT Fraud Powers”, <https://www.vatlive.com/vat-news/5-eu-countries-demand-anti-vat-fraud-powers/?sessionId=1520507722190&referrer=https%3A%2F%2Fwww.google.nl%2F&lastReferrer=www.vatlive.com>, (May 8, 2015).

<sup>23</sup> Report from the Commission to the Council and the European Parliament on the use of administrative cooperation agreements in the fight against the VAT fraud, COM(2004) 260, final.

“Although Member States are facing different variations of fraud, according to the general experiences, companies with the following characteristics should definitely be under special supervision of the tax authorities in each State: risky business sectors like construction, secondary raw materials trade and gold trade, certificate trade and so forth; enterprises with no assets and small founding capital; very young or old persons registered as a founders and responsible persons; foreign citizens being members of the board of directors; detection of the three-sided transactions or trade with the third countries; lack of an e-mail address, -telephone number and a web-site; payments to the partners in cash and so on.”<sup>24</sup>

Even though it may seem at the first that the fight against carousel fraud is a losing battle, many Member States proved that it is possible to, if not eradicate, then at least to minimize its effect, by using the right tools. France set the perfect example a few years ago when it exempted domestic trade from VAT in cases of carbon credit trade, while other countries, such as the UK, Germany and Spain either activated the possibility of the use of the reverse charge mechanism, which is going to be explained in Chapter 3, or they simply lowered the VAT rate to zero, leaving the fraudsters without a motive to pursue their criminal activities.

However, the fight against carousel fraud will never be fully successful as long as efficient tools are not introduced and available measures are being applied only by some Member States, consequently forcing fraudsters to move to other countries which did not introduce such measures. Finally, without proper and strong administrative cooperation between tax administrations, fraudulent activities will keep happening and there are no successful measures to combat them.

### **2.3. Existing Tools for Fighting Carousel Fraud**

In order to construct an efficient and well-rounded VAT system, the European Union is forced to maneuver between two opposite tendencies; on the one hand, the natural tendency of levying an extra administration burden on the businesses with each new amendment of the existing system, and on the other hand, a tendency to create a system that will be easy to maintain and will close all the loopholes of the existent system.

Until 2017, all suggestions and legal possibilities introduced by the EU were served to a great extent only to “paper over the cracks” rather than enact core changes, and were partially efficient only in combating the type of fraud in question, leaving the burning question - how to remove multiple flaws of the current VAT system, without an answer.

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<sup>24</sup> Ana Dorić Škeva and Goranka Ramljak, “Uloga analize rizika u sprječavanju PDV prevara”, *Porezni Vjesnik*, (November 2015): 37.

With the incentive to eradicate the growing number of frauds causing significant budgetary losses, the Commission passed two Directives with amendments of the VAT Directive: *Directive 2013/42/EU on the common system of value added tax*, as regards a *quick reaction mechanism* against VAT fraud- aimed at enabling immediate measures to be taken in cases of sudden and massive VAT fraud and *Directive 2013/43/EU on the common system of value added tax*, allowing Member States to apply, on an optional and temporary basis, a *reverse charge mechanism*, with the goal to prevent certain types of known fraud, in particular carousel schemes.

“Besides adopting the mentioned Directives, The Commission recommended that administrative steps should be taken to make intensive use of the administrative cooperation machinery, allocate more human resources to multilateral controls, reduce the average response time to mutual assistance requests, adopt computerized auditing techniques as soon as possible, and set up national fraud departments empowered to exchange information with other Member States.”<sup>25</sup>

The Commission stressed the importance of strong administrative cooperation between the Member States, because, as it will be presented later, by using Eurofisc (an instrument which Member States use to multilaterally exchange information for the early detection of fraudulent schemes), most Member States did confirm that the system has significantly helped them with detecting missing traders, conduit companies, deregistering companies and so forth. What are the practical implications of application of the mentioned tools and to which extent they serve as effective defense against the fraud, will be discussed in the following Chapter.

### **3. Reverse Charge Mechanism**

#### **3.1. Introduction**

The reverse charge mechanism is a tool applied to simplify trade within the EU market<sup>26</sup> and prevent the occurrence of VAT fraud. Namely, the reverse charge shifts the responsibility of reporting a VAT transaction from the supplier of goods or services to the buyer. That way, the reverse charge mechanism can be applied in both domestic transactions where it is applied in high-risk sectors such as metal, glass and construction as well as in cross-border transactions. Its role is two-fold: on the one hand to prevent different types of fraud and on the other hand to ease the administrative burden regarding VAT collection and remitting in terms of cross-border transactions.

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<sup>25</sup> Commission of the European Communities, proposals for a Council decision authorizing Latvia to extend the application of a measure derogating from article 21 of the Sixth Council Directive 77/388/EEC on the harmonization of the laws of the member states relating to turnover taxes, COM(2005) 376, final.

<sup>26</sup> “The Reverse Charge Mechanism”, <https://www.vatglobal.com/reporting-obligations-vat-guides/the-reverse-charge-mechanism>.

In case this mechanism is not applied, sellers which are not registered in the Member State of delivery should register in each and every EU country where the goods are supplied to, which would in the end represent a significant cost and administrative burden for such sellers.

Although the general rule laid down in Article 193 of the VAT Directive states that the supplier is liable for the remitting the VAT to the tax authorities, as it will be demonstrated later, the Directive also offers several possibilities to switch that burden from the business supplier to the (business) customer by using a reverse charge. The rationale of such option is, as noted before, besides easing the operational costs of smaller business, e.g. simplifying tax collection, to allow Member States to combat fraud more efficiently in certain risky sectors.

When a transaction is subjected to reverse charge, the recipient of the goods or services reports both their purchase (input VAT) and the supplier's sale (output VAT) in their VAT return. "These two declarations offset each other from a cash payment point of view, but the authorities have full visibility of the transactions."<sup>27</sup> At the same time, the supplier of goods or services does not mention at all the VAT on the issued receipt but only remarks the fact that the reverse charge has been applied.

What is important to emphasize is the principle character of VAT, which makes it fundamentally different than the sales tax and that is the fact that European VAT is levied on each stage in the supply chain – so called fractionated payment.<sup>28</sup> "That way, fractionated payment serves as a built-in protection of tax revenues against the hidden transactions because it ensures that the tax authorities collect at least part of the VAT on those transactions; businesses cannot claim input VAT relating to hidden transactions without attracting the attention of the tax authorities."<sup>29</sup> However, due to different incentives, such as combating tax fraud or easing tax collection, many examples where the principle of fractionated payment is not completely followed can be found in the Directive; *optional reverse charge* used to combat carousel fraud (Articles 199 and 199a of the VAT Directive) for the specific categories or services, *quick reaction mechanism* (Article 199b) which can be used after obtaining the authorization by the Commission in case of imperative urgency and irreparable financial losses, *special measures for derogation* in order to prevent evasion (Article 395), where authorization of the Commission is necessary, but was so far never granted although five applications were submitted.

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<sup>27</sup> Ibid.

<sup>28</sup> Henk van Arendonk, Sjaak Jansen, and Rene van der Paardt, *VAT in an EU and International Perspective* (Amsterdam: IBFD, 2011), 100.

<sup>29</sup> Beate Wohlfahrt, "The Future of the European VAT System", *International VAT Monitor*, (November/December 2011): 387.

“This system puts on the retail sector the charge of collecting VAT due for the whole consumption chain, risking having the fraud shift to the last stage of the distribution chain, which is the main reason why some countries are opposed to such mechanisms.”<sup>30</sup>

### 3.2. Generalized Reverse Charge Mechanism

The idea of the generalized reverse charge mechanism is not new - Austria in 2005 and Germany in 2006 required derogation of Article 395 of the VAT Directive by demanding the application of RCM to all domestic B2B transactions. These requirements were backed by the argument that in the case the supplier is relieved of VAT liability, it will have a positive effect on the elimination of VAT fraud. However, The European Commission was not too keen to back such a proposal. Deeming that such a drastic detachment from the fundamental principles of VAT would not benefit further development of VAT, especially taking into consideration the financial burden which would be levied on both tax administration and businesses, other solutions were sought. The idea was not to combat fraud on the level of each Member State but rather on the level of the European Union and common EU rules.

However, on 21 December 2016, after a long debate and political pressure, the European Commission proposed a temporary and optional generalized domestic reverse charge on domestic supplies of goods and services, as a part of the *Action Plan*<sup>31</sup>, aiming to introduce a definitive VAT system based on the principle of destination. Since the formation of a definitive system requires significant amount of time and preparation, the European Commission proposed a package of measures which were supposed to ease the transition towards a definitive system. Those measures could be divided into conventional and temporary derogations. “While the conventional measures were focused on better cooperation between the Member States and Member States with non-EU countries, better tax administrations and their cooperation along with improvement of the voluntary compliance and tax collection, temporary derogation concerned the general reverse charge mechanism.”<sup>32</sup> Pending the implementation of a definitive VAT regime, the general reverse charge proposal would allow Member States who are particularly badly affected by VAT fraud to combat those frauds by using a special measure where payment of VAT on domestic B2B supplies of goods and/or services would be the recipient’s responsibility instead of the supplier’s. If the domestic supply would be made to natural persons, a non-taxable legal person, or to a fully exempt business or the invoice is under €10 000, the VAT would be collected, deducted, and remitted as in the present system.

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<sup>30</sup> European Commission, *Assessment of the application and impact of the optional ‘Reverse Charge Mechanism’ within the EU VAT system*, (Luxembourg: Publications office of the European Union, 2014), 8.

<sup>31</sup> Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold, COM(2016) 811, final.

<sup>32</sup> “20 Measures to Tackle the VAT Gap Action Plan”,

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/tax\\_cooperation/vat\\_gap/2016-03\\_20\\_measures\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/tax_cooperation/vat_gap/2016-03_20_measures_en.pdf).

That way, GRCM forces the supplier to verify the status of every single acquirer, which certainly adds additional administrative burden on the businesses. Application of a generalized reverse charge mechanism would be restricted, allowing Member States to make use of it until 30 June 2022 on domestic supplies of goods and services.

However, in order to be allowed to apply such a measure, four important criteria would have to be met. “Firstly, a Member State which asks for the application of such a mechanism should apply a general reverse charge to all domestic supplies of goods and services; secondly Member State’s VAT gap should be five percentage points above the median European VAT gap. As such, only Member States with a VAT gap exceeding 15.40 percent would qualify for the GRCM. According to these same figures, 11 Member States would qualify for the application of the GRCM: Bulgaria, the Czech Republic, Greece, Italy, Latvia, Lithuania, Hungary, Malta, Poland, Romania and the Slovak Republic.”<sup>33</sup> “Thirdly, the level of carousel fraud in the Member State should make up more than 25 percent of its VAT gap and finally, general reverse charge mechanism would apply to transactions above the threshold of €10 000 per invoice and Member State would be also obliged to fulfill specific electronic reporting obligations.”<sup>34</sup>

“According to the European Commission, because of its derogation from the fundamental principle of the fractioned payments, a specific legal basis for such a temporary application of a GRCM to goods and services above a certain threshold is the best way forward and is in line with the VAT Action Plan.”<sup>35</sup>

Since neighboring states are often involved in carousel fraud schemes, a generalized reverse charge mechanism would also be applicable for the Member States involved. For its application, one Member State would have to share a common border with a Member State that is authorized to apply the GRCM, establishing that a serious risk of shift of fraud towards its territory exists because of the authorization of the GRCM to that Member State; be in a situation that other control measures are not sufficient to combat fraud on its territory. What could arise from such a regulation is the theoretical possibility that each Member State would be allowed to apply such a mechanism, which is not what the Commission had in mind when drafting the proposal.

In order to enforce the generalized reverse charge mechanism, Member States should first obtain authorization from the European Commission.

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<sup>33</sup> “Fighting VAT Fraud: Commission Proposal on Generalised Domestic Reverse Charge Mechanism”, <https://www2.deloitte.com/nl/nl/pages/tax/articles/fighting-vat-fraud-commission-proposal-generalised-domestic-reverse-charge-mechanism.html>, (January 12, 2017).

<sup>34</sup> “VAT Reverse Charge Mechanism: Preventing VAT Fraud”, <http://www.consilium.europa.eu/en/policies/vat-reverse-charge/>.

<sup>35</sup> Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold, COM(2016) 811, final.



Since the precise frame and functioning of the GRCM would be shaped at the level of each Member State, this temporary regime would probably cause precisely what the European Commission was concerned about from the beginning – significant costs in monitoring and implementing changes for businesses which are operating in several Member States.

Assessment of the generalized reverse charge mechanism suggests that, like every proposed measure, it has its strength and weaknesses. What could be viewed as a positive outcome of the application of the GRCM is the high probability of successfully tackling missing trader fraud. Moreover, from the customer's perspective, there would be no need to pay VAT to the supplier, which could possibly entail cash-flow advantage and from the supplier's perspective, when comparing the application of the alternative of GRCM – One Stop Shop system, no need to learn VAT systems.

However, the negative effects of the application of GRCM such as blooming administrative costs regarding the reporting of all transactions, changing the IT system, obligation for the supplier to verify the status of each customer and verifying an invoice turnover, are certainly not appealing for enterprises.

Even though Member States from the central Europe including Austria, Bulgaria, the Czech Republic, Hungary and Slovakia have successfully pressured the EC into allowing a generalized reverse charge mechanism for countries that meet certain criteria,<sup>36</sup> the proposal of a generalized reverse charge mechanism seems to be a very risky business with plenty of uncertainties as regards of the scope of the measure, especially with determining the VAT gap criteria, its temporarily character and the possibility of the Commission to repeal the authorization. Furthermore, as the *European Court of Auditors*<sup>37</sup> correctly ascertained, with this mechanism used only in certain countries, the fraudsters would simply move to another EU country which has not introduced such a mechanism into its system, thereby limiting the capacity to tackle VAT fraud at EU level. Further convergence to the system of sales tax is also definitely not something the EU was aiming at. Her Majesty's Revenue and Customs<sup>38</sup> shared the same view by strongly opposing the idea of transforming the current VAT system into what is essentially sales tax.

Organization Business Europe in its *Position paper*<sup>39</sup> from 28 March 2017 explicitly remonstrated the possibility of the introduction of the GRCM considering it a significant departure from the fundamental

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<sup>36</sup> Joe Stanley-Smith, "Breaking down borders: Liberating EU commerce through VAT reform", *International Tax Review*, (October, 2017): 3.

<sup>37</sup> European Court of Auditors, *Tackling Intra-Community VAT Fraud: More Action Needed*, (Luxembourg: Publications Office of the European Union, 2016), 9.

<sup>38</sup> House of Lords - European Union Committee, "Stopping the Carousel: Missing Trader Fraud in the EU", <https://publications.parliament.uk/pa/ld200607/ldselect/ldecom/101/101.pdf>, (May 8, 2007).

<sup>39</sup> "Generalised Reverse Charge Mechanism - a BusinessEurope Position Paper", <https://www.bussinesseurope.eu/publications/generalised-reverse-charge-mechanism-bussinesseurope-position-paper>, (March 28, 2017).

principle of fractional payment with the potential for creating internal market distortions without ensuring the absolute reduction of VAT fraud in the EU at an acceptable cost. It stressed the need of the European Commission to operate pro-actively and withdraw the GRCM the moment it starts to have a negative impact on the single market.

In the author's opinion, even though the general reverse charge mechanism certainly brings a lot of positive effects when it comes to combating fraud, its shortcomings should not be underestimated. Firstly, in the case of the application of the GRCM, the general principle on which the whole EU VAT system is based, – fractioned tax – is undermined in the sense that only businesses selling their merchandise to the final consumers will collect and remit VAT, while other participants in the transaction chain will not, which brings the VAT operating system very close to the retail sales tax. Bearing in mind that the European Commission is determined to finally draw up a definitive VAT system, such a scheme does not fit the current nor the future legal landscape. Furthermore, with the application of such a mechanism, carousel fraud will perhaps be alleviated, but with the total amount of VAT levied at one stage only, unlike in fragmented payment where each supplier in the chain is watching out for the previous supplier and with that securing the payment of VAT in each part of the chain, the other types of fraud will certainly emerge.

Application of the GRCM could also cause significant distortions in the internal market without being able to ensure an absolute reduction in VAT fraud in the EU at an acceptable cost. “Some critics see a generalized reverse charge as a merely expensive redistribution of fraud through the supply chain or across several Member States which increases administrative burden and cost drastically for both legitimate businesses and tax authorities.”<sup>40</sup>

Namely, with the current system putting an already significant administrative burden on businesses, further rise in compliance costs concerning reporting all transactions, adaptations of the IT systems and so forth, especially taking into consideration the relatively short lifespan of the GRCM, generalized reverse charge mechanism is not acceptable nor in line with EU agenda.

Bearing in mind the conclusions of the discussion in ECOFIN<sup>41</sup> on 16 June 2017 where no agreement concerning the application of the reverse charge mechanism could be reached due to diverging views of Member States and with the same scenario repeating on 23 May 2018<sup>42</sup> with France and Cyprus blocking the proposal due to raising concerns about GRCM distorting the free market transactions and VAT operating

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<sup>40</sup> Ibid.

<sup>41</sup> Economic and Financial Affairs Council

<sup>42</sup> “Economic and Financial Affairs Council, Friday 25 May 2018”, [http://www.consilium.europa.eu/media/35244/ecofin-background-25-may-2018\\_en.pdf](http://www.consilium.europa.eu/media/35244/ecofin-background-25-may-2018_en.pdf), (May 23, 2018).

through the supply chain, the future of generalized reverse charge mechanism doesn't look bright. Moreover, with the Commission's strong initiative to introduce the One Stop Shop as a part of the definitive VAT landscape, it seems that the generalized reverse charge system lost the battle against the One Stop Shop system.

### 3.3. Quick Reaction Mechanism

The quick reaction mechanism is designed to enable Member States to respond in real time to a sudden and massive fraud in a specific sector, which cannot be successfully tackled by using a traditional measures, subsequently leading to significant and irreparable financial losses.

Article 395 of the VAT Directive allows Member States to apply a reverse charge mechanism for a certain, short period of time after it has informed the European Commission about all the necessary information for the application of the mechanism. "Once the Commission has all the information it considers necessary for appraisal of the request, it shall within one month notify the requesting Member State and, in order to obtain their opinion, it should transmit the request to other Member States."<sup>43</sup> Within the three months of giving the notification to the other Member States, the Commission shall present to the Council either an appropriate proposal or object to the derogation requested.

"This positive proposal from the Commission is a process which can take up to eight months according to paragraph 4 of Article 395 of the VAT Directive, and unanimous adoption by the Council can lead to further delay."<sup>44</sup> "In such a case the process is, by nature, slow and cumbersome in comparison to quickly emerging fraud phenomena at the international level, e.g. carousel fraud in services which are very quickly passed on to the next trader (rather than more traditional type of fraud in goods)."<sup>45</sup>

It is not only the length of the proceedings to obtain the Commission's approval that seems to be problematic. The question arises how the Commission will interpret the terms "sudden and massive forms of fraud", "economic sector", "traditional control and enforcement measures" and "irreparable losses". "In the absence of clear definitions of these terms or specification of the circumstances under which Member States can apply for a derogating measure, the proposal seems to be too discretionary."<sup>46</sup>

Since almost all Member States are facing the severe problem of fraud, many of them created special units which would help them tackle all kinds of fraud more efficiently. "With that being said, the question arises

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<sup>43</sup> Article 395, paragraph 2, subparagraph 2 of the VAT Directive

<sup>44</sup> Ben JM Terra, "The European Quick Reaction Mechanism against VAT fraud", *World Journal of VAT / GST Law*, vol. 1 issue 2 (2012): 185.

<sup>45</sup> *Ibid.*

<sup>46</sup> Ine Lejeune, Stein de Maeijer and Liesbeth Vermeire, "Quick Reaction Mechanism against EU VAT Fraud", *International VAT Monitor*, no. 2, (2013): 96.

whether it would be possible for those states to obtain the Commission's approval for the introduction of quick reaction mechanism, or to put it differently, whether the application of the QRM can be justified in Member States that are equipped with sufficient means of control and enforcement to respond to sudden and massive VAT fraud."<sup>47</sup>

Assuming that all conditions for the application of the QRM procedure are met, it is unclear how the Commission will use its powers in practice. For instance, will it authorize individual Member States to apply the reverse charge mechanism to specific businesses or to an entire economic sector, including businesses that are not themselves involved in VAT fraud? "If the reverse charge mechanism applies sector wide, all businesses in the sector have to adjust their administrative processes and ERP systems<sup>48</sup> in time and are thus burdened with a potential risk of non-compliance. Adjustment of administrative processes and ERP systems is very expensive for all businesses, regardless of their size."<sup>49</sup>

What is evident in practice is that the European Commission is not too keen on easily authorizing the Member States to apply the quick reaction mechanism. Namely, it refused a number of requests for derogation to apply the reverse charge mechanism in different sectors, to name just a few: concerning pig-farming and animal fodder industry (COM(2013)148 of 19.3.2013) and sugar sector (COM(2014)229 of 22.4.2014) – both requests coming from Hungary; -precious stones (COM(2014) 623 of 10.10.2014) – requested by Estonia; -the meat sector (COM(2017) 24 final of 19.1.2017) requested by Slovakia and the most recent case from 19 January 2018 where Latvia<sup>50</sup> requested authorization to apply the measure derogating from Article 193 of the VAT Directive regarding the supply of construction goods and services. In the explanation of the rejection, the Commission often used peculiar reasons, to say the least. For example, in the case regarding the Hungarian request from 2014 for the application of the reverse charge mechanism in relation to supplies of sugar in excess of 200 kg, the Commission declined the request arguing, among other things, "that it appears that fraud problems in the sector already started to occur in 2007"<sup>51</sup>, "even though steep increase of non-paid VAT was noted during 2013,"<sup>52</sup> suggesting that the "sudden" criterion is not met. Furthermore, although it recognized that VAT losses in the sector are considerable, the Commission concluded that in relation to the total estimated VAT gap in Hungary, they corresponded to only 0,291% indicating the need for a more comprehensive solution to address VAT control and collection issues. Given explanations are to great extent confusing, leaving many questions such as setting the clear

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<sup>47</sup> Ibid.

<sup>48</sup> Enterprise resource planning (ERP) is the integrated management of the core business processes, often in real-time and mediated by software and technology

<sup>49</sup> Lejeune, *Quick Reaction Mechanism against EU VAT Fraud*, 96.

<sup>50</sup> Communication from the Commission to the Council in accordance with Article 395 of Council Directive 2006/112/EC, COM(2018) 015, final.

<sup>51</sup> Communication from the Commission to the Council in accordance with Article 395 of Council Directive 2006/112/EC, COM/2014/0229, final.

<sup>52</sup> Ibid.

criteria for granting a derogation without the proper answer. Additionally, the reasons for rejecting Latvia's request seems vague as well, without clear reasoning. Equivocal explanations such as "a derogation is in any case not a long-term solution, nor does it replace adequate control measures for the sector and for taxable persons" does not seem to be convincing, neither does "transferring the whole VAT liability to the last link of the chain would, therefore, increase the risks," especially if it is known that similar tools are endorsed in other sectors. This legal uncertainty regarding the prerequisites for the approval of request are not something that contributes to a creation of a well-rounded, efficient VAT system and leaves the impression that the Commission's decision are sometimes driven politically rather than out of legal necessity.

In conclusion, the author considers that the quick reaction mechanism suffers from the same maladies as the generalized reverse charge mechanism. In the case the application of the QRM is granted to a particular Member State, there is a major risk of fraudulent activities moving to other Member States which have not introduced the reverse charge mechanism. With that being said, it is obvious that the quick reaction mechanism is not a tool that would bring cohesion to the internal market, on the contrary. As it was stressed in the chapter dealing with the generalized reverse charge mechanism, it will certainly successfully tackle some types of fraud while simultaneously producing new types. Moreover, any type of reverse charge mechanism asks for significant financial investment both in administrative personnel and technology, platforms which will analyze and process all collected data etc. Businesses will not be spared from such a burden, which will be especially difficult for the smaller companies. Therefore, it can be concluded that current regulation is not following the European agenda which aims to build one coherent, simple, robust VAT system. On the contrary, with the introduction of mechanisms such as the quick reaction mechanism, the European Union instead of harmonization, promotes particularization. Instead of compliance reducing, one can witness blooming compliance costs and administrative challenges both for the governments and the enterprises.

"It is therefore questionable whether the advantages of the QRM for the tax authorities will outweigh the disadvantages for businesses and the potential adverse effect on the functioning of the internal market."<sup>53</sup>

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<sup>53</sup> Ibid., 98.

### **3.4. Optional Reverse Charge Mechanism**

Since the reverse charge mechanism was initially not seen as a permanent solution for combating fraud, the VAT Directive laid down exactly in which the sectors reverse charge mechanism is allowed. According to Article 199 of the VAT Directive, the Member States can opt to apply a reverse charge mechanism to the following types of transactions: construction work, including repair, cleaning, maintenance, alteration and demolition services; supply of staff engagement in activities covered by point (a) (construction work, including repair, cleaning, maintenance, alteration and demolition services); supply of immovable property, as referred to in Article 135 (1) (j) and (k), where the supplier has opted for taxation of the supply pursuant to Article 137; supply of used material, used material which cannot be re-used in the same state, scrap, industrial and non-industrial waste, recyclable waste, part processed waste and certain goods and services; supply of goods provided as security by one taxable person to another in execution of the security; supply of goods following the cession of a reservation of ownership to an assignee and the exercising of this right by the assignee; supply of immovable property sold by a judgment debtor in a compulsory sale procedure.

Article 199a of the VAT Directive prescribes further possibilities for the Member States to apply a reverse charge mechanism in the case of the transfer of allowances to emit greenhouse gases defined in Article 3 of Directive 2003 /84 /EC, transfer of other units that may be used by operators for compliance with the same Directive, supply of mobile telephones, supply of integrated circuit devices such as microprocessors and central processing units in a state prior to integration into end use products, supply of gas and electricity to taxable dealer as defined in Article 38 (2), supply of electricity certificates, telecommunication services, supply of game consoles, tablet PCs and laptops, supply of cereals and industrial crops and supply of raw and semi-finished materials, special arrangements for second-hand goods, works of art, collector's items and antiques.

The enumeration of those specific sectors in Article 199 has its origin in derogations which had previously been granted individually to certain Member States. Their integration in the VAT Directive has the benefit of making them available to all Member States.

According to Article 199a of the VAT Directive, the Member States can also introduce a reverse charge mechanism to the sectors listed in paragraph 1 of the same provision, until 31 December 2018 and for a minimum period of two years.

The Member States have to inform the European Commission when introducing such reverse charge measures and provide it with information mainly on the scope of the measure, its impact in terms of reporting

and control, as well as its effectiveness to tackle fraud including the potential consequences due to a shift of the risk of fraud to other activities. The Member States will also inform the European Commission of the date of introduction and the period covered.

According to the *survey*<sup>54</sup> conducted by the European Commission assessing the effects of the usage of optional reverse charge mechanism, most of the Member States welcomed the introduction of the measure, considering it an efficient tool in fighting VAT fraud and successfully preventing the re-occurrence of fraud. The optional reverse charge mechanism proved to be specifically effective in the battle against carousel fraud, where it served a dual purpose: causing either the full disappearance or significant decrease in targeted sectors, while simultaneously helping member states reduce the revenue losses and increase the collection of VAT. Since it was considered effective in limiting the forthcoming losses in VAT revenues, some Member States introduced it as a preventive measure, as there were enough signals indicating fraud risks in the given sector.<sup>55</sup>

Considering the impact on compliance cost and proportionality of the measure, the majority of the Member States were of the opinion that there is an optimal ratio between cost increase (especially taking into consideration costs concerning the modifications in accounting systems, invoicing, staff training etc.) and benefits deriving from the application of such a tool. Moreover, the introduction of the measure significantly influenced gains from VAT revenues, decrease in unfair competition, reduced assessment costs of potential VAT risks of transactions, reduced costs of tax disputes and improved cash flow.

However, while almost all Member States indicated that the application of the reverse charge mechanism helped them successfully cope with different types of fraud, especially carousel fraud, a number of business noted that the optional reverse charge increased the complexity of doing business, reduced legal certainty and accentuated a need for a standardized and harmonized implementation of the VAT Directive.

Both *Tax Faculty and the Institute of Chartered Accountants in England and Wales*<sup>56</sup> and *BusinessEurope*<sup>57</sup>, assessing the application of the optional reverse charge from the business perspective, understandably strictly opposed such an idea, considering this tool very expensive for business to set up and operate, creating barriers to the internal market, making a less harmonized set of rules while simultaneously increasing

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<sup>54</sup> To find out more about the study, look Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118, final.

<sup>55</sup> Ibid.

<sup>56</sup> Tax Faculty of the Institute of Chartered Accountants in England and Wales, “VAT - Optional Reverse Charge Mechanism”, <https://www.icaew.com/-/media/corporate/archive/files/technical/tax/tax-faculty/taxreps/2007/taxrep-67-07-vat-optional-reverse-charge-mechanism.ashx>, (October 15, 2007).

<sup>57</sup> “BusinessEurope Position Paper regarding the VAT Reverse Charge Mechanism”, <https://www.businesseurope.eu/sites/buseur/files/media/imported/2010-01098-E.pdf>, (April 27, 2010).

regulatory burden. Their conclusion was that the only effective way to counter this type of fraud is to remove the opportunity by charging VAT on cross-border supplies of goods and services, not considering a domestic reverse charge as the solution.

One could conclude that while the optional reverse charge mechanism serves its purpose, at least from the perspective of the Member States, it acts as an economic anchor for businesses, which logically leads to disputes between the companies and Member States, as it creates additional compliance costs for the enterprises. However, the introduction of any measure in any field of public interest, no matter how efficient the measure proves to be, will be faced with harsh opposition from companies whose natural, principle goal is to maximize profits while simultaneously minimizing costs, and an additional compliance burden is surely not in line with these aims. Resistance notwithstanding, after taking into consideration the magnitude of VAT fraud in the EU and the results that the optional reverse charge mechanism is producing, the application of this tool should be strongly backed up by legislators of all Member States.

Finally, the application of different types of reverse charge mechanisms will certainly, to a greater or lesser extent, enhance the efficiency of the fight against VAT fraud. However, in order to achieve the best results, another aspect of that fight should not be undermined – the intensive and continuous cooperation between the tax administrations of the Member States. Often a neglected segment of the fight against carousel fraud, solid administrative cooperation with the application of the right tools for the exchange of information such as the TNA and VIES systems could close many loopholes existing in current plan for combating fraud. With that being said, the following Chapter will give a detailed overview of all the aspects of the administrative cooperation on the EU level, pointing out possible solutions that should be adopted in order to make administrative cooperation among Member States even more compliant in the cases of carousel fraud.

## **4. Administrative Cooperation**

### **4.1. General Overview**

Effective cooperation among the Member States in any field is one of the key elements for the success of the European project of prosperity. Since the fight against different types of VAT fraud proved so far to have a restrictive effect, new ideas introduced by the European Commission combined with better coordination between the Member States seems the right way to go. In that sense, it is important to stress the role which effective administration cooperation between the Member States has in the prevention and early detection of the different types of VAT fraud.



The Commission was aware of this problem, consequently, it introduced on 7 October 2010 *Council Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax* (hereinafter: Regulation) which should serve as a basis for the administrative cooperation in the field of the European law. What was seen as the main aim to be achieved in the area of administrative cooperation is a fast and effective system of data-exchange, which often proved to be too inert.

“Main goals of the Regulation are correct assessment of VAT, monitoring the correct application of VAT, combating VAT fraud and finally, protecting the VAT revenue.”<sup>58</sup> “For that reason the Regulation prescribes tools for the achievement of those goals through the exchange of information on special demand or without prior demand by using standardized sheets, exchange of information through the electronic data base of *VIES system*<sup>59</sup>, controls which are simultaneously undertaken in two or more Member States (so called multilateral controls) and presence of tax officers in other Member States, which allows them access to documentation or participation in ongoing investigations and the usage of decentralized net – Eurofisc for the quick exchange of aimed information among the Member States about the suspicious businesses and similar questions.”<sup>60</sup>

In Commission’s *Report from 2014 to the Council and the European Parliament concerning the application of the Regulation (EU) No 904/2010*<sup>61</sup>, a comprehensive analysis was made as regards the application of the available tools and the results of the application of the Regulation. “Concerning the timeliness of replies and the notification procedure, one of the crucial aspects of the exchange of information, it can be read that the Member States noted that many of them were unable to respond to replies within the deadline, with requesting Member States rarely being informed of the reasons for the failure to do so.”<sup>62</sup> The time limit for providing information is laid down in Articles 10 – 12 of Regulation and is 3 months or 1 month.

In order to fight efficiently against VAT fraud and to ensure a proper collection of VAT, it is important for Member States to exchange information as soon as possible. Bearing in mind that the number of late replies

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<sup>58</sup> “Administrative cooperation in the field of VAT (from 1.1.2012)”, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:lf0003> (January 13, 2011).

<sup>59</sup> VAT Information Exchange System (VIES) is an electronic means of transmitting information relating to VAT registration (i.e., validity of VAT numbers) of the companies registered in the European Union. EU law requires that, where goods or services are procured within the EU, VAT must be paid only in the Member State where purchaser resides. For this reason, suppliers need an easy way to validate the VAT numbers presented by purchasers. This validation is performed through VIES.

<sup>60</sup> European Court of Auditors, *Tackling Intra-Community VAT Fraud: More Action Needed*, (Luxembourg: Publications Office of the European Union, 2016), 15.

<sup>61</sup> Commission Staff Working Document Accompanying the document Report from the Commission to the Council and the European Parliament on the application of Council regulation (EU) no 904/2010 concerning administrative cooperation and combating fraud in the field of value added tax, SWD/2014/039, final.

<sup>62</sup> Report from the Commission to the Council and the European Parliament on the application of Council Regulation (EU) no 904/2010 concerning administrative cooperation and combating fraud in the field of value added tax, COM/2014/071, final.

amounted to 43 percent, it makes no surprise that administration cooperation is not recognized as one of the important methods to combat fraud - many Member States are simply not abiding by the rules. In a situation where the VAT fraud is happening very quickly, with fast movement of goods followed by the disappearance of the companies, prompt reaction and exchange of information seems to be the key to success.

Apart from time, one of the crucial requirements for successful cooperation is short, clear and precise documentation needed and provided. The Commission was also aware of the problem, especially of the language barrier, which is significantly slowing down the exchange of data. Therefore, the solution was the introduction of e-forms in July 2013, where most information can be made available in fixed fields, securing a fast flow of information.

Significant changes have been made in the connection of VIES databases as well. By extending the list of information stored together with the amount and the quality of the information, it elicited a positive response among the Member States, which pointed out that the final outcome of those changes was seen through a reduced number of retroactive corrections and discrepancies, faster updates and more reliable turnover data. “Furthermore, the reduction in the timeframes for submitting and transmitting recapitulative statements has accelerated the speed of information exchange, thereby providing tax administration with an important advantage.”<sup>63</sup>

By achieving a faster exchange of information, the Commission aimed to continue upholding all Member States to work actively on the tools that will ensure up-to-date VIES database, which should consequently, along with other measures applied, construe a fast and reliable system providing all relevant information on intra-Community supplies and allowing a fast recognition of administrative mismatches between the deliveries in one Member State and the acquisitions in another.

“Mentioned Regulation has also significant importance due to introduction of *Eurofisc*-network which provides multilateral, swift and targeted exchange of information relating to VAT fraud, introduction of a feedback mechanism and automated access to databases of other Member States.”<sup>64</sup>

Based on everything stated above, one could conclude that the European Commission has made considerable efforts to establish a quality legislative framework regarding the administrative cooperation among the Member States. However, as long as the Member States themselves fail to see the advantages that quality

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<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

co-operation and rapid data exchange bring, all legal solutions will remain to a large, merely a dead letter, as is the case today.

To a certain extent, the resistance that tax administrations of Member States are providing in co-operation with tax administration of other Member States is understandable, since cooperation requires a high level of knowledge, both linguistic and formal, which is one of the reasons for the inert response upon request for administrative cooperation and exchange of information.

Nevertheless, it is important to bear in mind that carousel fraud is not a problem affecting only some States and that each Member State is at any time a potential victim. Precisely for that reason, a quick reaction can significantly improve the early detection of such fraud and prevent its spread, which is in the common interest of all Member States. Additionally, good administrative cooperation not only allows detection of fraud in the early stage of “execution”, but it could also alarm the relevant tax authorities of possible fraud occurrence in the future. It is important to bear in mind that fighting the various forms of fraud at EU level is not the individual struggle of States, and that precisely because of the possibility of easy spread to other States, Member States must act in a coordinated manner and resist the temptation for unilateral measures which will have only limited effect.

In that sense, the *International VAT Association*<sup>65</sup> in its report to the Commission regarding combating fraud in the EU introduced an interesting proposal for Member States’ administrations to consider establishing a multijurisdictional, VAT enforcement unit. The unit would require an adequate level of resources and incentives to overcome the endemic inertia of national administrations to tackling VAT losses in other Member States.

Finally, in order to accomplish effective administrative cooperation, it is necessary to provide an efficient platform through which this cooperation will take place. In that sense, the EU took serious efforts and by creating a decentralized net for the exchange of targeted information on the level of the European Union - Eurofisc, it set a solid foundation for successful battle against VAT fraud through administrative cooperation. The following text will explain the proposed decentralized net in more detail.

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<sup>65</sup>International VAT Association, “Combating a VAT Fraud in the EU, The Way Forward”, [https://practicenet.ie/practicenet/publications/pdf-file/iva\\_paper\\_final\\_001.pdf](https://practicenet.ie/practicenet/publications/pdf-file/iva_paper_final_001.pdf), (March 2007).

## 4.2. Eurofisc

Practice has shown that in order to combat VAT (carousel) fraud successfully, it is of crucial importance to exchange key information rapidly. Therefore, the European Commission has introduced Eurofisc as a decentralized net without legal personality established by the Member States of the European Union in order to ease and promote multilateral and decentralized cooperation enabling fast and targeted action, in other words, quicker exchange of information. Established by *Council Regulation on administrative cooperation and combating fraud in the field of value added tax No 904/2010* on 7 October 2010, it serves as a tool with the help of which Member States carry out the following activities:<sup>66</sup>

- 1) Establish a multilateral early warning mechanism for combating VAT fraud,
- 2) Coordinate the swift multilateral exchange of targeted information in the subject areas in which Eurofisc will operate,
- 3) Coordinate the work of the Eurofisc liaison officials of the participating Member States in acting on warnings received.

Member States are free to decide whether or not they will participate in the work of Eurofisc and whether to withdraw from it. After the decision to participate, a Member State has to be active in the multinational exchange of targeted information with the other participating states. Each Member State needs to appoint at least one official who will then represent an official connection with the Eurofisc. There are four working groups actively participating in their own field of work; the working group connected with carousel fraud; the working group operating with cars, ships and planes; VAT fraud crossing the border of the EU (customs procedure) and the working group monitoring the tracking of movements and development of the strategies countering frauds.

According to the annual report of the *working group WF3*<sup>67</sup> from 2012, Member States usually apply cross-checking method of data and by comparing their own data with the Eurofisc data, 7 Member States disclosed 27 missing traders including the highest number of 27 in Romania, 7 in France, 3 in Bulgaria, 2 in Slovenia and so forth. In 12 Member States, 51 conduit companies were discovered – 35 in Greece, 6 in Bulgaria; in 4 Member States new types of frauds were discovered, “three-party or side transactions” were discovered in Greece and Lithuania. In total 222 tax supervisions were undertaken – 154 in the Hungary, 49 in Greece

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<sup>66</sup> Article 33. paragraph 2 of the Regulation on administrative cooperation and combating fraud in the field of value added tax No 904/2010

<sup>67</sup> Working group dealing with VAT frauds comprehending crossing the border of EU (custom procedure)

and so forth, 10 companies were deregistered; 4 in Hungary, 3 in Bulgaria and one in Ireland, Latvia and Slovakia.

Member States agreed that the greatest value of Eurofisc is transmitting and receiving information in the early phase, although they also emphasized weaknesses such as difficulties in getting information back, lack of active participation in the WF3 by some Member States, information often not being precise enough, inefficient cooperation between the tax administration and customs of the Member States.

The importance of good and quick exchange of information can be illustrated through the example given by *Lisette van der Hel – van Dijk and Menno Griffioen*<sup>68</sup> explaining the magnitude of the economic effect that carousel fraud has on the state's treasury. They dismantled the sophisticated VAT fraud scheme discovered by the *Spanish tax administration*<sup>69</sup> in 2012 which included several Member States, real and shell companies and sale of computer parts. Namely, computer parts were sent directly from Denmark, Belgium and the Netherlands to a Spanish logistic centers, which then sold the parts to consumers. At the same time, shell companies were incorporated in Portugal, Romania and Spain. Even though the goods were sent directly to Spain, Danish, Dutch and Belgium companies sent the invoices to the shell companies in Portugal and Romania who subsequently invoiced the goods to Spanish shell companies. None of the mentioned companies actually received any of those goods, but served as a mere “screen” for the fraudulent activities. Later on, Spanish companies invoiced the goods to the Spanish logistics centers that in the end invoiced and delivered the goods to retailers. The Portuguese and Romanian companies either did not file VAT returns or – when they did – did not pay the VAT. Acting as missing traders they had disappeared at the moment the Portuguese and Romanian tax administrations wanted to investigate them because of discrepancies between their intra-Community acquisitions and the intra-Community deliveries of the Danish, Belgium and Dutch traders.

Even though carousel fraud is often explained through a rather simple scheme containing only three parties, in the presented case another, a fourth party – the shell Spanish companies, was added to make scheme more complicated and untraceable. This scheme led to the erosion of competition because without paying the VAT, it secured a privileged position on the market by offering cheaper goods to Spanish retail companies. “They manipulated their VAT returns by including fictitious turnovers and fictitious input tax resulting in no or hardly any VAT to be paid.”<sup>70</sup>

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<sup>68</sup> Example was given in their joint Article called *Tackling VAT Fraud in Europe: The International Puzzle Continues*

<sup>69</sup> “La Agencia Tributaria desmantela una trama internacional de fraude al IVA en el sector informático”, [https://www.agenciatributaria.es/AEAT.internet/Inicio/La\\_Agencia\\_Tributaria/Sala\\_de\\_prensa/Notas\\_de\\_prensa/2013/2013.shtml](https://www.agenciatributaria.es/AEAT.internet/Inicio/La_Agencia_Tributaria/Sala_de_prensa/Notas_de_prensa/2013/2013.shtml), (December 26, 2013).

<sup>70</sup> Lisette van der Hel - van Dijk and Menno Griffioen, “Tackling VAT Fraud in Europe: The International Puzzle Continues”, *Intertax*, vol. 44, issue 6/7, (August 2016): 505.

“In the given example it is crucial to note that it probably took three or even more months for tax administrations of Portugal and Romania to note the discrepancies between the intra-Community deliveries from the Danish, Belgium and Dutch companies and the intra-Community acquisitions in Portugal and Romania which have activated several administrative procedures and national audits.”<sup>71</sup> Their inability to ascertain the exact flow of goods in real time probably triggered mutual cooperation in the sense of requesting additional information from one to another. Exchanging information on the goods, invoices, VAT id numbers, payments etc. did untangle the whole situation, but the question remains: in what time table?

“It is clear from the example that unravelling the structure in first instance depends largely on Member State itself and its capability to detect the risk of fraud as soon as possible and subsequently to handle it swiftly.”<sup>72</sup> Due to the length of such investigation, the European Commission has realized that current systems of data exchange, such as the VIES system and Eurofisc have a lot of potential, but the level of integration and cooperation needs to be enhanced.

The level of progress concerning the exchange of information between Member States, although evolved over the years, is not sufficient enough to effectively combat cross-border VAT fraud. Therefore, the common framework – compliance risk management seems to be the right direction. “The application of such a common framework should enable the current traditional approach to shift towards a more preventing and proactive approach in which VAT fraud is tackled in cooperation with the “environment” in which a fraudster operates.”<sup>73</sup> However, with every attempt of harmonization and closer cooperation, the question of sovereignty of Member States and willingness to develop a common system arises. “In addition to the political dimension, the culture of a Member State, the level of development of tax supervision in the Member State and the presence of an adequate legal framework – national and international – play a role, asking for a change in the mindset of the tax authorities and that starts in with the implementation of compliance risk management in the individual Member States.”<sup>74</sup>

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<sup>71</sup> Lisette van der Hel - van Dijk and Menno Griffioen, “Tackling VAT Fraud in Europe: A complicated International Puzzle”, *Intertax*, vol. 44, issue 4 (May 2016): 293.

<sup>72</sup> *Ibid.*

<sup>73</sup> Menno Griffioen and Lisette van der Hel – van Dijk, “New European Approach to Combat VAT Fraud?”, *Intertax*, vol. 42, issue 5 (May 2014): 305.

<sup>74</sup> *Ibid.*

### 4.3. The European Commission's Proposal Concerning Eurofisc

As demonstrated earlier, results deriving from the Eurofisc are, even though full of potential, rather modest. There is often a misperception of how reaching the effects of the intensive cooperation between the tax administrations of the Member States really are. Therefore, in order to change this policy, on 30 November 2017 the European Commission prepared a set of proposals. “It aims at tackling cross-border VAT fraud by implementing the *Council, European Parliament and European Court of Auditors recommendations* and drastically and swiftly improving how tax administrations cooperate together and with other law enforcement bodies.”<sup>75</sup> One of the main aims, bearing in mind that VAT fraud can happen in a matter of minutes, meaning that Member States need to have the tools to act as quickly as possible,<sup>76</sup> is establishing a transaction network analysis (TNA), an online system where information would be shared within Eurofisc. “The system would enable Member States to process, analyze and audit data on cross-border activity to make sure that risk can be assessed as quickly and accurately as possible.”<sup>77</sup>

It presents the opportunity for Member State to conduct joint audits with other Member State when checking cross-border supplies, allowing them to form a single audit team to combat fraud – especially important in cases of fraud in the e-commerce sector.

Member States showed support for the usage of TNA software to process the VAT data faster and more efficiently, emphasizing the need for further development of automated exchange of information platforms for other fields where frauds often occur. “In this context, Member States are particularly interested in access to customs data or car registration information.”<sup>78</sup> Accordingly, a new set of measures will be available from 1 January 2020. “The first new set of data would be exchanged to tackle the abuse of the VAT scheme for importing goods free of VAT where they were supposed to be delivered to another Member State but were diverted to the black market.”<sup>79</sup> The main shortcoming of such a procedure is the fact that fraud can occur quickly, while tax authorities in the Member State of import and destination need to wait for importer's recapitulative statement.

“With this proposal, the relevant information in relation to customs procedures related to import of goods free of VAT submitted electronically with the customs declaration (e.g. VAT numbers, value of the imported goods, type of commodities etc.) would be shared by the Member State of import with the tax authorities in

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<sup>75</sup> Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706, final.

<sup>76</sup> “Questions and Answers on the VAT proposal for administrative cooperation”, [http://europa.eu/rapid/press-release\\_MEMO-17-4948\\_en.htm](http://europa.eu/rapid/press-release_MEMO-17-4948_en.htm), (November 30, 2017).

<sup>77</sup> Ibid.

<sup>78</sup> Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706, final.

<sup>79</sup> Ibid.

the Member State of destination, consequently enabling them to cross-check this information with the information reported by the importer in his recapitulative statement and VAT return, and by the recipient in his VAT return.”<sup>80</sup> “In addition, by cross-checking the customs information with the VAT recapitulative statements, the tax authorities would be able to detect cases of undervaluation at the moment of import, designed to avoid customs duties.”<sup>81</sup> Extended access to information could be granted to Eurofisc officials, for intra-Union supplies.

The Commission’s recent proposal regarding the improvement of administrative cooperation is certainly welcome and necessary for a more efficient fight against different types of VAT fraud. However, mere introduction of the measure without true will on the side of the Member States to actually carry them out in appropriately will end up being the Commission’s one more failed attempt to enhance administrative cooperation and information flow among the Member States, and without proper collaboration, other measures introduced to combat fraud will not be able to fulfill their full capacities.

## **5. Towards a New and Definitive VAT System**

### **5.1. Introduction**

The VAT system that currently exists in the European Union was designed in 1993 and was supposed to serve as a transitional system. Today, 25 years later, although still in use, it has proven unable to keep up the pace with the ever changing European economy, especially in the field of digital economy. Blooming compliance costs are creating significant differences between the economic operators, adversely affecting the those running cross-border business. Namely, according to the survey conducted by *Regulatory Scrutiny Board*,<sup>82</sup> the compliance costs per euro of turnover for businesses doing intra-Community trade have been established as 11% higher compared with the corresponding VAT compliance costs per euro of turnover for businesses engaged solely in domestic trade. Moreover, the existing system is suffering from serious shortcomings enabling different types of fraud which negatively affect, on the one hand, budgets of both Member States and the European Union, and on the other hand, cause a distortion of the competition and an uneven playing field.

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<sup>80</sup> Ibid., p. 11

<sup>81</sup> Ibid., p. 11

<sup>82</sup> Impact Assessment, Accompanying the document, Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, SWD(2017) 325, final.



As noted before, the European Union's legislative solutions had a very limited effect in combating different types of VAT fraud and with the estimated annual damage in amount of around €50 billion - or €100 per EU citizen<sup>83</sup> - each year only due to cross-border VAT fraud, the Commission decided to finally construct a definitive VAT system that will be more robust, simpler and fraud resilient, enabling the normal functioning of the single market. This VAT Action Plan from 2016 was accompanied by a *Proposal Implementing Regulation as regards certain exemptions for Intra-Community transactions*, COM(2017)568; *Proposal Council Regulation amending Regulation 94/2010 as regards the certified taxable person*, COM(2017)567; *Proposal Council Regulation amending Regulation 94/2010 to strengthen administrative cooperation*, COM(2017)706; *Directive 2017/2455 regarding supplies of services and distance sales*; *Regulation 2017/2454 regarding administrative cooperation and combating fraud*; *Regulation 2017/2459 amending Implementing Regulation 282/2011*; *Proposal regarding VAT rates*, COM(2018)20 and *Proposal regarding SME regimes*, COM(2018)21.

“With existing transitional VAT arrangements leading to “*a complex and fragmented VAT system*”<sup>84</sup> in sense of the high compliance costs for companies trading across borders, increased red tape for companies, a significant level of VAT cross-border fraud and obstacles hampering the single market, the Commission's proposal aimed at implementing the destination principle with simplifying rules for intra-EU B2B (business to business) transactions, reducing burdens and costs for cross-border intra-EU business and to reducing the level of VAT fraud.”<sup>85</sup> “Accordingly, 4 cornerstones of the definitive single EU VAT area were set:

- 1) **Tackling fraud:** charging a VAT on cross-border trade between the businesses,
- 2) **One Stop Shop:** introducing an online portal which would help companies that sell cross-border to deal with their VAT in a far simpler way by making declarations and payments using a single online portal,
- 3) **Greater consistency:** move to the principle of “destination” whereby the final amount of VAT is always paid to the Member State of the final consumer and charged at the rate of that Member State and finally
- 4) **Less red tape:** simplification of invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders.”<sup>86</sup>

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<sup>83</sup> “Towards a new and definitive VAT system for the EU”, [https://ec.europa.eu/commission/news/towards-new-and-definitive-vat-system-eu-2017-oct-04\\_en](https://ec.europa.eu/commission/news/towards-new-and-definitive-vat-system-eu-2017-oct-04_en), Press release, (October 4, 2017).

<sup>84</sup> “Proposal for a More Efficient VAT Treatment of Cross-border Business-to-business (B2B) Supplies of Goods and a Simpler, Fraud-proof Definitive VAT System”, [http://ec.europa.eu/smart-regulation/roadmaps/docs/2017\\_taxud\\_006\\_taxud\\_definitive\\_vat\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2017_taxud_006_taxud_definitive_vat_en.pdf), (December 22, 2016).

<sup>85</sup> “Setting VAT Rates, Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax”, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/603265/EPRS\\_BRI\(2017\)603265\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/603265/EPRS_BRI(2017)603265_EN.pdf), (September 2017).

<sup>86</sup> “European Commission Proposes Far-reaching Reform of the EU VAT System”, [http://europa.eu/rapid/press-release\\_IP-17-3443\\_en.htm](http://europa.eu/rapid/press-release_IP-17-3443_en.htm), (October 4, 2017).

Besides the fundamental principles laid down above, the Commission also presented so called “*quick fixes*”<sup>87</sup>, which should improve the daily application of the current VAT system until the new regulation is fully accepted and enforced. The first fix should ensure the simplification of VAT rules for “call-off stock arrangements”, i.e. simplification of the rules dealing with sales of goods stored in another Member State. The second measure would simplify chain transaction situations identifying the supply with which the intra-Community transport of goods should be linked. The next fix introduced is the simplification of the proof of transport of goods between two Member States needed for the application of the exemption (zero rating) to intra-Community supplies. All the rules aiming at the simplification of the process would be at the disposal only for certified taxable persons, a new institute introduced along with all the above mentioned measures which would operate as follows: if the customer is considered a certified taxable person, VAT could be reverse charged if the supplier is not established in the Member State where the B2B-supply of goods is taxed. Prerequisites for obtaining a status of the certified taxable person will be analyzed in detail later on, but for now it is necessary to stress here that that the presented criteria caused a wave of criticism, both by the Member States and businesses. The fourth and final fix involves clarification that, in addition to proof of transport, the VAT number of the business recipient is required. The above mentioned fixes should enter into effect as of 2019.

Since the focus of this Master’s thesis is on the measures serving as tools against VAT fraud, the quick fixes will be assessed only to the extent of their application in preventing the occurrence of VAT fraud.

However, even though the EC presented the proposal in question with great enthusiasm, believing that the proposed measures could efficiently close all the loopholes of the existing system, not everyone shares such an optimistic outlook. For example, former Dutch Minister of Foreign Affairs, Halbe Zijlstra, expressed his doubts about whether or not the new system is robust against fraud, pointing out the rapid adaptability of fraudsters and how fraud may still occur under the envisaged regime due to the differences in tariffs between Member States.<sup>88</sup>

Eyebrows were also raised regarding the introduction of the certified taxable person. Namely, the question arises whether the certified taxable person is reliable, i.e. how a certain person is going to be assessed before obtaining the status of a certified person and how the status is going to be monitored once it is awarded. As

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<sup>87</sup> “Single VAT Area”, [https://ec.europa.eu/taxation\\_customs/business/vat/action-plan-vat/single-vat-area\\_en](https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat/single-vat-area_en).

<sup>88</sup> “Dutch Government Raises Concerns about the Definitive VAT System”, <https://www2.deloitte.com/nl/nl/pages/tax/articles/dutch-government-raises-concerns-about-proposed-definitive-vat-system.html>, (November 21, 2017).

it is going to be presented later, these questions were not adequately addressed in the newest *proposal*<sup>89</sup> issued by the Commission in 25 May 2018 either, so uncertainties remain.

Since the concept of certified taxable person seems to be the most “problematic” among all the presented proposals, *Committee on Economic and Monetary affairs* issued on 3 May 2018 *Amendments*<sup>90</sup> on *Council directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States (COM(2017)0569 – C8-0363/2017 – 2017/0251(CNS))*, urging the Commission to further clarify and specify the concept and criteria for a CTP, via future implementing regulations and comprehensive guidelines, and to closely align it with the criteria for Authorized Economic Operator-status under the EU Customs Code. Amendments will be analyzed in more detail in the following Chapter.

*CFE Fiscal Committee* – an organization representing the tax profession in Europe, followed the Netherland’s line of reasoning, as well as questioning if the definitive regime will actually fight fraud or, instead, possibly create new means of perpetrating fraud. As the other critics, it detected a proposed new concept of a certified taxable person as a key element of the new proposals regarding a definitive VAT regime, consequently questioning the necessity for a CTP on the basis that it may just another layer of bureaucracy and uncertainty in circumstances whereby it will not be a universally applicable concept. Moreover, if the rationale for the introduction of CTP is to fight against missing trader fraud, it may have been useful to consider other measures that would not have such an impact on businesses.<sup>91</sup>

Finally, the large flow of money that will occur between both businesses and governments in the course of the application of the One Stop Shop system were pointed out by the Netherlands as another concerning aspect of the recent proposal. Whether these amounts will be received by all entrepreneurs and governments will depend on the financial solvency of the suppliers and customers and the supervision regarding the correct and complete payment of these amounts by the tax authorities of the various Member States. However, this was not the only shortcoming linked with the application of OSS. Namely, the CFE warned about the possibility of the occurrence of numerous litigations in the course of the application of OSS because past experiences showed that countries that have a variety of rates, classification of supplies and particularly of services has generated a lot of litigation. Such a situation could be especially cumbersome

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<sup>89</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329, final.

<sup>90</sup> Draft Report on the proposal for a Council directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, 2017/0251(CNS).

<sup>91</sup> “Opinion Statement FC 9/2017 ON European Commission Proposals on the way towards a single European VAT area”, [https://www.nob.net/sites/default/files/content/article/uploads/cfe\\_opinion\\_statement\\_fc9\\_17\\_proposals\\_towards\\_a\\_single\\_european\\_vat\\_area.pdf](https://www.nob.net/sites/default/files/content/article/uploads/cfe_opinion_statement_fc9_17_proposals_towards_a_single_european_vat_area.pdf), (1 December 2017).

for small and medium enterprises who do not possess enough knowledge and back-up logistics to guide them through the tangled legal regulation of each Member State.

In this Chapter, only brief assessments of the leading tax associations were represented. Full critical evaluations will be broken-down in following Chapters, each dealing with another measure from the proposal.

## **5.2. Destination Principle**

The existing VAT regime, labelled as a temporary regime, has a long lasting aim to permanently shift to a VAT system based on the destination principle, where the VAT would be charged on cross-border transactions based on the place where the customer is located. “On B2B transactions, this is currently effected through the use of zero-rating, under which no VAT is charged by the supplier but instead a business receiving a supply of goods from another Member State is obliged to account for VAT locally on a taxable acquisition of goods.”<sup>92</sup>

“However, two fundamental issues were identified with the current taxation system; firstly, the additional obligations and costs associated with VAT compliance for businesses engaging in cross-border trade and secondly, the existing levels of VAT fraud within the EU through fraudulent transactions such as carousel fraud.”<sup>93</sup>

Concerning carousel fraud, as it has been explained before, the system proved to be fragile because in a B2B supply of goods, the goods will cross the border VAT-free, enabling the fraudulent businesses to simply fail to account for VAT on their acquisition, whilst charging VAT on a domestic on-supply of those goods. With the VAT money collected from the domestic supply, the fraudulent company would simply disappear, keeping the VAT collected from the domestic supply and without having accounted for any VAT at all on their purchase. This was the one of the main objectives for urging the Commission to act by shifting from the current system to a VAT system where VAT would, unlike now, be charged on cross-border trade between the businesses.

Furthermore, the principle of destination would be also reflected through the new system of payment, whereby the final amount of VAT would always be paid to the Member State of the final consumer and

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<sup>92</sup> “Definitive Reform of the EU VAT System”, <http://www.elexica.com/en/legal-topics/tax/051017-definitive-reform-of-the-eu-vat-system>, (October 5, 2017).

<sup>93</sup> European Commission, *Implementing the ‘destination principle’ to intra-EU B2B supplies of goods*, (Luxembourg: Publications Office of the European Union, 2015), 5.

charged at the rate of that Member State. This “destination” based approach is already in place for *sales of e-services*<sup>94</sup>.

“In order to allow a soft transition for tax administrations and businesses”<sup>95</sup>, transformation of the current VAT system in accordance with a destination principle would go through a gradual two-step approach.

In the first legislative phase, the VAT treatment of intra-Community B2B supplies of goods would be settled while in the second legislative phase the new VAT treatment would be applied to all supplies of services.

This gradual transformation of the existing system has the following reasoning:

1. “Firstly, the introduction of the definitive VAT system means, above all, doing away with the transitional arrangements, which basically refer to goods due to the fact that prior to 1 January 1993 only cross-border intra-EU supplies of goods (and not of services) gave rise to imports and exports.”<sup>96</sup> So, the transitional arrangement was predominantly introduced for the supply of goods, consequently demanding that any later amendment of the system has to firstly deal with a goods.
2. “Secondly, the application of the principle of taxation at the destination becomes particularly necessary when it comes to goods, because political agreement has been reached regarding the services and it resulted in two Directives and a Regulation aimed at changing the rules on VAT so as to ensure that VAT on services accrues to the Member State where consumption occurs, i.e. according to the principle of taxation at destination.”<sup>97</sup> However, the rules concerning B2B supply of goods remained unchanged.
3. “Thirdly, intra-Community supply of goods proved to be much more burdensome in comparison to supply in services because, for example, proof of intra-EU transport of goods exists, there is a need to ascribe the intra-EU transport to a specific supply in the case of chain transactions and so forth.”<sup>98</sup>
4. Lastly, the new definitive system introduces some new solutions such as the One Stop Shop mechanism, which will incur a significant amount of compliance costs.

Therefore, it must be taken with reservation pending the initial results of the application of those new systems on the supply of goods before applying it to all supplies of services.

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<sup>94</sup> To find out more about current regulation concerning supply of e-services, visit <http://openjournals.maastrichtuniversity.nl/Marble/article/viewFile/351/294>

<sup>95</sup> Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee On the follow-up to the Action Plan on VAT Towards a single EU VAT area – Time to act, COM(2017) 566, final.

<sup>96</sup> Richard Cornelisse, “Definitive EU System: Getting Ready in Time”, <http://globalindirecttaxmanagement.com/thought-leadership-publications/building-blocks-of-a-vat-control-framework/definitive-eu-vat-system-getting-ready-in-time.html>, (October 6, 2017).

<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

As a consequence of the transition to the full destination principle, the current VAT system splitting cross-border B2B supply of goods into two different transactions for VAT purposes, an exempt supply in the Member State of departure of goods and an intra-Community acquisition taxed in the Member State of destination, will be replaced with a single transaction for VAT purposes: *an intra-Union supply of goods*.<sup>99</sup>

By applying the destination principle in a consistent way, another loophole that currently exists and adds to the complexity of the existing arrangements will be closed. Namely, according to the European Commission's *Proposal amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States*<sup>100</sup> from 25 May 2018, in order to ensure that the principle of taxation at destination is applied as widely as possible, the definition of an intra-Union supply of goods should include, without any restriction by way of a threshold, the supply to a non-taxable legal person, the supply to an exempt taxable person, the supply to a taxable person under the special scheme for small enterprises and a supply to the farmers under the flat-rate scheme. Up until now, these types of supply were taxed at the Member State of supply (origin), which is clearly not in line with the idea that the European Commission is promoting.

The destination principle follows the main logic of value added tax as being a tax on consumption which should be consequently levied in the country where consumption takes place.<sup>101</sup> There is nothing to be disputed there. However, the destination principle found itself under the scrutiny of tax professionals, businesses and Member States because of the tool that should be used in order to achieve taxation at the level of the country of consumption while simultaneously preventing the occurrence of fraud, i.e. because of the application of the One Stop Shop in the cross-border supplies. Therefore, the following chapter will explain how the destination principle should be realized through the application of the One Stop Shop and what are the possible implications of such application.

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<sup>99</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, Brussels, COM(2018) 329, final.

<sup>100</sup> Ibid.

<sup>101</sup> Ad Van Doesum, Herman Van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW*, (Alpen aan den Rijn: Kluwer Law International, 2016), 152.

### 5.3. From Mini One Stop Shop to the One Stop Shop

The commerce sector has faced a significant change in the last decades. Traditional ways of conducting business through the supply of physical goods is achieving significantly slower growth rates than digital commerce. Practical implications of this transition towards the digital sphere of economy was the rise of awareness that EU regulation concerning e-commerce was not in line with the primary logic of VAT, allowing the non-taxable persons/customers to “cherry pick” the VAT rate by purchasing e-services from the companies located in countries with the low VAT rates such as Luxembourg and Cyprus, instead of being taxed where the consumption actually takes place.

The European Commission was aware of this rate shopping opportunity enabled by the existing European legislation, and by changing the VAT rules it hoped to introduce more efficiency and fairness into indirect taxation. Accordingly, as of 1 January 2015, it introduced the new VAT scheme, by determining as the place of supply for all business-to customer (B2C) e-services, the place where the nontaxable person is located, independent of where the supplier of the service is located and of where the service is used or enjoyed. By taxing at the place where the customer is located, it wanted to ensure a level playing field between all businesses supplying telecommunication, broadcasting and electronic services on a given market and to deprive consumers of the possibility to choose the tax rate, or to put it differently, consumers would pay the same amount of tax regardless of where the supplier is located.<sup>102</sup> On top of that, such regulation should have enabled the fulfillment of the principle of neutrality with fairer competition between domestic suppliers and those established in other EU countries.

The taxation of the customers is done through the online system known as “Mini One Stop Shop” (MOSS). The Commission saw this tool as an important step towards ensuring fairer revenue distribution between the Member States. “After all, VAT is a consumption tax, and the new rules would ensure that taxation reflects where consumption takes place which should also boost tax revenues for the most Member States; the VAT on purchases that their residents make would now go to their own treasury and not to a small number of low-tax Member States where e-giants have established themselves.”<sup>103</sup>

However, the application of the Mini One Stop Shop was foreseen primarily for the B2C supply in the field of e-commerce, while in the case where an EU business would supply to another EU business, VAT would not be charged, but the reverse-charge mechanism would apply, leaving the customer accountable for the tax.

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<sup>102</sup> “Questions and Answers, VAT Changes from 2015“, [http://europa.eu/rapid/press-release\\_MEMO-14-448\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-448_en.htm), (July 1, 2014).

<sup>103</sup> Ibid.

“Mini One Stop Shop scheme started off as optional, and presents a simplification of measure following the change to the VAT place of supply rules, in that the supply takes place in the Member State of the customer, and not the Member State of the supplier consequently allowing these taxable persons to avoid registering in each Member State of consumption.”<sup>104</sup>

“A taxable person who opts to use the MOSS is required to register in the Member State of identification. For the Union scheme this Member State will be the Member State in which the taxable person has established its business.”<sup>105</sup> Even though it is an optional tool for the taxable persons, in case the taxable person decides to use Mini One Stop Shop, that person is obliged to apply the scheme in all relevant Member States.

“Under the given scheme, a taxable person which is registered for the Mini One Stop has to electronically submit quarterly mini One Stop Shop VAT returns detailing supplies of telecommunications, broadcasting and electronically supplied services to non-taxable persons in other Member States (the Member State(s) of consumption), along with the VAT due. These returns, along with the VAT paid, are then transmitted by the Member State of identification to the corresponding Member States of consumption via a secure communications network.”<sup>106</sup>

Even though the introduction of the Mini One Stop Shop system has aligned the inconsistency of the VAT system regarding the taxation of e-services with the principles of destination and neutrality as the leading principles of the VAT, the scheme is suffering from significant shortcomings, which could, especially taking into consideration the incomplete harmonization path of EU rules and strict MOSS rules, present serious challenges for the businesses providing e-services. “Those challenges are reflected through the fact that VAT enforcement authority remains with the Member State of consumption, taxpayers are potentially subject to up to 28 audits, each following different administrative procedures, rules, and potential penalties. The limited harmonization of VAT rules among EU jurisdictions leaves taxpayers exposed to significant risk when selling TBE services.”<sup>107</sup>

“Furthermore, The VAT treatment of *TBE*<sup>108</sup> services is based on the laws of the Member State of consumption, which preserves all the remaining taxing powers (i.e., applicable rates, exemptions, invoicing

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<sup>104</sup> “Guide to the VAT Mini One Stop Shop”, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/vat/how\\_vat\\_works/telecom/one-stop-shop-guidelines\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf), (October 23, 2013).

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Juan Vazquez, Harley Duncan and Philippe Stephanny, “The European Mini One-Stop Shop: A Model for Future Indirect Tax Compliance”, <https://www.thetaxadviser.com/issues/2017/jun/european-mini-one-stop-shop-indirect-tax-compliance.html>, (June 1, 2017).

<sup>108</sup> Telecommunications, broadcasting and electronic services



requirements, etc.) and finally receives the revenue the transaction generated. In other words, MOSS effectively deals with only a portion of the compliance burden facing a vendor (i.e., registration and return and remittance filing). A vendor of TBE services must, therefore, know and have systems to apply all other individual Member State tax administration rules to its transactions.”<sup>109</sup>

The European Commission recognized the Mini One Stop Shop as a tool that should not be restricted for use only in case of B2C e-service supplies, but its application should be expanded to B2B intra-Community supplies as well, thereby closing the loopholes of the existing system. Namely, the whole rationale behind the Commission’s proposal from 4 October 2017, is to combat carousel fraud in the most efficient way. Since the One Stop Shop is seen as the most effective tool against cross-border frauds, it has been suggested as one of the measures which should be applied in case of cross-border trade between businesses,<sup>110</sup> or to use the wording of the Commission’s *Proposal*<sup>111</sup> from 25 May 2018, use of the scheme should be available to any taxable person not established in the Member State of taxation in relation with the supplies of goods and services made in that Member State for which he is liable to pay value added tax. The operating principle would be the same as it is currently used in Mini One Stop Shop for e-services.

The proposal suggests that the scheme should also be available to taxable persons not established within the EU under the condition that they appoint an intermediary which is established in the Union. Comparable to what is already foreseen in the special scheme for distance sales of goods imported from third territories or third countries, the intermediary is the person that becomes liable for the payment of the VAT and for fulfilling the obligations laid down in the scheme in the name and on behalf of the non-EU established taxable person he represents.<sup>112</sup>

However, the burning questions still remain; firstly, how burdensome will the application be for the businesses and secondly, will the application of this tool serve only as a temporary deterrent against VAT fraud. “From the perspective of the supplier, probably the weakest point of the proposed concept is the fact that he/she can avoid declaring and paying VAT of the Member State of destination only in the case that the customer is certified as a compliant business by its tax administration (CTP), in which case the customer would continue to be liable for the VAT on goods purchased from other Member States. Only if the customer is certified as a compliant business by its tax administration, the customer would continue to be liable for

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<sup>109</sup> J. Vazquez, *The European Mini One-Stop Shop: A Model for Future Indirect Tax Compliance*

<sup>110</sup> “Towards new and definitive VAT system for the EU 4 October 2017”, [https://ec.europa.eu/commission/news/towards-new-and-definitive-vat-system-eu-2017-oct-04\\_en](https://ec.europa.eu/commission/news/towards-new-and-definitive-vat-system-eu-2017-oct-04_en), (October 4, 2017).

<sup>111</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329, final.

<sup>112</sup> *Ibid.*

the VAT on goods purchased from other Member States as is currently the case.”<sup>113</sup> *European Association of Craft, Small and Medium-sized Enterprises (UEAPME)*<sup>114</sup> assessed that the crosscheck of such information would be a difficult and time-consuming task.

Many experts<sup>115</sup> shared the same conclusion that the One Stop Shop concept will incur significant compliance costs and will provoke a lot of uncertainties for the businesses. The reason is, even though the One Stop Shop system could provide accurate information on VAT rates in Member’s States, the application of VAT rates and rules of another Member State may cause various questions for the supplier, and for example, an incorrect interpretation of foreign VAT rules could result in financial risk for the supplier.<sup>116</sup> In addition, for any business that is selling a varied range of products, establishing a VAT rate for each product in 27 other EU countries will certainly pose a challenge and incur significant costs. It will be forced to apply 27 different methods and even though Member States will publish their rules on the EU website, the information will not be legally binding. Moreover, the introduction of the possibility for Member States to apply additional reduced rates will only make the existing system more complicated, which is not in line with the idea that the European Union is striving towards.

“The transition to the new VAT system would also cause administrative burden for the companies and they would need to update their invoicing system continuously to follow the VAT rates and rules in other Member States, e.g. regarding credit notes, what could be specifically burdensome for micro and small enterprises, which hardly have CTP costumers.”<sup>117</sup>

#### **5.4. The Certified Taxable Person**

The Commission is aware of the fact that, although each new measure introduced to tackle a growing number of VAT fraud cases should successfully tackle those frauds cases, it will simultaneously cause additional administrative burden, consequently negatively affecting the efficiency of the companies. Therefore, it tried to distinguish between entrepreneurs which could be considered reliable taxable persons and taxable persons that cannot, awarding the first category benefits in the form of simplifications as of 1 January 2019.

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<sup>113</sup> “UEAPME’s Comments on the First Steps Towards a Single EU VAT”, [https://ueapme.com/IMG/pdf/180306\\_UEAPME\\_position\\_on\\_a\\_Single\\_EU\\_VAT.pdf](https://ueapme.com/IMG/pdf/180306_UEAPME_position_on_a_Single_EU_VAT.pdf), (March 6, 2018).

<sup>114</sup> Ibid.

<sup>115</sup> For example, European Association of Craft, Small and Medium-sized Enterprises (UEAPME) in its Position Paper or Allard van Nes, indirect tax consultant while giving a lecture during the seminar *Action plan for VAT: Towards a single VAT area*

<sup>116</sup> “UEAPME’s Comments on the First Steps Towards a Single EU VAT”, [https://ueapme.com/IMG/pdf/180306\\_UEAPME\\_position\\_on\\_a\\_Single\\_EU\\_VAT.pdf](https://ueapme.com/IMG/pdf/180306_UEAPME_position_on_a_Single_EU_VAT.pdf), (March 6, 2018).

<sup>117</sup> Ibid.

Those simplifications (earlier also referred to as a quick fixes) could succinctly be summarized as 1) simplification for call-off stock, 2) simplification for chain transactions 3) simplification for the proof of the exemption for intra-Community supplies, and they will all be at the disposal for certified taxable persons until the implementation of the definitive VAT system in 2022. Since the purpose of this Chapter is to analyze the certified taxable person in the context of intra-Community supplies and fraud which the current intra-Community supply regime is prone to, other simplifications will not be assessed.

“In the definitive VAT system when the customer is a certified taxable person, VAT can be reverse charged if the supplier is not established in the Member State where the B2B-supply of goods is taxed.”<sup>118</sup> To put it differently, the supplier does not have to charge VAT, shifting the obligation of reporting and paying VAT on the supply towards certified purchaser. “Similar to the supplier, the purchaser can make use of the OSS for the reporting and payment of such VAT if he is not established in the Member State of destination.”<sup>119</sup>

In order to become a CTP, a taxable person must meet three conditions:

- 1) the absence of any serious infringement or repeated infringements of taxation rules and customs legislation, as well as of any record of serious criminal offences relating to the economic activity of the applicant;
- 2) the demonstration by the applicant of a high level of control of his operations and of the flow of goods, either by means of a system managing commercial and, where appropriate, transport records, which allows appropriate tax controls, or by means of a reliable or certified internal audit trail;
- 3) evidence of financial solvency of the applicant, which shall be deemed to be proven either where the applicant has good financial standing, which enables him to fulfil his commitments, with due regard to the characteristics of the type of business activity concerned, or through the production of guarantees provided by insurance or other financial institutions or by other economically reliable third parties.<sup>120</sup>

The proposal contains one restriction regarding the applicability of the certified taxable person, namely, CTP status is available only for taxable persons established in the EU, leaving non-EU established parties

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<sup>118</sup> Madeleine Merckx, John Gruson, Naomie Verbaan and Bart van der Doef, “Definitive VAT Regime: Stairway to Heaven or Highway to Hell?” EC Tax Review, (February 2018): 75.

<sup>119</sup> Ibid.

<sup>120</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329, final.

(including, in the future, those from the UK) without possibility to use relevant simplifications, even if they are as “well behaved” as (or better behaved than) their EU-based counterparts.<sup>121</sup>

In the context of final building blocks that should permanently change the current European VAT legal landscape, the concept of a certified taxable person certainly takes one of the central places, which should, along with other measures, ensure successfully tackling carousel fraud. In that sense, Pierre Moscovici, European Commissioner for Economic and Financial Affairs, Taxation and Customs when interpreting the proposed measures revealed that the Commission estimated that the proposed reform could reduce the €50bn lost each year in cross-border VAT fraud by 80 percent, hoping that Member States would now seize the given opportunity to put in place a quality VAT system for the EU.”<sup>122</sup>

Assessing the more detailed proposal from 25 May 2018<sup>123</sup>, it can be concluded that the Commission, purposely or not, again failed to lay down detailed procedural rules regarding awarding the taxable person a status of certified person. “It seems that the European Commission leaves it to Member States to set up their own framework for testing whether or not the requirements are met, granting the status of CTP, monitoring the taxable persons that have been granted the CTP-status and withdrawing the CTP status of taxable persons that no longer meet the requirements. The proposals merely contain the obligation for Member States to grant taxable persons that meet the requirements the status of CTP and to introduce the possibility to appeal against a refusal of a CTP request.”<sup>124</sup> The proposal merely obliges Member States to recognize other Member States’ certified persons. This obligation could cause serious legislative differences and consequently political disputes between the Member States. Namely, what will probably happen in practice is that something that presents sufficient evidence for the company to be acknowledged as a taxable person in Germany, might not be sufficient to obtain the same status in another EU country. Allard van Nes, senior manager of indirect taxes and customs for the multinational company FrieslandCampina, raised serious concerns during the February 2018 conference *Action plan for VAT: Towards a single VAT area?*<sup>125</sup> regarding the criteria laid down for determining whether or not a certain taxpayer fulfills the requirements for obtaining CTP status. He considered criteria like “serious infringement of taxation or customs rules”, “a high level of control” or “solvency” being too vague, consequently introducing a lot of uncertainty into

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<sup>121</sup> “EU Btw-voorstel vor Certified Taxable Person”, <https://www.ey.com/nl/nl/services/tax/ey-tax-blogt-eu-btw-voorstel-voor-certified-taxable-persons>, (October 4, 2017).

<sup>122</sup> Aurel Dragan, “The European Commission proposes Final Technical Measures to Create a Fraud-proof EU VAT System”, <http://business-review.eu/money/the-european-commission-proposes-final-technical-measures-to-create-a-fraud-proof-eu-vat-system-171128>, (May 25, 2018).

<sup>123</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329, final.

<sup>124</sup> Madeleine Merx, John Gruson, Naomie Verbaan and Bart van der Doef, “Definitive VAT Regime: Stairway to Heaven or Highway to Hell?” EC Tax Review, (February 2018): 75.

<sup>125</sup> Seminar was held on 22 February 2018, at the Erasmus University in Rotterdam

business setting. It will take a high level of trust among the Member States to accept labeling someone as a certified taxable person.

Jeppe Kofod, Rapporteur for the *Committee on Economic and Monetary Affairs* commenting<sup>126</sup> the Commission's proposal called upon the EC to further clarify and specify the concept and criteria for a CTP, via future implementing regulations and comprehensive guidelines, and to closely align it with the criteria for Authorised Economic Operator-status under the EU Customs Code. Namely, this proposal also notably introduces the new concept of a certified taxable person, to certain extent in analogy to the "Authorised Economic Operator" in the EU Customs Code (although the AEO contains 5 stricter and more demanding criteria).

It is a point of great practical concern that it currently takes approximately 1 year to get an application for AEO approved – it will be essential that a CTP classification be obtained in a much shorter time frame if it is to have practical applicability, e.g. allow business to avail themselves of the "quick fixes".<sup>127</sup> It will present a great challenge for all Member States to handle a large number of the requests for CTP status. In this regard, it is necessary to ensure one general time-frame on the EU level within which all the applications should be processed. Otherwise, the oscillations in durations of the procedures for obtaining CTP status will lead to an unequal position between the economic operators operating in different Member States.

Although it was expected that the recent proposal from 25 May 2018 should contain much more detailed technical aspects regarding awarding the status of CTP, monitoring etc., the proposal did not introduce further explanations. Therefore, at this moment it is safe to conclude that the current concept will probably demand a significant amount of information and documentation that will have to be disclosed in order to obtain certified person status. The question of cost arises again. Especially taking into consideration that small and medium size enterprises make up 99 percent of businesses in the EU,<sup>128</sup> which will probably cause them additional administrative burden which is certainly not in line with the EU's tendencies towards a simpler VAT system.

Another possible problem that could emerge is related to monitoring the status of the certified taxable person. One could expect that all the companies will act according to the rules at the beginning of the evaluation, but the question remains, how will their status be evaluated after certain amount of time? The

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<sup>126</sup> Draft Report on the proposal for a Council directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, SWD(2017) 325, final.

<sup>127</sup> "Opinion Statement FC 9/2017 ON European Commission Proposals on the way towards a single European VAT area", [https://www.nob.net/sites/default/files/content/article/uploads/cfe\\_opinion\\_statement\\_fc9\\_17\\_proposals\\_towards\\_a\\_single\\_european\\_vat\\_area.pdf](https://www.nob.net/sites/default/files/content/article/uploads/cfe_opinion_statement_fc9_17_proposals_towards_a_single_european_vat_area.pdf), (1 December 2017).

<sup>128</sup> "What is an SME?", [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition\\_hr](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_hr).

reality is that the level and uniformity of monitoring parameters differ to a large extent between the Member States, so it is doubtful whether or not the Commission made the right decision when it let each Member State design the operational framework of the certified taxable person that will be applicable within its territory. In that context, *CFE Fiscal Committee*<sup>129</sup> (hereinafter: Fiscal Committee) rightly warned about the need of having a fully harmonized procedure of obtaining CTP status and that all Member States apply the same strict procedure. Moreover, in order to minimize the risk of fraud, the Fiscal Committee recommended strict monitoring of the certified taxable person after being recognized as such, taking into account changes of ownership of the CTP. Otherwise, it sees a great danger that the CTP status will distort where businesses are established (because they will move to where it is easiest to obtain it) and also will be used as a vehicle to continue committing fraud.<sup>130</sup>

Generally speaking, the conclusion can be made that even though the idea of the certified taxable person is certainly a positive one, there are still many uncertainties regarding the execution of the measures proposed. The European Commission is planning to put the concept of certified taxable person in force as of the beginning of 2022, which, taking all the circumstances into consideration, does not seem realistic.

Moreover, as noted earlier, the concept of certified taxable person could cause a lot of headache for small and medium enterprises so it is reasonable to expect their strong resistance. According to the European Association of Craft, Small and Medium-sized Enterprises (UEAPME), small and medium enterprises which are not able to apply for becoming a “Certified Taxable Person” status, due to lack of resources for what is a complicated certification process, may suffer from being an untrustworthy customer and will have less cash flow compared to larger companies with CTP status.<sup>131</sup>

Along with the small and medium enterprises, newly incorporated companies will also face similar problems in the sense that they will not meet the formal criteria to obtain CTP status due to a lack of history of tax compliance. This unsatisfactory situation will raise important question; should the EC make an exception for new companies and that way open a door for possible new fraudulent activities or keep consistency and cause the distortion of the competition in internal market? Finally and most importantly, who could in the end benefit from the application of CTP, multinational companies alone? From what has been displayed in this thesis, this seems like an accurate conclusion, and such an outcome is certainly not something that the European policymakers should be striving for.

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<sup>129</sup> “Opinion Statement FC 9/2017 ON European Commission Proposals on the way towards a single European VAT area”, [https://www.nob.net/sites/default/files/content/article/uploads/cfe\\_opinion\\_statement\\_fc9\\_17\\_proposals\\_towards\\_a\\_single\\_european\\_vat\\_area.pdf](https://www.nob.net/sites/default/files/content/article/uploads/cfe_opinion_statement_fc9_17_proposals_towards_a_single_european_vat_area.pdf), (1 December 2017).

<sup>130</sup> Ibid.

<sup>131</sup> “UEAPME’s Comments on the First Steps Towards a Single EU VAT”, [https://ueapme.com/IMG/pdf/180306\\_UEAPME\\_position\\_on\\_a\\_Single\\_EU\\_VAT.pdf](https://ueapme.com/IMG/pdf/180306_UEAPME_position_on_a_Single_EU_VAT.pdf), (March 6, 2018).

In the author's view, the concept of the certified taxable person at this point has a potential to become one of the main pillars of the future definitive VAT system, but has yet to gain such status. There are still too many uncertainties regarding awarding the status, such as unclear and vague requirements. Furthermore, the Commission failed to explain in the recently issued proposal from 25 May 2018 how it will regulate the monitoring of the status of the certified taxable person once the status has been awarded. Regarding the time-frame of awarding the status, the author raises concerns whether Member States will have enough technical and personal capacity to solve all the applications within the reasonable timeframe which could possibly create significant distortions in a single EU market.

If the European Commission is determined to make the concept of a certified taxable person a permanent building block, it cannot miss the opportunity to regulate in every detail the procedural aspects of obtaining and preserving CTP status. If it gives the Member States the possibility to independently regulate the area, due to diverse political and economic agendas of each Member State, the CTP concept will never fully come to fruition.

## 6. Conclusion

Taking an overall look at the Commission's Action plan on VAT: Towards a Single VAT Area from 4 October 2017 containing a proposal to adapt the *VAT Directive*, a proposal to adapt the *VAT Implementing Regulation* and a proposal to adapt the *Regulation on administrative cooperation and combating fraud* as well as the proposal amending the *VAT Directive as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States* from 25 May 2018, **with regards to what extent the solutions proposed by the European Commission will be able to close all the loopholes of the current VAT system and make it fraud resilient** – the conclusion can be made that although the ultimate goal has been set – the creation of a VAT system that will be, first of all fraud resilient, more robust and simpler, the road which leads to that goal is not yet determined.

The main objective of the proposed measures was to finally combat VAT fraud and ensure that more than €50 billion worth of damage is returned back to national and subsequently also to the European budget. This was to be achieved firstly through the introduction of the One Stop Shop mechanism in B2B intra-Community transactions where most VAT fraud occurs. "The idea to levy VAT on the intra-Community supply by making the supplier responsible for charging and remitting collected VAT through the online platform in his own country and subsequently sending it to the country of the customer is in line with the

destination principle and will contribute to a reduction of missing trader fraud as far as it is related to border crossing, but it is to be expected that this kind of fraud will shift to domestic situations.”<sup>132</sup>

Furthermore, many academics<sup>133</sup> expressed their concerns whether the introduction of the certified taxable person will actually prevent VAT fraud because CTP status will still allow taxable persons to purchase goods abroad without actually paying VAT, which is a notorious flaw in the current system that leads to VAT fraud. With many uncertainties concerning awarding the status of certified taxable person and its subsequent monitoring, it is safe to predict that many loopholes will leave plenty of space for fraudsters to maneuver. Whether they will first show compliant behavior with their economic activities in order to gain the desired CTP status before disappearing again, buying a business that already possesses the CTP status to carry out their malicious plans<sup>134</sup> or going for a third option, the proposed solution will allow them to continue with their fraudulent activities at the expense of the Member States’ budgets.

To conclude, the efforts made by the European Commission in co-operation with other bodies to build a new, definitive VAT system will certainly not be devoid of any results. However, from the analyzed proposals of the Commission, it can be deduced that the road to creating a definitive system will be expensive and although it will, if not eradicate, then at least significantly reduce the possibility of VAT fraud occurrence in intra-Community supplies, it will open up the possibility for fraud to occur in domestic supplies.

What is also important to note, if the EU really wished to build one robust, simple VAT system, it should strive harder to unify the rules and maximally simplify them. Otherwise, there will be legal uncertainty and it is precisely that uncertainty and significant administrative burden that are the main stumbling blocks to the development of the economy and the establishment of a strong, internal market.

Administrative cooperation between the Member States should also not be neglected, which although not poor, is still not at satisfactory level. The key to successfully combating the various forms of VAT fraud and crime in general is early detection and rapid reaction. This fact has to be seen by the Member States as a reason to strengthen cooperation among themselves, since it is beneficial for everyone. In this sense, the proposed measures, like the introduction of TNA software and faster and more efficient exchange of information in customs procedures related to import of goods free of VAT could serve as a valuable tool for achieving European goals, but only if the Member States actually use the tools available to them.

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<sup>132</sup> Ibid.

<sup>133</sup> For example, Madeleine Merckx, John Gruson and Naomie Verbaan & Bart van der Doef in their Article: Definitive VAT Regime: Stairway to Heaven or Highway to Hell?

<sup>134</sup> Madeleine Merckx, John Gruson, Naomie Verbaan and Bart van der Doef, “Definitive VAT Regime: Stairway to Heaven or Highway to Hell?” EC Tax Review, (February 2018): 82.



The key to success is for the Member States to put their own, particular interests to the side and work together in a concentrated effort to achieve the goal of a fraud resistant, robust and simple VAT system, a system that will create a strong internal market and equal entrepreneurial opportunities for all operating businesses across the European Union, which is not an easy task.

The author is aware of the fact that no matter what the European Commission proposes, there will always be interest groups who will oppose the idea due to their particular interests. That fact notwithstanding, the author believes that no proposal regarding a definitive VAT system issued by the European Commission as the EU key policy driver should be published before an extensive survey regarding the impact on weaker parties in the economic food-chain, small and medium-sized enterprises, is undertaken.

Bearing in mind that small and medium-sized enterprises make up a major share of the European economy, any policy created by the Commission, and for the purpose of this thesis, any VAT fraud solution, should first and foremost be evaluated from the perspective of those companies. The author is of opinion that the introduction of One Stop Shop and concept of a certified taxable person are positive innovations in the VAT legal landscape and will have a significant impact on the fight against carousel fraud, but the Commission needs to take things in its own hands and provide a legally-binding data base which would contain all the relevant information regarding VAT rates, procedural VAT rules and so forth, thereby freeing SMEs from additional administrative costs and uncertainties. Moreover, regarding awarding and controlling the CTP status, the Commission cannot miss this unique opportunity to regulate it itself, subsequently ensuring that no oscillations between the legislation of the Member States will occur and more importantly, ensuring that this institute will not favor only major players such as a multinational companies, but small and medium-sized companies as well. That way, two birds would be killed with one stone – ensuring that the carousel fraud is tackled with the right tools while simultaneously protecting the pillars of the European economy – small and medium-sized companies.

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