



Lund University

School of Economics and Management
Department of Business Law

Can the general reverse charge mechanism combat missing trader fraud
and provide for secure VAT collection?

by

Kostadin Pavlov

HARN60 Master Thesis

Master's Programme in European and International Tax Law

2016/2017

Academic year 2016-2017

Date: 2017-06-06

Supervisor: Oskar Henkow

Examiner: Cécile Brokelind

Author's contact information:

kostadin.pavlov@gmail.com

+46 760 88 11 00

Contents

Summary	i
Preface.....	ii
List of abbreviations	iii
1. Introduction	1
1.1 Background.....	1
1.2 Purpose.....	4
1.3 Method and material	5
1.4 Delimitations	5
1.5 Outline	6
2. Existing legislation	7
2.1 General rules in the VAT Directive	7
2.2 Types of fraud.....	10
2.3 Measures to combat fraud.....	13
3. Proposal for a general reverse charge mechanism	15
3.1 The Commission Action Plan on VAT and available alternatives	15
3.2 Conditions for applying the general reverse charge mechanism and how it works	16
3.3 Retail sales tax –RST	18
3.4 Summary of Chapters 1 to 3, and an overview of the ‘definitive’ VAT system	19
4. Deliberations on the GRCM	21
4.1 Opinion of the Council, the Commission and its respondents.....	21
4.2 Results the impact assessments.....	25
4.3 Opinions of the parties supporting the GRCM and those opposing it	29
5. Analysis	35
5.1 Assessment of the arguments	35
5.2 Possible impact on the authorities and businesses	40
5.3 Effect of the GRCM on MSs and VAT fraud	41
5.4 Effect of the GRCM on the collection of VAT	42
6. Conclusion	44
Bibliography.....	46

Summary

This thesis explores the European Commission's proposal on General Reverse Charge Mechanism. VAT is a final tax on consumption. It is imposed on every transaction in the supply chain with the general aim of being deductible and thus being neutral for businesses with the right to deduct. The initial aim of the VAT system was to operate as if all the transactions occurred in one single country; however, after the changes made during 1993, goods in cross-border transactions are obtained free of VAT. According to the changes, VAT-registered traders are exempt from VAT in the state of origin and the purchaser accounts for the VAT in the country of destination. As a result, the goods could be sold in the Member State of origin free of VAT or, if transported to the member state of destination, VAT could be collected but not remitted while the business customer in the second MS can deduct the VAT incurred. Those possibilities are used to commit missing trader fraud, and in some member states, the VAT gap is around 40%.

In 2016 the Commission adopted Action plan on VAT, aiming to introduce a definitive VAT system. As the preparation of the changes for the future VAT system requires some time, the Commission adopted several parallel measures to resolve the urgent problems about missing trader fraud. The Commission is of the view that the general reverse charge mechanism will stop missing trader fraud and that the VAT gap will be reduced. According to the Commission, the reform of the VAT should result in a new *simple, efficient and neutral, and robust and fraud-proof* VAT system. The objectives agreed by the Council and the European Parliament for introducing the general derogation are to stop missing trader fraud, lower compliance costs for both businesses and administrations and exert no negative impacts on the internal market.

The purpose of this thesis is to evaluate the proposed GRCM in *relation* to the aim of the EU's VAT system of which robust tax collection is one of the primary goals, and in *relation* to the objectives agreed by the Council and the European Parliament for the introduction of the GRCM.

More specifically, the question researched is whether the GRCM meets the requirements set by the European Commission – a simple, robust, and efficient VAT collection system, and remedies the problem with of MTIC fraud.

The conclusion from the analysis is that General Reverse Charge Mechanism as proposed today does not meet the requirements set out by the European legislator. Furthermore, carousel fraud is still possible, and compliance costs would be higher. The application of the GRCM would provide the sought-after result only if introduced sector by sector on a mandatory basis.

As an alternative to the proposed GRCM, correctly designed algorithms would be able to solve the problem of relocating of the VAT due and the VAT paid. Thus, combining the origin with the destination principle in one single automative collection-distribution point would be a promising possibility that needs to be researched in detail. A digital collection-distribution point would have to be established at the EU level, and integrated at the national level. Such a system should and would be able to introduce GRCM but without the risks, that the GRCM bears while the fractional collection system is preserved.

Key words: VAT Directive, MTIC fraud, carousel fraud, GRCM- general reverse charge mechanism, VAT collection, RST

Preface

The Master's Programme covered all areas of tax law and related case law from the Court of Justice of European Union, and it thus follows naturally not to cover each specific areas in depth. Taxes attract fraudsters, and Tax law becomes more complicated than only rules and mathematics. Fraud within the VAT system and outlining characteristics for a future fraud-proof system are agreed to be a very complex topic. With background from Criminology-Sociology of Law and more specifically the field of White Collar crime, the issue drew me in and turned into my primary subject for research.

I would like to express my gratitude to my wife Ayri for her constant support, encouragement and extra homework while I sat studying to meet deadlines. My daughters Meli and Alice put up with my countless busy evenings and constant multitasking while I tried to spend time with them.

I would also like to thank my supervisor, Professor Oskar Henkow, whose comprehensive guidance and expertise have been the primary source for the successful fulfillment of this thesis.

Finally I would like to extend my thanks to Professor Cécile Brökelind and the outstanding team of lecturers and tutors within the Department of Business Law at Lund University.

Word count 17 218

List of abbreviations

B2B	Business to Business
EC	European Commission
EU	European Union
GFV	Group on the Future of VAT
GRCM	General Reverse charge mechanism
IBFD	International Bureau of Fiscal Documentation
MS	Member States
MTIC	Missing Trader Intra-community fraud
OECD	The Organisation for Co-operation and Development
OSS	One Stop Shop
QRM	Quick Reaction Mechanism
RCM	Reverse Charge Mechanism
RST	Retail Sales Tax
Sixth Directive	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment
UK	United Kingdom
US	United States of America
VAT	Value added tax
VAT Directive	Council Directive 2006/112/EC on the common system of value added tax as amended by Directive 2008/8/EC
VEG	VAT Expert Group
VIES	VAT Information Exchange System

1. Introduction

1.1 Background

To fulfil the requirement of the Treaty¹, in 1967 the initial six Member States (MSs) decided to replace their turnover tax systems with a common value-added tax system (VAT). The similarity between those two systems is the aim to tax expenditures made by consumers,² and thus they are called consumptions taxes. In addition, the tax is not specific, like excise duties³, but rather a general tax, aiming to tax all final consumption. The difference between the two systems is that in the former⁴, the tax is imposed on every transaction in the chain, from production throughout distribution to the consumer, and thus a tax on tax is paid, whereas in the latter,⁵ credit is given for the tax previously paid and only the final consumer bears the burden of the tax. However, only taxable persons⁶ with the right to deduct the tax qualify for the credit, that is when the transaction is concluded in the course of the business. As a result, the tax is collected proportionally on the value added to each transaction, a system that is also called fractional collection. The following illustration provides an example of the turnover all-stage tax system, and the proportional VAT collection system is compared with a retail sales tax system (RST).⁷

Turnover tax				
Stages	Sales	Tax 4%	After Tax	To Treasury
Raw material	100	4	104	4
Processing	204	8,16	213	8
Wholesaler	313	12,5	325	12
Retailer	425	16,9	442	16
				40

VAT tax collection				Retail sales tax					
Stages	Sales	Tax 10%	To treasury	Tax 10%	Sales	Stages			
Raw material	100	+	10	10	0	-	100	Raw material	Line 1
Processing	200	+	20	20-10= 10	0	-	200	Processing	Line 2
Wholesaler	300	+	30	30-20= 10	0	-	300	Wholesaler	Line 3
Retailer	400	+	40	40-30= 10	40	40	400	Retailer	Line 4
Graph 1			40	40					

¹ See Article 99 Treaty of Rome, Treaty establishing the European Economic Community of 25 March 1957 (ex Article 93 in TEC, and now Article 113 TFEU); Treaty of Paris constituting the European Coal and Steel Community signed on 18 April 1951 signed by the first six member states, Belgium, The Netherlands, Luxembourg, Germany, Italy and France. This was based on decision from European Coal and Steel Community, High Authority, Report on the Problems Raised by the Different Turnover Tax Systems Applied within the Common Market, Tinbergen report 1953 turnover taxes on 1-53 of 5 March 1953, Official Gazette of the Community of 7th March 1953.

² For VAT purposes final consumer is every person both private and non-private, which has not the right to deduct the VAT paid on its purchases.

³ Excise duty is a specific tax calculated on the volume of the product imposed on production or importation.

⁴ Multi-stage cumulative 'cascade' tax system. See Terra, B. J. M.. - *A guide to the European VAT directives*. Vol. 1 and Vol. 2, Introduction to European VAT 2016, / Ben Terra, Julie Kajus. Online Resources p.155.

⁵ Non-cumulative tax system. See Terra & Kajus 2016 p.156-157.

⁶ For definition of taxable person see Article 9 to 12 of the VAT Directive- Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

⁷ For more information on Retail sales tax (RST) see chapter 3.3.

In an export –import situation, following the turnover tax system, exports were exempt (the tax already paid was reimbursed in the country of origin) and imports were taxed (according to the rules and in the country of destination). The tax was usually imposed at the physical frontier control, and this treatment continued even after the introduction of the Customs Union in 1968.⁸ That type of collection in the country of destination follows the so-called *the destination principle*, which is opposite to *the origin principle*.⁹

With the introduction of the First¹⁰ and the Second VAT Directive,¹¹ a common VAT system was established. Together the VAT Directives laid down the main principles of taxation. The implementation of the decision to finance the EU budget from its own resources in 1970¹², based on a proportion of the VAT collected from each MS,¹³ revealed the problems with the turnover tax and stimulated the future development of the VAT system. Essentially these problems were that MS had applied own variations of taxation in addition to many different rates. Furthermore, it was impossible to calculate the exact amount of tax collected and the intentional estimation for the refundable taxes on exportation entailed risk.¹⁴ Thus, the VAT system was seen as a better choice and described as the most growth-friendly forms of taxation.¹⁵

The introduction of the Sixth VAT Directive¹⁶ set out the requirement for the application of identical VAT bases. This meant that VAT was to be levied on the same transactions across MSs and other relevant futures targeting the harmonization of the VAT collection across the MSs due to the requirement for the EU's own resources. Further work in this direction targeted the removal of the fiscal barriers, and, between 1985- and 1990, the European Commission (EC) published a package of proposals.¹⁷

⁸ Customs duties on intra –community trade were abolished. European communities press and information, The value added tax in the European community, Community topics 36, 1970, p. 4; accessible at <http://aei.pitt.edu/34513/1/A682.pdf>. [accessed 28 March 2017]

⁹ European communities press and information, The value added tax in the European community, Community topics 36, 1970, pp. 4-5; accessible at <http://aei.pitt.edu/34513/1/A682.pdf> . [accessed 28 March 2017]

¹⁰ *First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.*

¹¹ *Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.*

¹² Council Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources, replaced by 88/376/EEC, Euratom: Council Decision of 24 June 1988 on the system of the Communities' own resources, Euratom of 24 June 1988 L195, p.24.

¹³ “The VAT own resource represented 11 per cent of EU revenue, being around Euro 14 billion in 2011. For the calculation of the VAT own resource, as a rule, a uniform call rate of 0.3% is levied on the harmonised VAT base of each Member State. However, this VAT base is capped at 50% of GNI for each Member State. The harmonised VAT base is calculated by the relevant Member State using what is known as the revenue method. It consists of dividing the total net VAT revenue collected by the Member State in question by the weighted average rate of VAT to obtain the intermediate VAT base. The intermediate base is subsequently adjusted with negative and positive compensations in order to obtain a harmonised VAT base pursuant the VAT Directive.” COM (2014) 69 final, p. 4.

¹⁴ European communities press and information, The value added tax in the European community, Community topics 36, 1970, pp. 4-5.

¹⁵ SWD (2016) 457, Commission Staff Working Document. Impact assessment - Generalised reverse charge mechanism. 21.12.2016, p.5.

¹⁶ Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment.

¹⁷ The Single European Act of 1985 sets up a deadline for the abolition of borders and in 1987 The Commission proposed a system that would be adapted to the internal market.

The initial proposal of the EC was to tax at the origin, while only two identical VAT rates applied across all MSs. The tax was to be paid in the country of origin ensuring a secure, undisturbed chain of taxation. However, the achievement of an identical VAT rates was impossible by that time due to the lack of political consensus, the EC proposed a clearing mechanism. The VAT was to be paid in the MS of origin, and as the aim of the VAT system is to tax final consumption, re-located to the country of consumption through that clearing mechanism, while the VAT collected from the consequent sale in the MS of destination would be assigned to the second MS.¹⁸ However, such a system was impossible to achieve at that time.

The concepts about the elimination of the frontiers triggered several rejections by the MSs and, as a result, the evolution of more sophisticated proposals. Finally, an alternative that was intended to last for four years was accepted and defined as '*the transitional system*'.¹⁹ It retained the destination principle but without frontier controls and tax on importation. According to the changes, VAT-registered traders²⁰ are exempt from VAT in the state of origin and the purchaser accounts for the VAT in the country of destination. This means that the seller exempts the supply while having the right to deduct the VAT²¹, and the customer accounts for the VAT on the acquisition in the country of arrival (destination) according to that MS's rates and conditions. As a result, the goods move within the community without being taxed, which is also known as *zero-rate*. The origin principle continued to apply to transactions to final consumers, which means that, once the VAT has been paid, the goods can move freely within the Community. The transitional system was intended to apply until the end of 1996 but it continues to operate even today (2017).²²

This transitional system, under which goods move untaxed, led to new fraud possibilities, such as missing trader intra-community fraud (MTIC).²³ VAT carousel fraud is one of the types of MTIC fraud, and because of its structure, as explained in chapter 2.2, it is resistant to enforcement measures.²⁴

In April 2016 the EC adopted an "*Action plan on VAT towards a single EU VAT area*" (Action Plan), aiming to introduce a definitive VAT system.²⁵ Meanwhile a proposal for a general reverse charge mechanism (GRCM), as a general derogation to combat carousel fraud, was laid down (for detailed information see chapter 3.1). Under the GRCM only the business selling to the final consumer will collect and remit VAT, while the businesses involved in the chain of

¹⁸ Proposal for a Council Directive completing and amending Directive 77/388/EEC - Removal of fiscal frontiers. COM (87) 322 final/2.

¹⁹ Directive 91/680/EEC of 16 December 1991 and Directive 92/11/EEC of 14 December 1992. The problem with the proposal has been the uncertainty with the regard to the enormous amounts that had to be transferred between the MSs.

²⁰ See Article 213(1) of the VAT Directive.

²¹ See Articles 138(1) and 169(b) of the VAT Directive.

²² For detailed overview and all amended regulations and Directives, see further European Parliament Fact Sheets, section 4.19.2. Value Added Tax (VAT). http://www.europarl.europa.eu/facts_2004/4_19_2_en.htm . accessed 28 March 2017]

²³ For detailed explanation, see Chapter 2.2 VAT Fraud.

²⁴ Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud, COM/2004/0260 final, p.3.

²⁵ COM (2016) 148 final, Communication from the Commission to the European Parliament, The Council and the European Economic and Social Committee on an action plan on VAT Towards a single EU VAT area -Time to decide.

transactions will not collect VAT. That means that VAT will be collected at the retail level, and thus works the same way retail sales tax (RST)²⁶. As a derogation from the general principle of the VAT Directive, fractional tax collection²⁷, the new mechanism is raising challenging questions.

1.2 Purpose

There are respective groups of professionals and respondents in the process promoting the GRM, but they face an equal proportion of skeptical opinions.²⁸ As the proposal is already a factum and several MSs have sought to introduce a reverse charge mechanism (RCM) on four occasions,²⁹ the GRM, as derogation from the current VAT Directive could be a reality in the near future. The purpose of this thesis is to evaluate the proposed GRM in relation to the aim of the EU's VAT system, of which robust tax collection is one of the primary goals,³⁰ and in relation to the objectives agreed by the Council and the European parliament for the introduction of the GRM.

More specifically, the question researched is whether the GRM meets the requirements set by the European Commission - a simple, robust, and efficient VAT collection system, and remedies the problem of MTIC fraud.

The preconditions set by the EC are;

“**Simple**”: A taxable person active across the EU should be faced with a single set of clear and simple VAT rules: an EU VAT Code. Such a code would lay down rules adapted to modern business models, and standardised obligations which take full account of the progress made in new technologies. A taxable person should only deal with the tax authorities of a single Member State;

• **Efficient and neutral**: Introducing a broader tax base, as well as implementing the principle of taxation at the standard rate, would generate more revenue at less cost, or alternatively allow the standard rate to be reduced in a revenue-neutral way. Any derogation from those principles would have to be rational and uniformly defined. Neutrality also requires equal rules governing the right of deduction and very limited restrictions on the exercise of that right;

• **Robust and fraudproof**: Modern methods of collecting and monitoring of VAT should maximise the revenues actually collected and limit fraud and avoidance as far as possible. Besides easing compliance for business, this will require the national tax authorities to concentrate on risky behaviors, target actual fraudsters and ultimately act collectively as a European VAT authority. An intensified, automated and rapid exchange of information between national tax administrations will be vital in achieving this goal.”³¹

²⁶ See further chapter 3.3.

²⁷ See 2.1.

²⁸ See chapter 4.

²⁹ Germany, Bulgaria, Austria and Czech Republic.

³⁰ “... in order to enable the system to be applied in a simple and neutral manner, and to keep the standard rate of tax within reasonable limits...” Preamble to the Second VAT Directive. It should be emphasized that the rate under turnover tax system has been between 1% and 4% where the rate in VAT system is between 6% - 27%. For RST 10% is the highest level.

³¹ 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, 6 December 2011, pp.5-6.

The European Parliament³² and the Council³³ agreed with the view of the EC that the new VAT system must fulfil those criteria and be based on the principle of taxation in the country of destination. The Council also supported for further research on the feasibility of new tax collection methods and urged the Commission to conduct in-depth analysis to examine the different possible ways of implementing the principle of destination. The objectives agreed by the Council and the European parliament for introducing the general derogation, the GRCM, are to stop carousel fraud, lower compliance costs for both businesses and administrations, and exert no negative impacts on the internal market.

To achieve the purpose of the thesis, first the current VAT system is introduced. Then an analysis of the proposal is conducted and its historical background is presented. Further, an assessment is conducted of the objectives agreed by the EU's legislative institutions and the argumentation by the parties involved in the process and by academics who have previously discussed the subject. Lastly, the proposed mechanism is critically evaluated in relation to the objectives laid down by the European legislator. It falls within the evaluation also to research possible options of taxation, albeit only as a secondary aim.

1.3 Method and material

The method used is a traditional legal dogmatic method whereby the EU preparatory works are the primary source for the research. In addition, relevant scholarly literature, recommendations, legal articles, papers, and governmental reports are analysed. The material used consists of a selection from the most reliable journals published on various platforms, such as the *IBFD*, *Tax Review*, *Intertax*, and so on. The research for the thesis includes publications in the Bulgarian, English, and Swedish languages. As the material contains great percentage of calculations and numbers on which final decisions are based, even simple recalculations were required.

1.4 Delimitations

Firstly, the subject concerns legislation at EU level. Nonetheless, the core question concerns individual MSs' resources, and their representatives' opinion will be included. Secondly, as there are many different types of fraud, only the most important ones are presented. Thirdly, as the research for this thesis was completed on 28 May 2017, publications hereinafter have not been taken into consideration. Fourthly, a pilot project was proposed by EC to test the functions of GRCM, which was rejected by the MSs and is thus excluded from the thesis.

³² The future of VAT European Parliament resolution of 13 October 2011 on the future of VAT (2011/2082(INI)), OJ C 94E , 3.4.2013, p. 5–12, para 16.

³³ Council of the European Union, PRESS RELEASE. 3167th Council meeting. Economic and Financial Affairs. Brussels, 15 May 2012.

1.5 Outline

In the second chapter, the author presents the current legislation in the light of the VAT Directive and its characteristics in detail. Then the study touches upon the main types of fraud and as a corollary, the derogations in the legislation related to fraud. In the third chapter, the author presents the main topics from the EC's Action Plan and the ongoing legislation followed by a detailed description of the GRCM and its analogue RST. Chapter four presents the argumentation of the EC and the discussions from the legal doctrine. In chapter five, the author analyses the argumentations of the parties, the impact of the GRCM on the tax authorities and businesses and then its impact on fraud and the collection of VAT. Finally, the author makes final remarks on the future possibilities and conclusions.

2. Existing legislation

2.1 General rules in the VAT Directive

2.1.1 Key features of VAT

The intention of VAT is to tax final consumption. Such consumption can even be use of goods and services other than those used for business purposes. VAT is imposed on every transaction in the supply chain with the general aim of being deductible and thus being neutral for businesses with the right to deduct. There are certain exceptions, which are hereinafter referred to as exemptions.³⁴ Simply described, four key features govern the VAT system. First, the final consumers pay the tax, second, the tax is levied for every supply, third, taxable persons³⁵ (businesses) collect the tax at each stage, and fourth, the tax is deductible by taxable persons for all business inputs.

In the current system, VAT applies to each transaction, and businesses having the right to deduct the VAT incurred do so from the VAT collected. The VAT incurred is the VAT paid (input VAT) to the previous supplier, and the VAT collected (output VAT) represents the sum collected from further sales. The process is repeated until the chain reaches an end consumer who has no right to deduct the VAT. Exempt businesses have no right to deduct the VAT incurred and as such are end consumers. The upper part of graph 4 illustrates the following domestic transaction between “A” –the manufacture, “B” –the national distributor, “C”- the local distributor, “D” – the retailer and the end consumer. “A’s” net price is 100 and the VAT rate is 20%. “B” pays the sum of 120, the price plus VAT 100+20, and “A” remits the VAT of 20 to the tax authorities. “B” has the right to deduct the VAT paid which in this case is 20. When “B” adds a profit margin of 100 the new net price becomes 200. Adding VAT of 20 %, which in this case is 40, results in 40 (VAT collected) minus 20 (VAT paid to “A”) resulting in 20 to be remitted to the treasury. “C” adds the value of 100 and thus collects 60 of VAT minus 40 paid to “B” and the results of 20 are to be remitted to the treasury. Then “C” adds the value of 100 and the new gross price for the end consumer is 400+80 of VAT. When the final sale is concluded “D” remits VAT of 20 (80-60) to the tax authorities. The total tax is borne ultimately by the end consumer but collected and remitted partly by A, B, C and D, 20+20+20+20=80.³⁶

To facilitate the VAT paid on every transaction, a reliable method of accounting is used, the so-called subtractive indirect method, which is also referred to as the invoice credit method.³⁷

According to the rules for invoices, businesses are obliged to account for output VAT on every transaction and submit periodical statements according to the national rules (usually per month or quarter). In the illustration discussed above, “A” has to invoice the net price of 100 plus VAT of 20 so “B” knows not only the price that it pays but also the proportion of VAT charged, which

³⁴ Under Article 13 of the VAT Directive, public bodies and other bodies governed by public law are exempted from VAT, even financial sector and some other sectors are exempted.

³⁵ For the purpose of this thesis, using business or businesses will mean taxable person/s.

³⁶ Michael Tumpel. *A Hybrid VAT System in the European Union*, 2007, pp.1-9 and SWD (2016) 457 p.6.

³⁷ See Terra & Kajus 2016, 18.4.

“B” can deduct immediately.³⁸ The situation is similar even for “C” and “D” when they sell further along the chain.

An invoice has three functions. First, it contains information on the VAT rate applicable, second, it enables businesses to prove their right to deduct, and third, it allows the tax authorities to cross-check the transactions. In the example above, the tax authorities can check whether the VAT paid by “A” and the input VAT deducted by “B” match.³⁹ However, as the submission of the periodical statements showing the amount of the transactions and the corresponding VAT charged and deducted is made at the end of each period while the right to deduct input VAT is immediate, the tax authorities can only control the information on whether the VAT deducted by “B” has been remitted by “A” ex-post. The need for each supplier to account for the input and the output VAT on an invoice that represents the right to deduct the input VAT makes the VAT system self-policing. In the case of fraud committed by either “A”, “B”, “C”, or “D”, only 20 of the VAT would be missed and not the whole sum of 80.⁴⁰ On the one hand, such a fractional collection of the VAT avoids the non-payment of the total VAT in the case of default of a single supplier in the chain. On the other hand, however, it allows for different types of fraud (described in the next chapter).⁴¹

2.1.2 Neutrality

Neutrality, as defined in Article 2 of the First VAT Directive, is the governing principle of the EU VAT system. It offers an advantage over other tax systems, because it results in neutral treatment. Neutrality can be divided into internal neutrality and external neutrality.

Levying VAT on every transaction for both goods and services throughout the supply chain, in which businesses have the right to deduct the input VAT related to business acquisitions and only the end consumer pays the VAT, guarantees internal neutrality. External neutrality guarantees neutral treatment in import-export transactions. When VAT is levied on goods produced in one country and the goods are not consumed in the same country, the VAT is to be refunded in the case of exportation of those goods corresponding to the amount previously levied. Subsequently, the VAT is levied in the country of importation with the same rate as on like domestic goods.⁴² That is the basis of the principle of destination, whereby the VAT treatment is the same irrespective of where the goods or services come from or are rendered.⁴³

To sum up, VAT is neutral for the businesses within a single MS and for the country where the goods arrive. Furthermore, final consumers are not required to make decisions based on the VAT rate, as it applies broadly and neutrally to every good and service.

³⁸ According to Article 167 of the VAT Directive, the right to deduct occurs when the VAT becomes chargeable, i.e. immediately.

³⁹ Terra & Kajus 2016, Online version 18.4.

⁴⁰ Ibid, p. 160.

⁴¹ Tumpel 2007, p. 10.

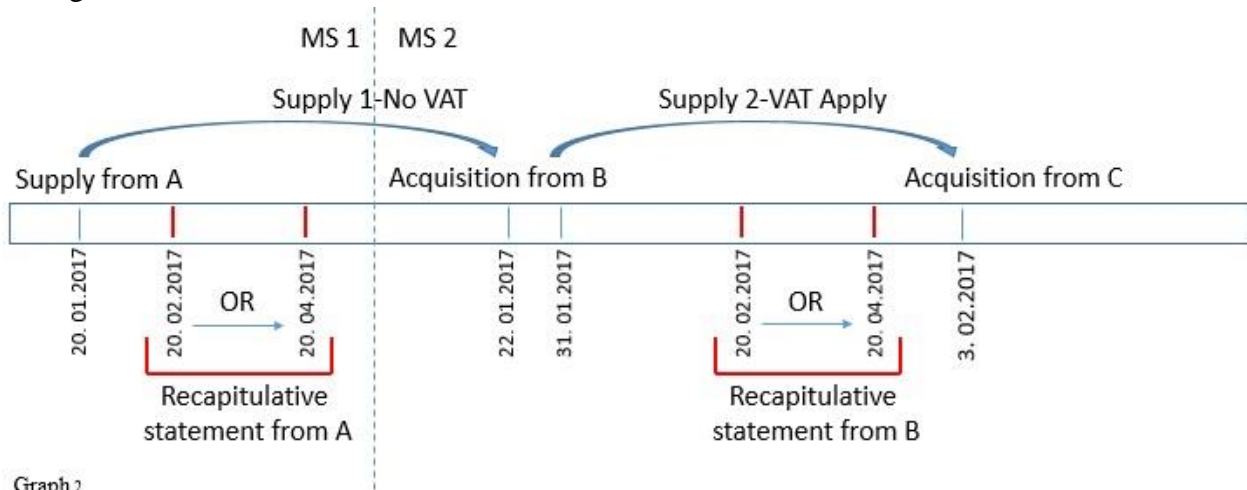
⁴² Terra & Kajus 2016. 7.2.3.

⁴³ Ibid, 7.2.3.

2.1.3 Intra-community supply

As previously mentioned intra-community transactions under the current VAT Directive are exempt (zero-rated), and domestic transactions are taxed.⁴⁴ The zero-rate treatment of cross-border transactions allows the goods to cross the border tax-free. The only check that was introduced under the 1993 reform was the VAT Information Exchange System (VIES). The VIES is a centralized European platform in which every VAT-registered trader accounts for the VAT related to intra-community supplies or acquisitions.⁴⁵ As a result, the burden of accounting for the VAT is left to the acquirer itself. The accounting for the VAT is made through a recapitulative statement, which, according to the treatment in different MSs must be submitted each month or each quarter if the limit of 50 000 EUR for the previous quarter has not been exceeded.⁴⁶ Such treatment of cross-border supplies creates a time gap between the report for exported or imported goods and the time when tax authorities become qualified to require the payment of the VAT due on the particular transaction.

In the following illustration, Company “A” makes the supply one month, or four months, before submitting the recapitulative statement. According to the zero-rate rule Company “B” receives the goods free of VAT (zero-rated) and makes a further supply a few days afterwards, however, this time it is a domestic supply and thus it charges VAT and subsequently receives a refund for the VAT paid on its overall domestic acquisitions. Both Company “A” and Company “B” have the right to deduct the VAT incurred.



Graph 1

One important aspect here is the timing for declaring the VAT, which will be discussed further in the analysis. This zero-rate rule governing the charge-deduction mechanism in an intra-

⁴⁴ See Articles 138(1) and 169(b) of the VAT Directive. According to article 138 (1) the supply to another EU MS is exempt and according to Article 169 (b) there is right to deduct the VAT that has incurred.

⁴⁵ In case of acquisition, see Article 242 of the VAT Directive.

⁴⁶ See Articles 262-263, and Articles 40-42 of the VAT Directive and Article 55 Regulation (EU) No. 282/2011 [Obligation to communicate VAT identification numbers].

community acquisition, combined with the time for control and the actual declaration/payment of the VAT, allows for different fraudulent practices, discussed in depth in the following subchapter.

2.2 Types of fraud

According to several studies, there are more than 16 different types of VAT fraud.⁴⁷ As the thesis aims to examine whether the GRCM meets the requirements set by the EU legislator, and the GRCM is more than the RST, even fraud that is possible under the RST will be discussed.

The following types of frauds are recognized under both VAT and RST:

Under-reported sales-businesses can choose to report only a proportion of the supply by either falsifying the records and accounts to match or not reporting them at all. Under the VAT system, there is the possibility of simply not issuing an invoice, and in cases of issued invoices, it still depends on whether the customer is VAT registered to be able to deduct the VAT and thus make a cross-check possible. To be registered, a business must comply with certain thresholds at which registration becomes compulsory. The levels are different in the various MSs.⁴⁸ If registered for VAT, the customer can seek to deduct the VAT, and then is up to the tax authorities to discover the imbalance between reported and requested VAT. The fraud can be committed until the authorities discover it, if they do so. Such fraud is common when supplying to private persons when the input VAT is lower than the output VAT (such as personal services, private home reconstruction works, home decoration, etc.).⁴⁹

Failure to register – under VAT small businesses can choose not to register and thus operate close to the threshold level and save both the VAT compliance costs⁵⁰ and the VAT for which they have to account. There are also “ghost” traders, which could operate unknown to the authorities and evade both income taxes and VAT. As in the first type, small businesses supplying end consumers are more likely to commit this type of fraud.⁵¹

Misclassification of the goods – when a business makes both taxed and exempt supplies or uses different rates⁵², it can intentionally record sales from the higher rate as the lower one.⁵³

⁴⁷ Michael Keen and Stephen Smith, *VAT Fraud and Evasion: What Do We Know, and What Can be Done?* International Monetary Fund, 2007, p.7 footnote 7 and Alan A. Tait. *Value Added Tax: International Practice and Problems*, International Monetary Fund, 1988, p.308.

⁴⁸http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_anexi.pdf. [accessed on 14 April 2017]

⁴⁹ Keen & Smith 2007, p.8.

⁵⁰ VAT compliance costs refers to all the costs that a business has in order to administrate the VAT. According to the findings of this study, the costs associated with complying with cross-border VAT obligations are 11% higher than the VAT compliance costs associated with domestic trade. EY, *Implementing the 'destination principle' to intra-EU B2B supplies of goods, Feasibility and economic evaluation study*, Final Report Contract: TAXUD/2013/DE/319, 2015, p. 13.

⁵¹ Keen & Smith 2007.

⁵² According to Articles 96-99 of the VAT Directive three different rates can be applicable in each MS, which creates enormous differentiation on EU level.

⁵³ Keen & Smith 2007, p. 8.

Omission of self-deliveries – this can occur in cases in which the proprietor or the employees consume a not-declared business production.⁵⁴

Tax collected but not remitted – this can occur by false accounting, by engineering bankruptcy, or in various other ways. This is the missing trader fraud MTIC, in which the tax is collected by a business, that later disappears⁵⁵(see the detailed presentation below).

Untaxed imported goods can further be sold on the home market of the MS. This is more of a problem for the RST for which the USA has constitutional obstacles to charging tax on out-of-state supplies. However, tax-free acquisition is a major problem even for the EU VAT system, as discussed in the introduction, and it will be explored in this chapter.⁵⁶

Beside the types of fraud listed above, the following are also recognized under VAT.

False claims for credit or refunds are very likely to occur at the starting stage of a business, when large input transactions in the absence of corresponding output transactions (sales) are usually expected. Another possibility is a claim for zero-rate transactions of non-existing goods.

Credit claimed for exempt input transaction - this is possible when a business conducts both taxed and exempted transactions and claims to deduct the VAT related to the exempt input transactions. It is also possible when a business acquires goods or services for private use but deducts the VAT. In cases of *mixed use*, for both business and private purposes the proportion of non-deductible VAT might be allocated to the former. The last would be applicable even in the RST system.⁵⁷

Bogus traders symbolize companies with the sole intention to generate false invoices to recover VAT while exploiting the impossibilities of the tax authorities to cross-checking whether the corresponding VAT has been paid.

The types of fraud committed by the time when the transitional system was introduced (1993) consisted of falsified T2 documents⁵⁸ or customs stamps or alternatively bribing customs officials. The scope of those types' of fraud made them difficult to commit on a regular basis, and therefore they occurred infrequently. Compared with fiscal frontiers, the new transitional rules made the VAT system more sensitive to fraud.⁵⁹Possibilities for fraud result not only from the zero-rate treatment but also from other characteristics of the VAT system, such as different rates, high tax, exemptions, thresholds, timing the VAT returns, and the actual payment of the VAT.

⁵⁴ Ibid, p. 8.

⁵⁵ Ibid, p.9.

⁵⁶ Ibid.

⁵⁷ Keen & Smith 2007, p.9 and Traikova, Evelina. *Center for Police studies related to VAT evasion and prevention. /Research rapport/*, Research Institute for Criminalism and Criminology. 2013. p. 27. http://www.nikk.mvr.bg/NR/rdonlyres/52BA60FB-37B0-4F98-9BB3-949E9E4ADF15/0/052013_DDS_traikova.pdf. [accessed on 10 May 2017]

⁵⁸ Customs transit documents.

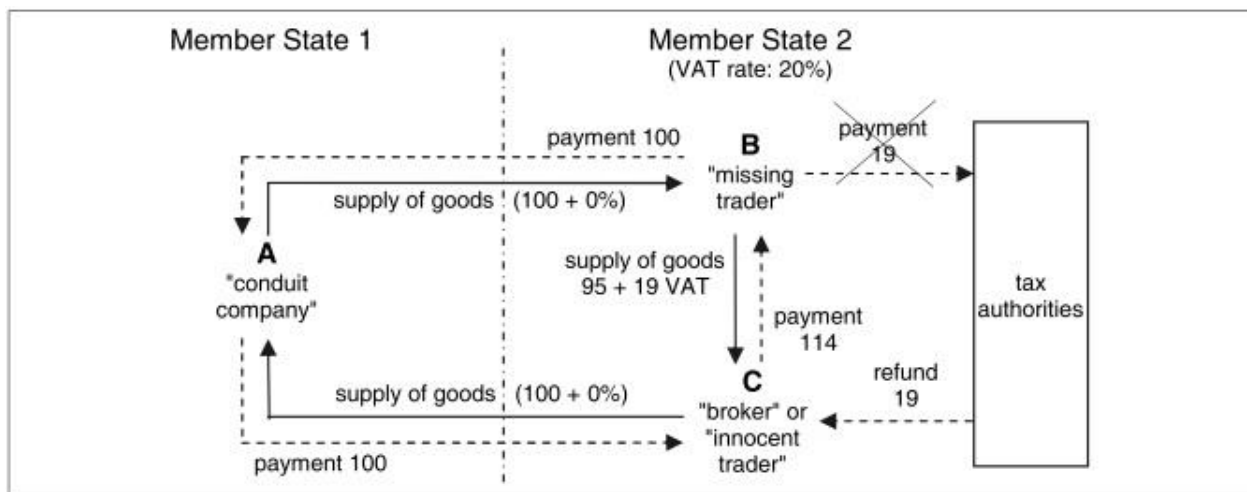
⁵⁹ Gravenh ge dr. A.A. Aronowitz mr. D.C.G. Laagland. G. Paulides mr. drs. J.M. Nelen, *Value-Added Tax Fraud within the European Union*. Pilot Study European documentation and research network 1995, p.49.

MTIC fraud

Three entities usually engage in carousel fraud.

In the picture bellow, company “A”- the ‘*conduit company*’ from MS 1 sells goods for 100 to company “B”- ‘*the missing trader*’ in MS 2. As it is an intra-Community supply, “A” applies the zero-rate and account for the deduction of the VAT in MS 1. Company “B” supplies the goods to Company “C”- ‘*the broker*’ in MS 2 according to the rules on domestic supply and charges the price plus the VAT - 114. As “B” knows that the payment to the tax authorities would not be made, the goods can be sold at a lower price, in this case for 95. Subsequently “B” does not remit the VAT to the tax authorities and disappears. Then “C” sells the goods for 100 back to “A” in MS 1, while applying the zero-rate for the intra-Community supply and claiming a refund for the VAT of 19 paid to “B” (which in reality has not been submitted to the tax authorities by “B”). In such a situation, the transaction can be repeated and the tax authorities in MS 2 are obliged to refund the VAT of 19 that it has not received.⁶⁰

Nonetheless, more advanced options can be found as examples, including one or several “buffer companies” in a one or several MSs. The company used as a buffer might never know about the fraud and thus interrupt the investigation of the tax authorities.⁶¹ The purpose of buffer companies is to cover the real scheme, to distract tax authorities, and to slow down audits.



Graph 3. Source: Swinkels (2008,p. 4)

As the right to deduct VAT is immediate, the tax authorities in MS2 cannot refuse to refund the VAT paid by “C”. Receiving goods free of VAT from other MSs is an opportunity for choices. One choice could be to sell the goods on the white or on the black market. However, selling on the white market gives the chance to earn more first by collecting the VAT and then by “going missing”. In general, for domestic transaction, the supplier charges the VAT. The business

⁶⁰ Swinkels, Joep. Carousel Fraud in the European Union, *International VAT Monitor*. March/April 2008, p. 104.

⁶¹ See *Lisette van der Hel - van Dijk, Menno Griffioen, 'Tackling VAT-Fraud in Europe: A Complicated International Puzzle'* (2016), *Intertax*, Issue 4, pp. 290–297 44.

customer can recover the VAT charged by declaring the input VAT in his tax return. When the supplier does not remit the VAT to the tax authorities, the same administration is obliged to repay/credit VAT, which it had never received, as input credit to the business customer. Businesses that conclude quick transactions and are willing to “go missing” without paying the VAT are impossible to stop. In addition to those missing traders, there are liquidations and bankruptcies, which can be both natural and planned.⁶²

The problem increases with the fact that the tax authority in a single MS can only follow the chain of the transaction in that MS and not at the EU level. This loophole in the legislation makes VAT carousels onerous to tackle and provides for enormous losses for MSs.⁶³ As it is apparent that a single MS cannot fight carousel fraud at the community level, the EC has searched for solutions.⁶⁴ To combat the increasingly sophisticated fraudulent and evasion practices, the EC and the MSs have adopted different measures. The next chapter contains detailed information on those specific measures.

2.3 Measures to combat fraud

The general rule in Article 193 of the VAT Directive stipulates that the supplier is liable for the payment of VAT to the tax authorities. Under the current VAT Directive, there are possibilities to apply a reverse charge mechanism (RCM) whereby the liability to pay the VAT shifts to the business customer. Such a derogations from the general system may be allowed for certain sectors⁶⁵ or transactions⁶⁶ to combat fraud or simplify tax collection. In cases of imperative urgency, MSs, after notifying the EC, can apply the RCM to specific supplies as a so-called quick reaction mechanism (QRM).⁶⁷ An alternative possibility for MSs to request derogation to apply the RCM is Article 395.⁶⁸ Under this article, the Council acting unanimously⁶⁹ on a proposal by the EC, may give authorization for the introduction of a specific measure to simplify collection procedures or prevent tax evasion or avoidance. However, such a measure should not, except to a negligible extent, affect the revenue of the VAT collected. Moreover, the Court of Justice of the European Union (CJEU) has stated that derogating measures, under Article 395 for simplifying tax collection or preventing certain types of tax evasion or avoidance, must be necessary and appropriate for realizing the specific objective that they pursue and have as little effect as possible on the objectives and principles of the VAT Directive.⁷⁰ Further, the EC has adopted 20

⁶² COM (2006) 404 final, p. 4.

⁶³ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud {SEC(2006) 659}, COM (2006) 254 p.3.

⁶⁴ Ibid, p.3.

⁶⁵ See Article 199 of the VAT Directive.

⁶⁶ See Article 199a of the VAT Directive.

⁶⁷ See Article 199b of the VAT Directive and 12627/13, PRESSE 342. Council approves measures to tackle VAT fraud schemes, Brussels, 22 July 2013.

⁶⁸ VAT Directive.

⁶⁹ Any changes to the VAT Directive must follow special legislative procedure and after consultations with the European Parliament and the Economics and Social Committee, be adopted with unanimity of the Council.

⁷⁰ Judgment of the Court of 27 January 2011 in C-489/09-Vandoorne, ECLI:EU:C:2011:33, para 27.

measures to tackle the VAT gap and its main component, fraud, of which the three most important are of interest for this thesis.⁷¹

The introduction of various types of **reporting obligations** has been considered as a toll for combatting fraud. There are further proposals for improving the reporting obligations by introducing prefilled VAT returns, electronic submissions, and other types of solutions that have not yet been adopted in general.⁷²

In 2006, the EC adopted a derogation applying the **reverse charge mechanism** in the construction sector.⁷³ For more than two months before the adoption and respectively the implementation of the derogation, the Commission concluded that the application of the reverse charge has proved its effectiveness in the construction sector.⁷⁴ Since then the reverse charge has been applied to different sectors in various MSs.⁷⁵

Joint and several liability (third-party liability) was prepared in 2005, introduced in 2009, but entered into force from 2011.⁷⁶ According to the rules, traders can be held liable for the VAT due on the intra-community acquisition. The new rule was later confirmed by the CJEU, according to which traders are responsible for evasion if they have known or should have known that VAT could be left unpaid elsewhere in the chain.⁷⁷

According to several MSs, the RCM has shown acceptable results and they requested a derogation to apply the RCM in general manner to all domestic supplies (see chapter 4.1). A complete description of the process underlying the proposal for a GRCM follows in the next chapter.

⁷¹ See the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee on a coordinated strategy to improve the fight against VAT fraud in the European Union, COM/2008/0807 final, and 20 measures to tackle the VAT gap http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/tax_cooperation/vat_gap/2016-03_20_measures_en.pdf . [accessed on 15.04.2017]

⁷² Article 57th Regulation (EU) No. 282/2011 [Reporting obligations]; EY 2015, pp.66-68; PWC 2010, p.156.

⁷³ Council Directive 2006/69/EC of 24 July 2006 amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion or avoidance, and repealing certain Decisions granting derogations, OJ L 221, 12.8.2006, p. 9–14.

⁷⁴ COM (2006) 254 final, p.9.

⁷⁵ For full list of sectors an MS see Assessment *of the application and impact of the optional. 'Reverse Charge Mechanism' within the EU VAT system*. Specific Contract No 6 TAXUD/2013/DE/333, pp.8-12 and Konstantin, Pashev. *Fighting VAT Fraud: The Bulgarian Experience*, Centre for the Study of Democracy, Working Paper 0606/2 En, June 2006, p17.

⁷⁶ Council Directive 2009/69/EC of 25 June 2009 amending Directive 2006/112/EC on the common system of value added tax as regards tax evasion linked to imports. Article 3, and see further Article 205 of the VAT Directive.

⁷⁷ ECJ judgment of 11 May 2006 in Federation of Technological Industries and Others v. Commissioners of Customs and Excise, Attorney General, Case C-384/04, ECLI:EU:C:2006:309, p.47.

3. Proposal for a general reverse charge mechanism

3.1 The Commission Action Plan on VAT and available alternatives

Shortly after the financial crisis, in December 2010 the EC adopted a Green Paper on the future of VAT⁷⁸ to close the VAT gap⁷⁹. The VAT gap represents the difference between the estimated tax and tax collected for each MS. Some of the main reasons for the existence of the VAT gap are bankruptcies, financial insolvencies, fraud, and evasion. The goal of the Green Paper was to conduct a broad consultation process on the future VAT system for which the relevance of the commitment to a definitive VAT system with taxation at the origin was still valid.⁸⁰ A year later (2011), the EC published its Communication on the future of the VAT system.⁸¹ The purpose of the Communication was first to set out the fundamental features of the new VAT system, which should be the long-term objectives guiding all future work on VAT, and second to outline the areas with priority in which rapid action is needed to move toward these objectives.⁸² As guiding principles for achieving such a change, it was set out that cross-border trade must be simple and safe, and not to generate additional costs.⁸³ According to the EC, the reform of the VAT should result in a new ‘*simple*’, ‘*efficient and neutral*’, and ‘*robust and fraud-proof*’ VAT system.⁸⁴

After conditional agreements by the EU legislators⁸⁵, the EC continued with in-depth technical analysis⁸⁶ and broad consultations with MSs, through the Group on the Future of VAT⁸⁷ (GFV) and with businesses, through the VAT Expert Group⁸⁸ (VEG). Similar to the Council, the VEG agrees with the EC to the extent that the new measures should not affect VAT revenues, as they

⁷⁸ Green Paper on the future of VAT – Towards a simpler, more robust and efficient VAT system ... a simpler, more robust and efficient VAT system COM (2010) 695 final, 10 December 2010.

⁷⁹ “The VAT Gap is a measure of VAT compliance and enforcement that provides an estimate of revenue loss due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies, as well as miscalculations. It is defined as the difference between the amount of VAT collected and the VAT Total Tax Liability (VTTL), which is expressed in the report in both absolute and relative terms. The VTTL is the theoretical tax liability according to tax law, and is estimated using a “top-down” approach.” Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report. TAXUD/2015/CC/131, p.8.

⁸⁰ For proportion of carousel fraud according to VAT Gap in each MS. Extraction from SWD (2016)457, p.15.

⁸¹ COM (2011) 851 final.

⁸² Ibid, pp.4-5.

⁸³ “The impact on the cash flow of business should be similar to that for domestic transactions to ensure a genuine level playing field.” SWD (2014) 338 final, final, Commission Staff Working Document on the implementation of the definitive VAT regime for intra-EU trade. p.5.

⁸⁴ COM (2011) 851 final, pp.5-6.

⁸⁵ See under 1.2.

⁸⁶ See Order no. TAXUD/2009/AO-05 – Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern ... collection of VAT through the means of modern technologies and/or financial intermediaries. Price Waterhouse Cooper 2010 and Implementing the ‘destination principle’ to intra -EU B2B supplies of goods Feasibility and economic evaluation study Inception report Contract: TAXUD/2013/DE/319 21 May 2014.

⁸⁷ “Informal Commission expert groups composed of representatives of national tax administrations provide the Commission a forum for consulting VAT experts from Member States on pre-legislative initiatives.”

https://ec.europa.eu/taxation_customs/business/vat/informal-commission-expert-group-discussions-with-member-states_en. [accessed on 12.04.2017]

⁸⁸ “The VAT Expert Group assists and advises the European Commission on VAT matters. The group is composed of individuals appointed in a personal capacity with the requisite expertise in the area of VAT and organizations representing in particular businesses and tax practitioners which can assist in the development and implementation of VAT policies.” http://ec.europa.eu/taxation_customs/business/vat/vat-expert-group-0_en. [accessed on 12 April 2017]

should ease collection and reduce the burden for businesses.⁸⁹ Based on the work concluded at that moment, the EC adopted the Action Plan, aiming to introduce a definitive VAT system based on the principle of destination. As the preparation of the changes for the future VAT system requires some time, the EC adopted several parallel measures to resolve the urgent problems with regard to carousel fraud.

Those urgent measures are divided into conventional and temporary derogation. Conventional measures comprise improvement of the cooperation within the EU and with non-EU countries, better tax administrations, and improvement of the voluntary compliance and tax collection.⁹⁰ Meanwhile, a temporary derogation planned to be in line with the definitive VAT system, has been proposed. To tackle the VAT gap, the EC and its political governance are determined to move beyond the current VAT Directive and introduce the general reverse charge mechanism, discussed in detail in the next chapter.

3.2 Conditions for applying the general reverse charge mechanism and how it works

According to Article 5(3) of the Treaty of the European Union, which defines the principle of subsidiarity, legislative action at the EU level can be taken in cases in which the MSs alone cannot achieve the envisaged aim. As the GRCM represents general derogation and cannot be accepted as normal derogation under Article 395 of the VAT Directive, MSs cannot act individually and the EC has to take action and propose legislation.⁹¹

Under the proposal, MSs should be allowed to opt for the temporary derogation applicable to business-to-business (B2B) transactions. However, there are four important criteria. First, if a MS requests to apply the GRCM, it should do so to all domestic supplies of goods and services; second, the VAT gap of the MS must be a minimum of 5% above the EU median (which as 10% in 2015); third, a minimum of 25% of the gap must be due to carousel fraud; and fourth, the GRCM would apply to transactions above a threshold of €10 000 per invoice, and MSs must introduce specific electronic reporting obligations. Neighbouring MSs would also be able to apply for the GRCM if there is a danger of fraud moving into their territory and other control measures are not sufficient.

The initial plan is that the derogation would be allowed after three months from the application and last until 30 June 2022, with the reservation that, in the case of a negative impact on EU trade, the EC can repeal its decisions.⁹² Apart from the continuing application of the current invoicing rules⁹³, the GRCM operates in the same way as the RST; the tax is imposed only at the last stage of the supply chain. This means that the MS applying the GRCM will abolish the

⁸⁹ EU VAT Expert Group adopted an opinion on the definitive VAT regime for the taxation of intra-community B2B supplies, 12 June 2014, p.2.

⁹⁰ See Action plan under point 3 and 20 measures to tackle the VAT gap.

⁹¹ COM (2016) 811 final, p.3.

⁹² Council reference 15817/16 from 16 January 2016.

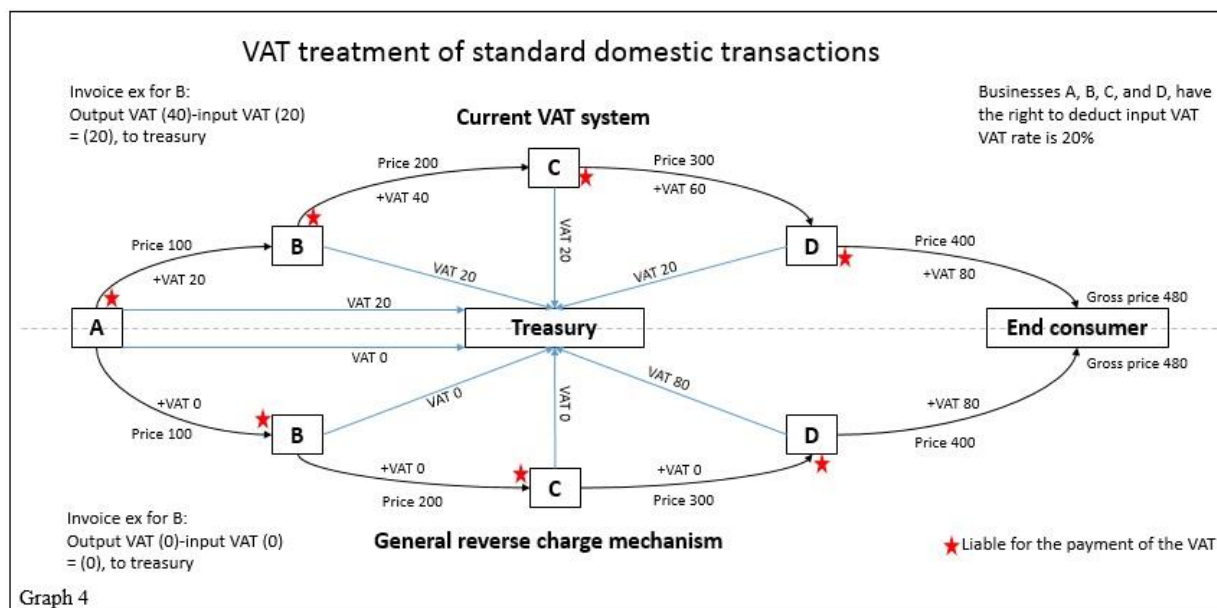
⁹³ See further explanations under graph 4.

fractional collection system for transactions above the threshold and collect VAT only from business selling to the end consumer.⁹⁴

Under the GRCM the tax is to be accounted for by the acquiring business and not by the supplier. Thus, the acquiring business is liable for the payment of the VAT. If the acquirer is entitled to deduct the corresponding VAT, he will do so in the same tax return $+0/-0=0$, and the result will be nil, that is, no payment to the tax authorities. If the domestic supply is made to private individuals, to a non-taxable legal person, or to a fully exempt business or the invoice is under €10 000, the VAT is to be collected, deducted, and remitted as in the present system. Thus, under the GRCM the supplier must always verify the status of the acquirer. As such, the GRCM does not affect the rules on intra-community acquisition of goods or services and the zero-rate continues to apply for those supplies.⁹⁵

How GRCM works

The next graph shows a comparison between the current VAT system and the proposed GRCM. For details on the upper part, see chapter 2.1.



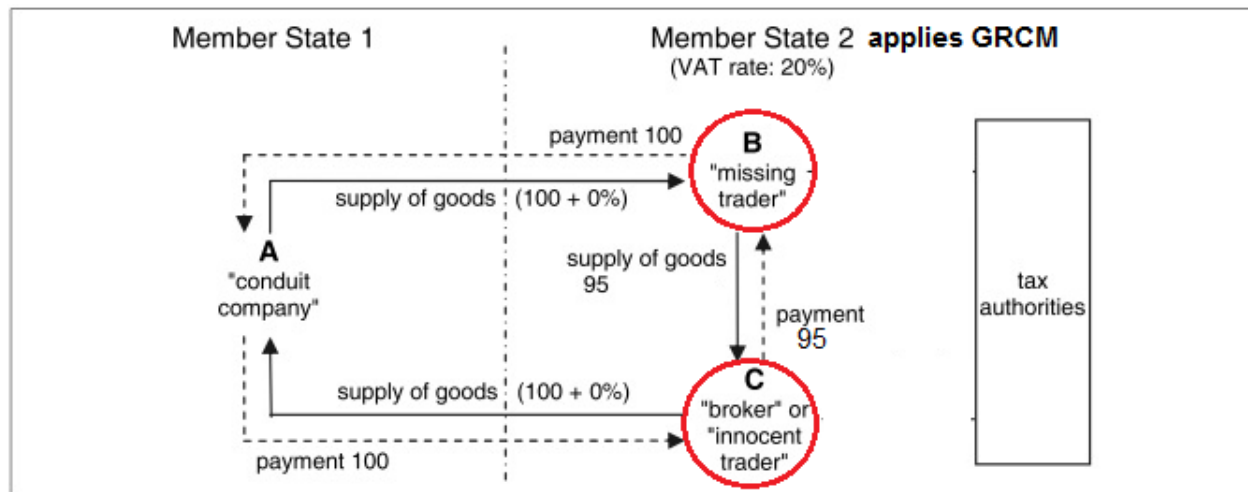
Under the GRCM the transactions between “A”, “B”, “C” and “D” are free of VAT; however, each entity that is next in the chain accounts and is thus liable for the VAT. “A” sells to “B” for 100 and “B” pays only 100. As no VAT applies, no VAT is paid to the treasury. VAT is charged only when selling to the end consumer; in this case “D” sells for 480 (400+80 VAT). Only “D” remits the VAT to the Treasury, and, in contrast to the current system under GRCM, only “D” collects and remits the VAT. In the case of faults by “A”, “B” will be liable to pay the VAT if no further transaction is present, and so on. The invoice method applied in the current VAT system

⁹⁴ COM (2016) 811 final, Article 1.

⁹⁵ Commission staff working paper on measures to change the VAT system to fight fraud {COM(2008) 109 final}/* SEC/2008/0249, p.19.

continues even under the GRCM to keep records of the transactions and to identify the business liable for the VAT.

To demonstrate the treatment under the GRCM, the proposed rules are applied in the graph illustrating VAT carousel fraud in chapter 1.1.



In this example, MS2 has a VAT gap of 20% and more than 25% of the gap is due to carousel fraud. MS2 has requested the derogation and has received the right to apply it. The invoiced domestic transaction is above the threshold of €10 000, and the GRCM rules apply. “B” receives the goods free of VAT based on the intra-community acquisition rules but when selling them to “C” cannot charge VAT as the transaction reverse charged and the liability to account for the VAT lies with “C”. In its tax return, “B” has to account for the zero-rate acquisition by stating the price of 100 and input VAT of 20 minus output VAT of 20, thus “0”, and the domestic transaction to “C” stating the price of 95 and output VAT of 0. In such a situation, carousel fraud is impossible to commit, as no VAT is collected by “B”. The price cannot even be reduced as in the real carousel case because it will result in direct financial loss for “B”.

Apart from stopping carousel fraud above the threshold, the GRCM shift the collection of taxes to the end of the chain, which is very similar to the RST. Further research on such a major change of the collection system is vital for the purpose of the thesis and the RST can function as a model for comparison.

3.3 Retail sales tax –RST

Both VAT and RST aim to tax based on the destination.⁹⁶RST is levied at a single stage, the final sale to the end consumer. The tax is thus neutral to any transactions in the production/distribution channels. Of all the OECD countries, only the US uses the RST system. However, in the US there is no invoice method that can allow the cross-checking of a whole transaction chain. As RST covers all sales to end consumers, every business selling to end consumers must impose and

⁹⁶ OECD, Consumption Tax Trends 2016, pp.22- 24. Available at, http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/consumption-tax-trends-2016_ctt-2016-en#.WPdkPGFYXIU#page24. [accessed on 19 April 2017]

subsequently remit the tax. This implies that businesses must check in advance whether their consumer is a business with the right to deduct or an end consumer. Checking every single transaction is an enormous burden by itself. In addition, the businesses that sell to end consumers are liable for the total collection of tax.⁹⁷

3.4 Summary of Chapters 1 to 3, and an overview of the 'definitive' VAT system

As seen in the detailed introduction, the initial aim of the definitive VAT system was to introduce VAT system on EU level that operates as in a single country; however, after the changes made during 1993, goods in cross-border transactions are obtained free of VAT. This is a result of the separation of the transaction into exempt supply and taxable acquisition while no border control exists. As a result, the goods could be sold in the MS of origin free of VAT, or, if transported to the MS of destination, VAT could be collected but not remitted while the business customer in the second MS can deduct. Those possibilities are used to commit the above-listed frauds. The EC is of the view that the GRCM will stop carousel fraud and that the VAT gap will be reduced.

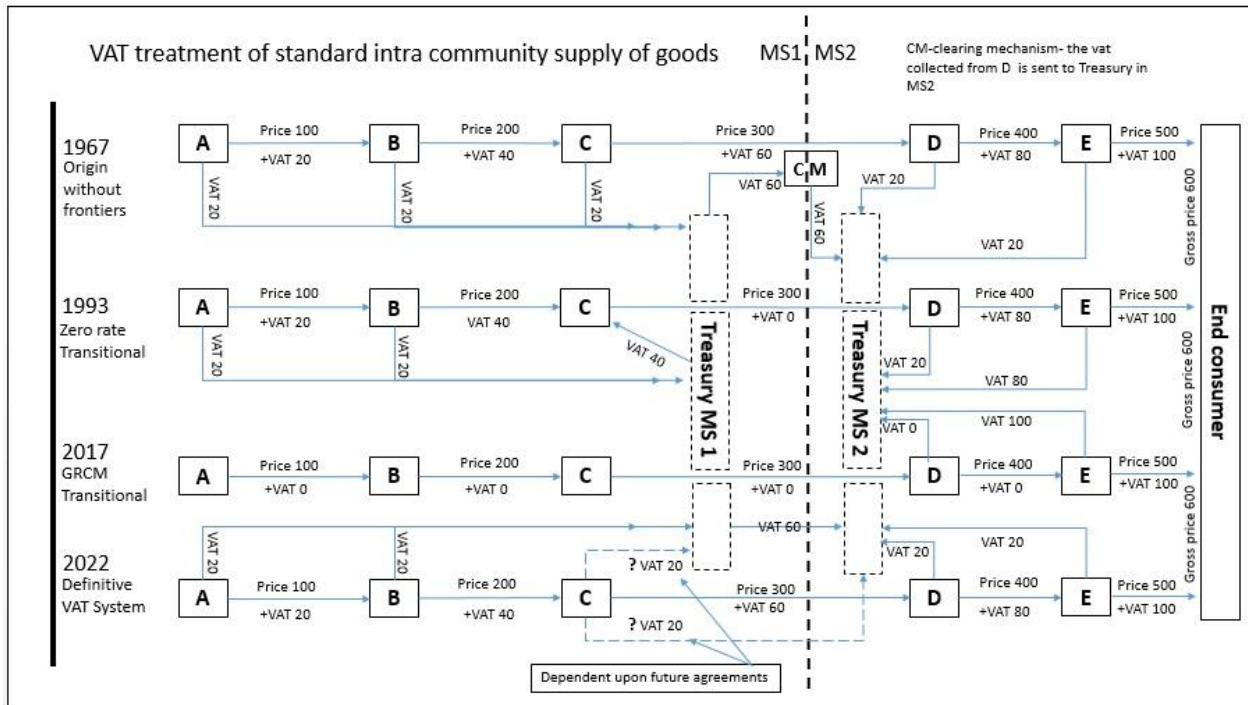
The following graph illustrates the different types of VAT treatment according to the time line between 1967 – and 2022. On the first line, the idea for the origin system is illustrated (not the real treatment in which exports were exempt and imports taxed at the borders⁹⁸). The VAT is collected on a fractional basis, while deduction for input VAT is allowed. The VAT collected in MS1 is sent back to MS2 for the specific good. On line two, the transitional system is illustrated where the transactions in MS1 are treated as in the origin system. In addition, the zero rate rules apply, and the goods are received free of VAT in MS2. After the goods are sold to “E”, “D” has to remit the VAT of 20, or the sum according to the rate in that MS, to the Treasury in MS2. Then “E” collects the rest of the VAT and remits it to the treasury in MS2. On line three, the GRCM is illustrated where no VAT applies, and thus no VAT is paid to the Treasury. The VAT is invoiced as +0-0=0. “D” in MS2 receives the good free of VAT; however, when the goods are sold to “E”, “D” accounts as in MS1, =VAT +0-0=0 and when “E” sells the goods to the end consumer has to remit the VAT of 100 to the tax authorities in MS2. When “D” sells the good to “E”, which is the main problem of the present system creating possibilities for the frauds described, “D” would not be eligible to collect the VAT and disappear. In addition, the acquiring business is responsible for accounting for the VAT and its payment to the tax authorities in MS2.

Lastly, as the secondary aim of the thesis requires, the future system of VAT is illustrated and enhanced by the authors early analysis. According to the current plan of the EC, the system will return back to the fractional collection, and “D” and “E” in MS2 will be liable only for the VAT corresponding to the last transactions and not as in the zero-rate situation, the whole sum. The system will operate as the current domestic one (see graph 4). The only difference will be that the tax authorities in MS1 will have to send the VAT collected for the specific supply to the tax authorities in MS 2 or “C” will be liable for the VAT in MS 2 and thus pay the VAT directly to the tax authorities in MS 2. The exact rules are still unknown but according to the EC, this system

⁹⁷ Terra & Kajus 2016, p. 154.

⁹⁸ In such a system, there is no broken taxation link as in any other situation.

will ensure a consistent transaction link with no accumulation of the VAT in only one place in the chain.



According to the present plans, there are two possibilities for a definitive VAT system. In the first case, the Treasury from MS1 would have to send the VAT collected to the Treasury in MS2. In the second case, because MS2 is the state of consumption and thus has the right over the VAT collected for the specific transaction or goods, “C” would be liable for the VAT in MS 2. However, in any event there should still be a transaction mechanism, according to which the collected VAT from “A” and “B” in MS1 would have to be sent to the treasury in MS2. In any event, there would be some kind of hybrid treatment for the chain before “C”, which would have to operate similar the treatment envisaged by the clearing mechanism.⁹⁹ The only difference from 1967/1992 would be that the tax authorities from MS2 would have the right over the VAT and thus be able to proceed with audits in any other MS. Close cooperation and mutual trust among the tax authorities are required these being the reason for transitional period of almost 20 years. There could be arguments that only “C” will have to pay the VAT collected to the treasury in MS2. However, in such a case, if “A” or/and “B” has not remitted the VAT corresponding to the specific transaction or goods to the treasury in MS1, “C” will have to remit the VAT corresponding to other transactions and thus MS1 will have to bear the burden of the VAT loss by “A” or/and “B”.¹⁰⁰ In theory¹⁰¹, the system will be taxation at destination, but, in practice, if each transaction is analysed for itself, it becomes apparent that the result will be taxing end consumption in the MS of destination, while any losses will be carried by the MS of origin.

⁹⁹ Han Kogels, 'Some Remarks on the Future of VAT' (2011) 20 EC Tax Review, Issue 6, pp. 260–262, p.2.

¹⁰⁰ See discussion on theoretical and practical application of the VAT system, in chapter 5.

¹⁰¹ The difference between theoretical and practical application of the VAT Directive is discussed under chapter four and five.

4. Deliberations on the GRCM

4.1 Opinion of the Council, the Commission and its respondents

The development in the EC's argumentation on the GRCM has its roots in March 2005 with the delivery of a proposal for a reverse charge in fraud-affected sectors.¹⁰² Shortly after Austria in October 2005, in April 2006 Germany required a derogation under Article 395 of the VAT Directive¹⁰³ to apply a RCM to all domestic B2B transactions. Austria asked for the threshold of €10 000 per invoice and Germany for a threshold of €5 000. Both MSs argued that under the RCM businesses would not have VAT liability (not permitted to charge VAT) and carousel and respectively missing trade fraud would stop (the incentive to abscond would disappear).¹⁰⁴ For that purpose, Austria would introduce additional requirements for monthly global turnover figures for each single business, and Germany would require an electronically submitted declaration including the value for each non-taxed supply.

The EC was of the opinion that such fundamental changes to the VAT Directive countered the principle of proportionality¹⁰⁵ and required alternative approach. According to the EC, the application of the GRCM would lead to three different types of tax regimes plus one for exports: one for the classical system, one for the GRCM in which the criteria were fulfilled, and one for the intra-Community system. Moreover, this differentiation of systems and the requirement to verify each customer would add extra layer of difficulties. In addition, the tax authorities would have to invest significantly more resources to be able to control and deal with the VAT debt, as the bulk of businesses that remits the VAT changes to the majority. This is because under the classical system, 80% of the VAT is paid by less than 10% of the businesses and the control can be concentrated on them. The EC also concluded that the derogation would fail the test under Article 395 and if not “would make life more complicated” for both businesses and tax authorities rather than providing less opportunity for fraud.¹⁰⁶ Furthermore, the derogation envisaged by the MSs would affect even compliant businesses in sectors that are free of fraud, as the proposed system is much more complex.¹⁰⁷

As an alternative approach, the EC saw possibilities to develop a new anti-fraud strategy at the EU level (at which MTIC fraud was the major issue in focus) and not through stand-alone national solutions.¹⁰⁸

¹⁰² Proposal for a COUNCIL DIRECTIVE amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion and avoidance, and repealing certain Decisions granting derogations, COM(2005) 89 final, pp. 7-8.

¹⁰³ See chapter 3.2.

¹⁰⁴ Communication from the Commission to the Council in accordance with Article 27(3) of Directive 77/388/EEC COM (2006) 404 final, pp.1-5.

¹⁰⁵ The principle of proportionality is defined in Article 5 of TEU and limits the actions taken by EU institutions to what is necessary to meet the objectives of the treaties.

¹⁰⁶ COM(2006) 404 final, p. 6.

¹⁰⁷ Ibid, p. 7.

¹⁰⁸ Ibid, p.4 and COM (2015) 538, p. 3.

Directly after the German application to implement RCM, the EC adopted a communication of which the goal was to proceed with the debate on strategies to combat VAT fraud.¹⁰⁹ The need to develop a coordinated strategy was based on the argumentation for improved tax collection, cooperation, and risk management at the EU level. Under the consultation process, three other MSs required adoption of the RCM. To explore the possibilities the EC engaged an external party to research the impact on businesses and tax administrations.¹¹⁰ According to the report, introducing the GRCM would result in higher costs for businesses and tax administrations, reflected in a negative cash flow for small and medium-sized enterprises.¹¹¹

In November 2006 the Council stressed the urgent need to establish anti-fraud strategy at the EU level and primarily in indirect taxation. The guiding requirements should be efficient use of administrative cooperation, priority for protection of the MS's own VAT revenue, and quicker and detailed exchange of information.¹¹² In May 2007 the EC published a working paper describing the progress on the preparation works.¹¹³

In June 2007 the EC received a request from the ECOFIN Council to examine two far-reaching solutions to tackle VAT fraud:¹¹⁴ first to tax intra-Community transactions in the MS of departure and second the effect of the application of the GRCM.

In August 2007 the EC issued a second consultation paper with the aim of acquiring more information on the possible introduction of the GRCM and its impact on businesses.¹¹⁵ It was followed by a communication aiming for a future investigation into some key elements¹¹⁶ that would play a general role in the establishment of a VAT anti-fraud strategy within the EU.¹¹⁷ A report, seeking for the Council's future instructions was published on the same day.¹¹⁸ In December 2007 the Council adopted two important decisions. First, in the future B2B supplies of services would be taxed in the country of destination by introducing one stop system the so-called One Stop Shop (OSS). Second, the Council urged the EC to present the results and plans for finding both conventional and far-reaching measures, to tackle VAT fraud.¹¹⁹ The Council emphasized that the establishment of a VAT anti-fraud strategy requires in-depth analysis to

¹⁰⁹ COM (2006) 254.

¹¹⁰ Study in respect of introducing an optional reverse charge mechanism in *the* EU VAT Directive. Final Report to the European Commission. 20 June 2007. (PWC A)

¹¹¹ *Ibid.*, pp.40-41.

¹¹² 2766th Council Meeting Economic and Financial Affairs Brussels, 28 November 2006, p. 26.

¹¹³ Commission staff working document—'Progress Report on the preparation of an anti-fraud strategy at EU level', SEC/2007/0740 final.

¹¹⁴ 2804th Council meeting. Economic and Financial Affairs. Luxembourg, Press: 126 Nr: 10319/07, 5 June 2007.

¹¹⁵ Consultation paper, Possible introduction of an optional reverse charge mechanism for VAT – Impact on businesses, 13 August 2007.

¹¹⁶ Such as cash flow, influence cross border competitiveness and administration costs.

¹¹⁷ Communication from the Commission to the Council of 23 November 2007 concerning some key elements contributing to the establishment of the VAT anti-fraud strategy within the EU [COM (2007) 758 final.

¹¹⁸ Commission staff working document - "Report on the state of play of the discussions on the conventional measures to combat VAT fraud proposed by Member States" SEC(2007) 1584.

¹¹⁹ 2836th Council meeting. Employment, Social Policy, Health and Consumer Affairs. Press: 270 Nr: 15698/07, Brussels, 4 December 2007 p.31.

identify the needs for modern administration while reducing the administrative burden by 25% of the existing level by 2012¹²⁰.

In February 2008 the EC published its communication¹²¹ and working paper¹²² containing the information required by the Council. The EC submitted that as the time available was relatively short, the value of the analysis was limited. The information was received from businesses, tax administrators, and studies by external consultants.¹²³ According to the EC, a number of issues required more in-depth analysis. It also required clear and concise guidance from the Council on two questions. The first one was related to taxation in the country of origin. According to the EC there are many positive elements but one vital negative one is that an MS would be dependent on transfers made (through the clearing mechanism) by other MSs and that seems to be politically unattainable at the moment. If the Council's answer is to continue in that direction, a proposal will be prepared; if not, the only possibility left is taxation at the destination.¹²⁴ The second question concerned the introduction of the GRCM. According to the EC, such treatment would generate both positive and negative effects. As a new concept, the GRCM will introduce a third system within the EU. Such a deviation would hamper the functioning of the internal EU market and the future harmonization or improvement of the VAT system. The future harmonization would be at risk, as MSs would form their interest based on the system that they apply. Not least, the EC concluded that the GRCM would have a negative financial impact on businesses and create new types of fraud.¹²⁵ The EC admitted that it cannot distinguish whether the GRCM is appropriate solution to MTIC fraud¹²⁶ and concluded that the GRCM could function only if applied mandatorily at the EU level or discarded as an option.¹²⁷

In December 2010 the EC published its Green Paper aiming to trigger broad consultations on the future of the VAT system with the objectives of achieving a simpler, more robust, and efficient VAT system.¹²⁸ The arguments for reviewing the system were that the EU should have a simplified, more competitive, and more modern VAT system. Meanwhile intra-community and domestic transactions must be treated in the same way and the administrative burden for the businesses reduced. Finally, the neutrality of the VAT system must be ensured in parallel with tackling the VAT fraud in both the EU and the MSs.¹²⁹ As the working paper of the EC was based

¹²⁰ "The Council's Action Programme for reducing administrative burdens in the European Union" and Ibid p.32.

¹²¹ COM (2008) 109 final.

¹²² SEC {2008} 249.

¹²³ Study on applying the current principle for the place of supply of B2B services to B2B supplies of goods. Place of establishment of the customer, TAXUD/2011/DE/304, Final Report Final Report 8 February 2012.

¹²⁴ COM (2008) 109 final, p. 7.

¹²⁵ COM (2008) 109 final, p. 10.

¹²⁶ SEC {2008} 249, p.45.

¹²⁷ {SEC (2008) 249}, COM (2008) 109. p.9.

¹²⁸ COM (2010) 695 final and {SEC (2010) 1455 final}.

¹²⁹ COM (2010) 695 final, pp.3-6.

only on a single study¹³⁰ of an independent party, the EC distanced itself from the results and did not conclude that new ways of collecting VAT are worth analysing further.¹³¹

However, the European Parliament¹³² and the European Economic and Social Committee¹³³ recommended that the EC should continue the work on overhauling and reforming the VAT system. Based on a new study¹³⁴ and the already collected information, the EC proposed taxation at the destination. Two main argumentations formed the proposal: first, that the reformed VAT system would play crucial role in the fulfillment of the Europe 2020 objectives¹³⁵ and second that stakeholders had proposed the GRCM as possible political solution with the reservation that taxation at the origin is the best solution but was impossible to fulfil at political level at that time. Based on the facts that MSs have not accomplished the initial aim of accepting two identical VAT rates, to apply the origin principle while securing fair competition and free movement of capital, goods, and services as envisaged in the Treaty, the Commission proposed a solution based on the principle of taxation at destination.¹³⁶ Further historical development can be followed in chapter 3.1.

In its approval of taxation at the destination the Council emphasized that "...[t]he importance of ensuring that initiatives designed to arrive at a simpler VAT system for businesses do not impose additional burdens on national authorities; the strategic objective of simplicity should be seen as a two-way concept that applies to businesses and national authorities alike."¹³⁷

In June 2015 the Republic of Austria, the Republic of Bulgaria, the Czech Republic, and the Slovak Republic requested derogations to apply the RCM to all B2B domestic supplies, but the applications were rejected on the same legal grounds as those of Austria and Germany in 2007.¹³⁸ Austria and Germany submitted a new requests to apply the RCM in June 2016. It was subsequently rejected on the same legal grounds as the preceding ones. Meanwhile, as described in chapters 3.1 and 3.2, the preparation of the legislation on the GRCM was undergoing its final development.

¹³⁰ Green Paper on the future of VAT - Towards a simpler, more robust and efficient VAT system" Milan, 6 May 2011 and Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries Order no. TAXUD/2009/AO-05 – Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries Final Report – 20 September 2010.

¹³¹ SEC (2010) 1455 final, p.104.

¹³² European Parliament resolution of 13 October 2011 on the future of VAT, , P7_TA(2011)0436, (2011/2082(INI)).

¹³³ Opinion of the European Economic and Social Committee on the Green Paper on the future of VAT — Towards a simpler, more robust and efficient VAT system COM(2010) 695 final,OJ C 318, 29.10.2011, p. 87–94.

¹³⁴ A retrospective evaluation of elements of the EU VAT system Final report TAXUD/2010/DE/328 FWC No. TAXUD/2010/CC/104.

¹³⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF>. [accessed on 22 April 2017]

¹³⁶ 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.

¹³⁷ Council of the European Union, PRESS RELEASE. 3167th Council meeting. Economic and Financial Affairs. Brussels, 15 May 2012, point "B"4.

¹³⁸ Communication from the Commission to the Council in accordance with Article 395 of Council Directive 2006/112/EC COM (2015) 538 of 28.10.2015.

During discussions in the Council, on 21 March 2017, MSs expressed their concerns about the period of five years and the right of whom to adopt and repeal decision on derogation given to a MS.¹³⁹ Some MSs disagree with the period of five years and the exposure to the repeal mechanism, which will have the effect of decreasing the period. This issue is closely connected to the overall disagreement by the majority of the MSs that the EC should have the right to adopt and repeal a decision. As it seemed to be impossible to reach an agreement on that issue, the Council proposed to use “reverse unanimity”. In this process the EC based on a set of predefined criteria, will presents a proposal for repealing the decision, which will be accepted unless the Council unanimously rejects the proposal within 30 days. In short, *if* the EC decides to submit a proposal for adopting or repealing a decision, the Council might unanimously reject it.

Among many consultations and studies carried out to research the possibilities for the new VAT system, the EC ordered an impact assessment of the GRCM and conducted one by itself.¹⁴⁰ Thus, the next chapter will discuss the outcome from the impact assessments.

4.2 Results the impact assessments

This chapter provides an in-depth investigation into the detailed analysis of the assessments, the result of which can form the basis for the analysis in chapter 5.

In general, the assessment conducted in 2014¹⁴¹ investigated first the cash flow impact per MS and per sector and second the cash flow of businesses for ongoing and implementation costs.¹⁴² The assessment was as detailed as it could be, and only its essence will be extracted. The conclusion is that the RCM compliance costs are disproportionately higher in relation to the non-RCM costs, even when compared with the overall compliance costs for both sales and purchases. The proportion of RCM trade and non-RCM trade is 25% to 76% and the costs for RCM trade are relatively higher.¹⁴³

According to the assessment, those costs are related to sales quotation- confirmation- processing, invoicing, and collection. If divided into sales and purchases, it becomes apparent that mostly sales activities contribute to the higher RCM compliance costs. The costs for activities related to either the sales or the purchases are greater than those for non-RCM.¹⁴⁴ Further, there is a significant impact on businesses in relation to the introduction of new VAT rules,¹⁴⁵ and more than 20% of SMEs experience negative cash flow issues when implementing those rules. The

¹³⁹ <http://www.consilium.europa.eu/en/policies/vat-reverse-charge/>, [accessed on 22 April 2017] and Proposal for a directive as regards the temporary application of a generalised reverse charge mechanism - Orientation debate at the Council, March 2017.

¹⁴⁰ SWD(2016) 457 final.

¹⁴¹ Assessment of the application and impact of the optional ‘Reverse Charge Mechanism’ within the EU VAT system, Specific Contract No 6 TAXUD/2013/DE/333 implementing Framework Contract No TAXUD/2012/CC/117, Final Report, EY November 2014.

¹⁴² Graph showing the estimate is available in Annex 1.

¹⁴³ EY 2014, pp.55-56.

¹⁴⁴ EY2014, p.57.

¹⁴⁵ Ibid, pp.63-65.

latter is relevant even to large businesses depending on the accounting system that they use.¹⁴⁶ Lastly, the compliance costs for businesses dealing with the RCM in several MSs is 20% higher than for those dealing with the RCM in only one MS.¹⁴⁷

According to a more extensive study on VAT, ordered by the EC, the compliance costs are between 0.3 (Denmark), -8% (Croatia), - 9% (UK), and 25% (Slovenia) of the VAT collected by the businesses. The costs are disproportionately carried by SMEs and, more importantly, those costs do not fall over time if no policy action is taken.¹⁴⁸

The EC's own assessment accompanying the proposal for GRCM focused on the evaluation of the various options to achieve the objectives from the Action plan¹⁴⁹ following the outcome of the legislative process¹⁵⁰. The first important fact that would strike any reader is the way in which the final numbers are calculated. The EC makes its "own calculation"¹⁵¹ based on a study that makes its own calculation by

“... [u]sing "Member State survey results. For countries, where no data was available, MTIC fraud was estimated using 3 different approaches: i) arithmetic average of the data provided (20%), ii) weighted average of the data provided (24%) iii) using proxies based on similarities of size of VAT gap”¹⁵²

The results showing the level of carousel fraud are obviously incorrect, even admitted by the EC, which implies that carousel fraud is very difficult, - or close to impossible to measure.¹⁵³ As regards the various options, the EC presented five different solutions.

Derogation to apply the GRCM

- | | |
|--------------------|--|
| Option 1 - | without any threshold |
| Option 2a - | above a certain threshold for preselected MSs to any domestic supplies |
| Option 2b - | above a certain threshold for preselected MSs to all domestic supplies |
| Option 3a - | above a certain threshold for any MS fulfilling pre-defined criteria to any domestic supplies |
| Option 3b - | above a certain threshold for any MS fulfilling pre-defined criteria to all domestic supplies ¹⁵⁴ |

¹⁴⁶ Ibid, p.66.

¹⁴⁷ Ibid, p.67.

¹⁴⁸ A retrospective evaluation of elements of the EU VAT system, Final report TAXUD/2010/DE/328 FWC No. TAXUD/2010/CC/104 pp. 97-120.

¹⁴⁹ See chapter 3.1.

¹⁵⁰ Such as Instructions given by the Council and the European parliament.

¹⁵¹ SWD (2016) 457 p.39.

¹⁵² EY 2015 p. 118 footnote 130.

¹⁵³ SWD (2016) 457 p.57 and “What raises some voices of criticism is the fact that the “top-down” approach used for the Estimation” Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report ,TAXUD/2015/CC/131, p.17. “The data problems inherent in calculating the compliance gap mean that VAT Gap estimates are likely to contain a substantial (and largely unknowable) margin of error.” TAXUD/2012/DE/316, p.110.

¹⁵⁴ SWD (2016) 457.

Based on excluding argumentation,¹⁵⁵ options 1, 2a, 2b, and 3a were rejected and only option 3b was accepted as best fulfilling the objectives. The table below contains a summary extracted from the comparable table in the impact assessment.

Objectives	Best case scenario	Worst case scenario
Impact on carousel fraud and Member States' tax revenue	Reduction of carousel fraud in more Member States applying the GRCM in the short term. New patterns of fraud (e.g. fraud shift to the retail stage) appear on a longer term but coincide with the implementation of the definitive VAT system.	New risks of fraud develop in the short term in more Member States applying the GRCM at the same time as the reduction of carousel fraud and prolong in the longer term until implementation of definitive VAT system.
Impact on compliance costs to business	In the short term, in the Member States applying the GRCM, the impact on the smallest businesses will be very limited due to the threshold. New obligations on other businesses should be limited in the Member States in which the reporting obligations which are necessary to the GRCM are already in place. In the longer term, new costs to revert back to the normal VAT system will coincide with the implementation of the definitive VAT system.	The necessary obligations accompanying the GRCM are not in place and would need an urgent implementation. Anti-fraud measures (other than GRCM) adopted by the rest of the Member States increase compliance costs to their businesses. In the longer term, large set up costs will be incurred twice (to revert back to the normal VAT system).
Impact on administrative costs to tax administrations	Administrative costs in the short term are expected to be limited in the Member States applying the mechanism. Administrative costs linked to the end of the GRCM are expected in the longer term.	Increased administrative costs are expected in the rest of the Member States in order to curb fraud shifting to their country (through anti-fraud measures other than GRCM) or to implement the GRCM in the short term.
Impact on the functioning of the internal market	Impact on the internal market is limited.	In case of negative impact on several Member States, safeguard clause would allow to revoke a derogation.
Link with the VAT reform process		Option 3b is at odds with the single European VAT area but addresses the immediate problem of certain Member States. It is in line with the political as it should preserve the internal market.

156

It follows that the introduction of the GRCM would allow new types of fraud, and new means for combatting the fraud would be required to meet the objectives. In addition, according to an independent study¹⁵⁷ carried out for the EC, the risk of fraud could also arise at the domestic level¹⁵⁸. The forms of fraud would be different, as the VAT would mainly be concentrated on the retail stage. The VAT-free acquisition of goods could increase the interest of businesses without full right to deduct in using hijacked VAT numbers to receive goods free of VAT. Moreover, free VAT acquisitions would enhance the interest of businesses determined to commit fraud, in trying

¹⁵⁵ Eemeren, F. H. van. - Topical Themes in Argumentation Theory: Twenty Exploratory Studies [Electronics resource]. – 2012, pp.70-75.

¹⁵⁶ SWD (2016) 457, pp.52-56.

¹⁵⁷ PWC 2007.

¹⁵⁸ Cross-border fraud is not concerned under GRCM.

to divert VAT to themselves, or in the worst case, to sell the goods to the black market¹⁵⁹. The goods could also be sold in any neighbouring MS either by selling to end consumers and collecting VAT or by selling to black markets. In the former situation, MSs with higher VAT rates would be more attractive to maximize the benefit, and in the latter, the fraudulent businesses would have a greater competitive advantage when compared with bona fide¹⁶⁰ traders.¹⁶¹ The threshold would also stimulate the splitting up of transactions to collect VAT and commit carousel fraud at a lower level.¹⁶² According to the last-mentioned study, new policies regulating the following matters are required to combat the new types of fraud under the GRCM.¹⁶³

- Listing all domestic sale- purchase goods,
- Adopting obligations for invoicing, accounting, and declaring,
- Implementation of IT services,
- Introducing and complying with a digital taxable person's identification card (ID) that shows the status of the business.

Accordingly, the objective linked to carousel fraud cannot be met or could be met at a minor level if certain measures are adopted.

Reducing compliance costs is the other important objective. As the total VAT is to be paid at the last stage, the self-policing system has to be replaced with another collection-control system. This implies that there must be two different VAT systems. It is estimated that the compliance costs for businesses in the MS applying the GRCM would be substantial. Both established and non-established businesses would be affected, as they have to adapt their invoicing, accounting, and declarations to different systems. Businesses' set-up costs are estimated to be around 2 billion for Germany alone, with up to 200 million ongoing annual costs. In addition, other administrative costs will arise from the management of the threshold. For each individual transaction, businesses must assure the VAT status of the customer and store the information obtained. As the application of the GRCM requires monthly submission of an electronic return, an IT system must also be implemented. The study from 2014 shows that compliance with the GRCM would increase the cost for businesses by 43%.¹⁶⁴ Thus, the objective cannot be met.

In summary, the objective of reducing the VAT fraud in specific MSs is - **not met**, or has very small chances of being met depending on the domestic policy. The objective of reducing the administrative burden – is **not met**. The objective of avoiding fraud shifting from sector to sector or MS to MS – is **met only** with regard to sectors.¹⁶⁵

¹⁵⁹ According to the business association in Sweden, GRCM will stimulate trading on the black market as goods are acquired VAT free. Svenskt Näringsliv. Remissyttrande. Promemoria om omvänd skattskyldighet för mervärdesskatt vid handel med visst skrot. 2 Maj 2012. p.4.

¹⁶⁰ Businesses fully complying with the rules.

¹⁶¹ SWD (2016) 457, p.50.

¹⁶² SWD (2016) 457, p.51.

¹⁶³ SWD (2016) 457, p.51 with reference to Pricewaterhousecoopers, 2007 (B).

¹⁶⁴ SWD (2016) 457, p.51 with reference to EY, 2014.

¹⁶⁵ SWD (2016) 457, p.47.

4.3 Opinions of the parties supporting the GRCM and those opposing it

This chapter will present the arguments from MSs, doctrine, and various reports and studies. It is of great importance to cover all the possibilities to ensure a complete analysis and answer the research question.

Most of the MSs participating in the *GFV* were opposed to the initiative to introduce the GRCM. Actually only four¹⁶⁶ were in support of the GRCM.¹⁶⁷ The other MSs expected risk for the national budgets and continuing fraud. From the consultation with the *stakeholders*, there were two equal supporting groups, one for the one-stop-shop OSS and one for the GRCM. Most of the respondents acknowledged that there are other measures within the current system, that can potentially combat fraud with a similar effect.¹⁶⁸ The *VEG* emphasized that the collection of VAT is in danger and that new fraud opportunities would arise. An interesting fact to address is that Austria asked for and supports the GRCM, while the *Austrian Federal Economic Chamber* is of the opinion that the GRCM will create more problems than it will solve. Furthermore, according to consultations with stakeholders introduction of fourth VAT regime, (domestic transactions (1) under GRCM, (2) under the current VAT regime, (3) intra-community, and (4) exports to third countries) is unnecessary as there are other solutions, such as “electronic cash accounting “.¹⁶⁹

In its replay to the EC, Austria emphasized that the GRCM would eliminate missing trader fraud “entirely” and only micro fraud would be left. In cases of bankruptcy, there would be no budgetary losses as in the current system in which the VAT not recovered due to an insolvent supplier can be adjusted with the tax authorities. The absence of insolvency problems in the transaction chain will free up resources that can be used at the retail stage. According to Austria, when the GRCM is applied, VAT will be deductible even without invoice. At the same time, there is a need for new obligations, such as¹⁷⁰

- Identification of every customer;
- Monthly submission of recapitulative statements in which each transaction to all partners is specified to enable automatic cross-checking and process automatic reconciliation to find discrepancies;
- For each transfer under GRCM rules payment is to be made through bank transfer;
- Non-established businesses have to register on a digital portal.¹⁷¹

Those rules will make more information available and ensure quick control. Businesses that are willing to split supplies will be detected easily.

The Czech Republic supported the arguments made by Austria and agreed with the opposition that the fraud will move to the end of the transaction chain. However, the need to sell enormous

¹⁶⁶ SWD (2016) 457, Annex 2, on p.65 with reference to GFV working paper n°53 of 2016.

¹⁶⁷ Ibid, Annex 1, on p.62.

¹⁶⁸ Ibid, Annex 2, on pp.62-64.

¹⁶⁹ SWD (2016) 457, Annex 2, on p.67.

¹⁷⁰ Ibid, Annex 6, on p.74.

¹⁷¹ Ibid, on p.77.

quantities to end consumers to reach a high value of VAT will serve as an obstacle to fraudulent behaviour. The Czech authorities concluded that the risk of splitting up the transactions and involving higher numbers of buffer businesses will diversify the risk. It will also be logistically and economically more complicated to commit fraud than in the current system. One additional requirement to the Austrian list would be a detailed control for VAT registration and the application of rules for the status of unreliable VAT payers with the aim of excluding fraudsters.¹⁷² The Czech Republic concluded that the GRCM is based on the assumption that the main characteristics of the VAT system (neutrality and proportionality) can be preserved while VAT fraud can be tackled if the VAT collection is given priority over the economic principles and is in line with the current level of technology.¹⁷³

The consultation with stakeholders also included opinions from academics. Generally, two works were analysed by the EC, one of which supports the GRCM and one of which opposes it.¹⁷⁴ The EC referred to the comment made by Sebastian Pfeiffer and Robert van Brederode that the full right to deduct the input VAT turns the fractional collection of VAT into an “illusion”. According to them, the GRCM is the best tool to combat fraud. On the other hand, Gorka Zubeldia is of the opinion that the GRCM does not comply with the general principle of the VAT system, neutrality, and the general principle of proportionality. Accordingly, the GRCM will turn the VAT system into a retail sales tax with a much wider base of businesses to audit.

Statements like illusion and non-compliance with general principles require detailed research. When examining the articles written by Pfeiffer and van Brederode, it becomes clear that their support for the GRCM is unconditional. Nevertheless, before analysing their works, it would be preferable to begin with previous academic comments on the GRCM, which the EC has not analysed. Several authors have deliberated on the RCM/GRCM and those presented unite the main arguments of others.¹⁷⁵

With regard to the comment that the self-policing mechanism of the VAT system is an illusion, credit must be given to Richard Hemming and John Kay (1981).¹⁷⁶ Their reasoning refers to the credit-input mechanism whereby the VAT paid is at the same time as it is due to the acquirer and

¹⁷² SWD (2016) 457, Annex 6, on p 85.

¹⁷³ Ibid, p.83.

¹⁷⁴ Gorka Echevarría Zubeldia "Turning VAT Inside Out", IBFD, IVM, 04/2015, p.204; Robert F. van Brederode and Sebastian Pfeiffer, "VAT's Superiority: Is the Emperor Dressed like Adam?", IBFD, IVM, 04/2015, p.226; Robert F. van Brederode and Sebastian Pfeiffer, "Combating Carousel Fraud: The general reverse charge", IBFD, IVM, 03/2015; Robert F. van Brederode and Sebastian Pfeiffer, "Debate on general reverse charge", IBFD, IVM, 05/2015, p.288.

¹⁷⁵ Björn, Forssén. 'Omvänd skattskyldighet inom byggsektorn – Skapar den flera momsproblem än den löser?', Svensk Skattetidning, nr 4, 2007; Karin, Norberg and Franciska Pettersén. 'Förfarandemissbruk inom mervärdesskatteområdet', Skattenytt, nr 1, 2008; Paul, Quigley. 'Extension of French Reverse Charge Mechanism', International VAT monitor, January/February, 2007; Staffan, Renström. 'Mervärdesskatt – omvänd skattskyldighet mellan byggföretag', Skattenytt, nr 3, 2007; Dmytro, Serebriansky and Olena, Sokolovska. 'Strengths and weaknesses of the VAT reverse charge mechanism: A theoretical framework'. Research Institute of Financial Law, State Fiscal Service of Ukraine. 15 August 2016; Marusa, Beca. 'The Effects of the Reverse Charge for the Supply of Cereals and Industrial Plants on the Romanian Companies', "Ovidius" University Annals. Economic Sciences Series. – 2012. – Vol. XII. – Issue 1. – pp. 12671272.

¹⁷⁶ Michael Keen and Stephen Smith. VAT fraud and evasion: What do we know, and what can be done, IMF working paper, WP/07/31. 2007, p.7 with reference to Hemming, Richard and John Kay, 1981, "The United Kingdom," In *The Value Added Tax: Lessons from Europe*, ed. by H. J. Aaron (Washington: Brookings Institution).

as a result the tax office does not have the right over the collected VAT throughout the transaction chain. As the right to deduct the output VAT is immediate, theoretically, in such a situation, the tax authority does not have the right to the amount collected from the previous business and fractional collections is illusory.

In their article on fraud and evasion Micheal Keen and Stephen Smith (2007), investigated different types of measures to tackle fraud. They submitted that, as the GRCM will remove part of businesses' output tax liability, there will be (in 0- out 0 =) 0 VAT due, and refund claims may increase, especially when businesses conduct both taxed and exempt activities, which will create difficulties for control for tax authorities and the risk of fraud.¹⁷⁷ They compared the level of non-compliance with regard to VAT and direct taxes in the UK, for which the numbers are nearly the same, 15% for the VAT and 14 % for the direct taxes. They highlighted that, viewed from MSs' financial perspective, "...1€ paid in fraudulent VAT return is no more costly than 1€ of under-declared taxes".¹⁷⁸ The authors concluded that the zero-rate rules make VAT carousel fraud possible. However this problem has to be addressed within the current system. In their view there is no need to detract attention from all the aspects from the current VAT system that work well and from elements that in general application are not less important than the fraud cause.¹⁷⁹

In his support for the GRCM Michael Tumpel¹⁸⁰ admits that the costs of domestic transactions under the GRCM will increase. Nevertheless, the author argues that increasing the costs for domestic supplies to the level of costs for intra-community ones, which require extra compliance, would not be against the principle of proportionality, as both would be treated in the same way.

According to Joep Swinkels (2008) carousel fraud could be interrupted if tax authorities from all MSs communicate directly and have overview of each transaction chain. Based on the already-known disadvantages¹⁸¹ of the GRCM, Swinkels is of the opinion that the GRCM is not the best solution to tackle carousel fraud. The author concludes that fraudsters are attracted by the high value of VAT and will always find a way to steal money. The problem comes down to the missing trader and the naïve acquiring businesses attracted by low-value acquisitions that are possible in cases of carousel fraud¹⁸². According to Swinkels, the only solution is to impose strict third-party liability and high penalties, which will force businesses to rethink each transaction.¹⁸³

While stating that there is no reliable source confirming the exact level of carousel fraud, Kasper Lind (2013)¹⁸⁴ accepted unconditionally the numbers provided by the EC.¹⁸⁵ With regard to the

¹⁷⁷ Keen and Smith 2007, p.24.

¹⁷⁸ Ibid, p.28.

¹⁷⁹ Ibid, p.29.

¹⁸⁰ Michael Tumpel. *A Hybrid VAT System in the European Union*. Draft 04/24/2007, p.28.

¹⁸¹ Lead to new types of fraud, eliminates the fractional collection and the entire turnover is allocated to the retailer, the business customer status must be controlled, tax will be collected only after the end consumer pays, there will be four VAT regimes to comply with, tax audits must cover larger number of businesses.

¹⁸² When committing carousel fraud goods can be sold cheaper.

¹⁸³ Swinkels 2008, p.113.

¹⁸⁴ Kasper Lind (2013) Reverse charging: the best possible solution for preventing VAT fraud, *World Journal of VAT/GST Law*, (2013) vol2, issue 2, 97-115, DOI: 10.5235/20488432.2.2.97.

¹⁸⁵ Lind 2013, pp.98-99.

current system, Lind considers that modern reporting system tracking and declaring supplies in real time are a solution to fraud.¹⁸⁶ According to him, the best solution would be an automatic system for VAT returns and refunds, similar to split payment (the system proposed to the EC by PWC)¹⁸⁷. However, the time required for the introduction of such a system is considered as an obstacle. With regard to the GRCM, apart from all the pros and cons discussed above, and by referring to the tax collection in Germany for 2010 (180 billion), the author submits that the collection of VAT at the final stage would be felt negatively in the MSs' cash flow.¹⁸⁸ Lind concludes that, in the absence of a definitive tax system based on origin, the introduction of the GRCM "... [w]ould not be a significant loss so much as an acceptance of reality."¹⁸⁹ Following this line of reasoning, Adriana Daganova (2014) concludes that, the introduction of the GRCM as an urgent measure in the most abused sectors could be a partial solution but only if there was a mechanism for refunding the VAT within 10 days.¹⁹⁰

Two years after Lind, Pfeiffer and van Brederode (2015) published two articles on the GRCM. The first one¹⁹¹ researched carousel fraud and its possible solutions. In addition to the pros and cons mentioned above, the authors identified the need to compensate retail sector businesses, as they would incur costs for the collection of the total consumption tax. Otherwise, it would be discriminatory in relation to the businesses in the chain that do not have those costs.¹⁹² The general conclusion was that the GRCM would perform better in fighting VAT fraud. According to studies based on reports from the Swedish Tax Agency, the introduction of the GRCM would combat single cases of fraud effectively but the extent to which it would combat organized frauds is debatable.¹⁹³

In their second article, Pfeiffer and van Brederode challenged¹⁹⁴ the VAT system and proposed a benchmark RST system¹⁹⁵ instead. They submitted that the VAT system is based on theoretical assumptions and the illusion of fractional collection.¹⁹⁶ The authors compared transactions within

¹⁸⁶ Ibid, p.104.

¹⁸⁷ See PWC 2010, p.11.

¹⁸⁸ Lind 2013, p.110.

¹⁸⁹ Lind 2013, p.101; Keen and Smith 2007, p.29; similar conclusion is reached by Tasev, Ivailo. The crisis may be gone, but not for the tax authorities. Institute for Market Economics, Sofia, 2011. <http://ime.bg/bg/articles/krizata-mai-si-trygva-no-ne-i-zadanyite/#ixzz4gBcm3Sn0>.

¹⁹⁰ Daganova, Adriana. Priorities of the OP "Development of the Competitiveness of the Bulgarian Economy. *Analysis of socio-economic development and Competitiveness of Bulgaria* (2007-2013). Center for Economic Development. 2014. http://www.bmgk-bg.org/content/fm/14/935/Competitiveness_analysis_2014_NEW.pdf. [accessed on 24 April 2017]

¹⁹¹ Robert F. van Brederode and Sebastian Pfeiffer, "Combating Carousel Fraud: The general reverse charge", IBFD, IVM, 03/2015.

¹⁹² Ibid, p.156.

¹⁹³ Pernilla Rendahl. Är mervärdesskatten en konsumtionsskatt eller företagsskatt? En rättsvetenskaplig studie av Mervärdesskattelagens ändamålsenlighet. Handelshögskolan, Gothenburg University. April 2015. p. 73 with reference to Skatteverkets rapport av den 25 mars 2010, dnr 131 213362-10/113, s. 2. https://www.svensktnaringsliv.se/migration_catalog/Rapporter_och_opinionsmaterial/Rapporter/momsrapportpdf_621754.html/BINARY/Momsrapport.pdf. [accessed on 24 April 2017]

¹⁹⁴ Robert F. van Brederode and Sebastian Pfeiffer, "VAT's Superiority: Is the Emperor Dressed like Adam?", IBFD, IVM, 04/2015, p.226. Henceforth cited as Pfeiffer and van Brederode 2015 (2).

¹⁹⁵ They mean RST taxing both goods and services while providing full tax relief to businesses.

¹⁹⁶ However, if we look at each sale in isolation, it becomes clear that VAT collected by the seller from the buyer and remitted to the tax administration is reimbursed to that same buyer through the credit (deduction) system. If, at the end of the chain, no sale to

the VAT system with similar¹⁹⁷ transaction under an RST (see graph 1, lines 1, 2, or 3). Consequently, they argued that, in cases of insolvency, evasion of tax within the RST does not exist. The authors then referred to the claim that mixed supplies would evade taxation under the GRCM. They argued that, in the case of dual-use, the current system could assure proper VAT collection only on audit, as the business may choose not to declare the proper allocation of VAT as taxed or exempt.¹⁹⁸ Pfeiffer and Van Brederode concluded that a theoretical benchmark RST system is overall better than the current VAT system. However, such a general challenge of the VAT system was not approved without further argumentation.

Directly after the first publication, Gorca Zubeldia, in a very short article, criticized Pfeiffer and van Brederode's approach. The author submitted that, during the time for consultations on a definitive VAT system, "... [t]he number of bold and quite unrealistic proposals ... that ... [a]re no more than wishful thinking" increased.¹⁹⁹ Zubeldia dismissed the authors approach and method of evaluation. By stating that VAT is to be turned inside out and become RST, Zubeldia disagreed with the authors and welcomed serious debate on the definitive VAT system.

In a proposal for a hybrid VAT system, Joachim English²⁰⁰ expressed his support for a "type of" RST system as a better solution in the short term. The author confirmed all of the above weaknesses of the current VAT system and respectively GRCM, and focused on a situation of insolvency and input VAT credit. English argued that, under the current system, insolvent businesses could continue to acquire goods or services and claim input VAT credit even when deprived of any chance to set up their debts with the supplier before declaring insolvency. As the supplier would not be able to retrieve the VAT from the default business customer, it would have the right to adjust its VAT liability and demand reimbursement of the VAT paid to the tax authority.²⁰¹ This would result in a VAT loss for the Treasury. A possible solution could be to link the changeability of VAT and the corresponding credit to the payment by the customer or introduce shorter VAT return periods, something that is also supported by other academics.²⁰²

The author also provided concrete analysis on the future problem related to the identification of the customer under the RST and the use of ID numbers by questioning the possibilities of the tax authorities to control the kind of fraud that ID numbers imply. Under the US RST system in which tax is on average 7 % compared with approximately 20% in the EU, there is a significant "excess registration" problem.²⁰³ The average for such excess registrations in the EU is therefore unknown. In addition to all the arguments mentioned above, the author submitted that under the

a consumer is made, through the credit system, no Tax will accrue to the tax administration at all." Pfeiffer and van Brederode 2015 (2) p. 230 with no referral to Hemming and Kay 1981.

¹⁹⁷ Placed on same position in the transaction chain.

¹⁹⁸ Pfeiffer and van Brederode 2015 (2), p.234.

¹⁹⁹ Gorca Echevarría Zubeldia, "Turning VAT Inside Out", IBFD, IVM, 04/2015, p.204.

²⁰⁰ Joachim English, "Hybrid" forms of taxing consumption: A viable alternative to EU VAT?, World Journal of VAT/GST Law 2015, 119-131.

²⁰¹ English pp.4-5 with reference to Judgment of the Court of 15 May 2014 in C-337/13 - Almos Agrárkülkereskedelmi, ECLI:EU:C:2014:328, para.22.

²⁰² English pp.4-5 and Keen & Smith 2007, p. 12.

²⁰³ English p.10.

GRCM exempt sectors²⁰⁴ would be liable for their VAT inputs and while they are entitled to zero or lower VAT credit would have to remit VAT to the authorities (for the first time).²⁰⁵ With regard to the arguments that VAT is collected only in the last stage, English emphasized that, in practice and certainly under the European VAT system “... [l]arge sectors of the economy are not entitled to a full input deduction.”²⁰⁶ The author concluded that a more oriented RST system would perform better than the current one; however, extensive economic analysis and simulations are required to prove that the new system would not turn out to be less robust than the current system. Therefore, English proposed a hybrid VAT system in which additional measures to combat fraud within the current system should be developed and proposed that in the meantime, alternative methods of taxing end consumers but not taxing B2B transactions, “at least in principle”, should be researched.²⁰⁷

In summary, combatting carousel fraud with the application of the GRCM is possible only to a certain extent. Possibilities of new types of fraud are known and accepted factors by all the parties involved in the consultation process. The GRCM would not function in MSs with weak policies or with a tax administration that lacks the resources to conduct audits or to collaborate with other MSs or has a high corruption level. The introduction of the GRCM is also unavoidably related to increased costs for both authorities and businesses. The argumentations for and against are mainly based on: (1) the credit method applied, (2) the insolvency of a trader, (3) the collection of the VAT as revenue from a single MS and the EU, and finally (4) the micro fraud related to different rates and mixed or exempt supplies. All the participants involved in the process recommend automative collection system of some kind.

²⁰⁴ For example the financial sector, medical care, educational institutions etc.

²⁰⁵ English p.13.

²⁰⁶ Ibid.15.

²⁰⁷ Ibid.16.

5. Analysis

The question researched concerns whether the GRCM meets the requirements set by the EC-for a simple, robust, and efficient VAT collection system and remedies the problem of MTIC fraud. The analysis will first assess the arguments from chapter four and the different opportunities related to them. It will then investigate the potential impact on businesses, MSs, and VAT collection. As the analysis requires broad consultation, some new resources will be included.

5.1 Assessment of the arguments

The main arguments for introducing the GRCM are the following: (1) to stop carousel fraud; (2) to ensure equal treatment for domestic and intra-community transactions; (3) VAT collection at the last stage, and thus (4) no tax loss in cases of insolvency. The main arguments against the introduction of the GRCM are that (1) carousel fraud would still exist, (2) abolishing fractional collection carries a danger for MSs' revenue, (3) there will be one more VAT regime, (4) the compliance costs will be higher for both businesses and administration, and, (5) there is a risk of new types of fraud.

With regard to carousel fraud, the result from the assessments provides a clear conclusion that carousel fraud would still be possible. In addition, other types of fraud would occur. One of the main beliefs of the EC, and thus a ground for introducing the GRCM is that a "...[n]ew fraud pattern take a few years to appear (as it seems to have been the case in 1993...)." ²⁰⁸ However, this is not the case, as will be discussed further with regard to the emission allowances case, in which the fraud was committed by only one laptop and appropriately developed software, which is definitely in line with the technology of the twenty-first-century²⁰⁹. Furthermore, VAT fraud depends on the legislation of a single MS. MSs with high level of corruption or weakness in the legislation or in tax administrative practices experience higher level of fraud.²¹⁰ Moreover, goods can be sold in any neighbouring MS either by selling to end consumers and collecting VAT or by selling on their black markets. When selling the goods with VAT and not remitting it to the tax authorities, the business can "go missing", which is same as missing trader fraud.²¹¹

With regard to the statement of illusionary fractional collection by Hemming and Kay (1981), this would be correct only for a single transaction, as rightly observed by English, Pfeiffer, and van Brederode. Thus, the fractional collection is not an illusion, because in any event the acquiring business will seek profit and thus create value. Any ongoing business that engages in many activities and not in only one transaction has costs and as such is partly an end consumer.²¹² This will consequently increase the price. The VAT paid for that increased value stays with the tax authority and secures the revenue.²¹³ A transaction undertaking by four businesses might take

²⁰⁸ SWD (2016) 457, p. 41.

²⁰⁹ It should be recalled that we live in cyber era committed to introduce AI-Artificial intelligence systems. See How Artificial Intelligence Will Secure the 21 st Century Machine Learning and Mathematics Introduce a Brave New World of Predictive Cybersecurity That Rewrites the Rules of Protection; Tech Trends 2016/7 Innovating in the digital era. Deloitte innovative university press and Megatrends 2015 Making sense of a world in motion. EY.

²¹⁰ SWD (2016)457 Annex 5 on p.72.

²¹¹ See chapter 4.2.

²¹² See comment on English in chapter 4.3.

²¹³ S. Cnossen, The Technical Superiority of VAT Over RST. Australian Tax Forum 4, 419-464 (1987) p. 427.

minutes or a year. With the fractional collection, the tax revenue is secured by the payments²¹⁴ and the authorities do not have to wait for the time when the chain ends with an end consumer and the retailer remits the tax. Thus, the self-policing system, when applied in practice is not really an illusion but rather a robust tax collection system securing national revenues.

With regard to the claims made by Pfeiffer and Van Brederode (2015), it is of great importance to stress that in their comparison no account was taken of the difference in their models. As their first model they used a transaction in a chain; see for example lines one, two or three in Graph 1. Then they compared same transaction under both RST and VAT. However, they missed the fact that transactions under RST are without tax and thus not the ones of interest to fraudsters.²¹⁵ If comparing taxed transactions, the last level, line four should be tested with insolvency, whereby the RST would give no tax to the Treasury and the VAT system would still give tax of 30. Thus, their argument cannot be accepted.

Furthermore, the authors argued that the theoretical benchmark RST system (model 2) is better than the current VAT system (Model 3). However, the authors compared the current “transitional” VAT system

- first, by applying its theoretical characteristics (input-deduction mechanism) (model 4) to the theoretical application;
- second, by applying the same theoretical VAT system to its practical application, this time in practice (mixed supplies);
- and finally by comparing the current “transitional” VAT system as applied in practice with a theoretical benchmark system that does not exist.

Such an inconsistent comparison reduced the quality of their evaluation and only showed the weaknesses of the current “transitional” VAT system, which are already well known. Many of the scholars, including Pfeiffer and Van Brederode by their reasoning of an “illusion”, have established that the theoretical and practical applications differ. However, a better method would be first to compare the theoretical treatments, second to compare the practical ones, and third to test perfectly designed VAT and RST systems.

With regard to Tumpel’s argumentation, the number of businesses concluding intra-community supplies is far lower than the number operating in the domestic markets. In addition, the EC has an obligation to reduce the compliance burden with regard to *any* measures changing the VAT collection and the Council has agreed to changes that do not impose extra costs, rather the opposite, providing for savings of a minimum of 25%.²¹⁶ According to the EC, in 2006²¹⁷ the number of businesses submitting tax returns were 27 959 318 of which only 2 604 362 performed

²¹⁴ According to the jurisprudence of CJEU, business customer, based on objective reasons, might be refused the right to deduct or be held jointly and severally liable for the payment of VAT. See judgment of 6 July 2006 in *Axel Kittel and Recolta Recycling SPRL*, Joined Cases C-439/04 and C440/04, ECLI:EU:C:2006:446 and judgment of 11 May 2006 in *Federation of Technological Industries and Others*, Case C-384/04, ECLI:EU:C:2006:309.

²¹⁵ Pfeiffer and van Brederode 2015 (2), pp.230-231.

²¹⁶ See – objectives from 2007 in 2836th Council meeting p.32.

²¹⁷ For 2013 there were 29 834 986. See Standard VAT Return: Frequently asked questions, MEMO 13/8826 of Brussels, 23 October 2013, Annex.

intra-community transactions.²¹⁸ According to Tumpel it is proportional when 91% of all taxpayers must level their costs to only 9 % of all taxpayers. However, when using numbers as in this example, the result is clearer, and it becomes obvious that such a treatment is not proportional.²¹⁹

A similar situation arises even with the MSs in total. According to the results from the EC and its consultants, there are MSs with a very low level of fraud and a smaller VAT gap. The application of the GRM in one MS might cause higher administrative and business costs even in a neighbouring MS. That could be the situation if the fraud from the first MS moves to the second MS and the latter is forced to introduce the GRM. Then fully compliant businesses and well-working administrations must accept higher costs and unknown types of fraud. According to the assessment of the EC, only four MSs would be able to request the GRM, as in the rest the proportion of carousel fraud is under 25%.²²⁰ In the case of the movement of the fraud to every MS, 23 MSs will have increased compliance costs because of the first ones applying the GRM. In addition, as the time period for permission for the derogation is three months, in a chain of 4-5 neighbouring MSs, the last might experience a sufficient increase in carousel fraud without being able to request the derogation, while the level of fraud in the first might be lower than that in the last one. Such a danger might call for other solutions, such as the increased physical control of foreign trucks²²¹ applicable in Hungary.²²² Observed from the EU's perspective and the principle of proportionality, it becomes clear that the only plausible approach to use the GRM is, as the EC stated in 2008²²³, to apply it mandatorily in all MSs.

As regards the argument on insolvency within the transaction chain in the current VAT system, it should be observed that a mid-size retailer has at least 100 suppliers. English argued that the rules in the current VAT system provide possibilities for more acquisition of goods and services when a business is insolvent but has not declared insolvency. Accordingly, as the proposal for the GRM does not aim to change those rules, they would be applicable even under the GRM. The faulting retailer can continue to acquire goods and sell them by collecting the VAT and then disappearing. In addition, in the case to which the author referred, Hungary used the derogation under Article 90(2) of the VAT Directive and successfully refused the reduction of the taxable amount and as consequence, reduction of the VAT to be collected.²²⁴ As every MS can adopt legislation with the requirements for the derogation, this becomes an internal MS problem and not one of the current VAT system. Moreover, when a business at the retail stage becomes insolvent than the VAT from the other 100 would be also lost. Additionally, the possibilities to acquire goods and services when a business is insolvent are strictly related to the MS and its

²¹⁸ SEC (2008) 249, p.51.

²¹⁹ See footnote 83 with regard to the proposal agreed by the Council "The impact on the cash flow of business should be similar to that for domestic transactions to ensure a genuine level playing field." SWD (2014) 338 final.

²²⁰ See SWD (2106) 457 pp. 17-22.

²²¹ SWD(2016)457 Annex 3 on pp.69-70.

²²² From 2015, Hungary applies Electronic Road Freight Control System ("EKAER") where every carrier transporting goods by road must register and submit records so that all transports could be traced. EY 2015, p.59.

²²³ COM (2008) 109 p.10.

²²⁴ C-337/13 - Almos Agrárkülkeresk, paras 23-28.

business organizations providing information on the status of each business.²²⁵ Lastly, the argument of a lower risk of insolvency is based on the assumption that the number of businesses selling to the final consumer will remain the same. The problem is that the technology today allows even manufacturers and other businesses in the chain to sell to end consumers. The introduction of the GRCM can stimulate more businesses to begin with this type of practice. Large retailers may even trigger such a change, as they will find themselves to be overburdened in collecting and subsequently remitting all the VAT and thus refuse to sell certain products. Such are the types of products that do not allow the application of a higher margin and as a result become expensive to manage. The only acceptable conclusion is that the situation of insolvency and its effect on VAT collection could be identified only after application in practice.

To fulfill the third requirement “robust and fraudproof”, the EC, in its legislative process, relies on controlling the behaviour of professional fraudsters based on the belief that new types of fraud take time to appear. Accordingly, this subject requires contextual analysis of the problem and as it becomes even more important for the thesis such analysis is provided.

The Czech Republic and some of the scholars, mainly Swinkels, adopted an opposite position to the EC, when it comes to individual behavior. One side believes that, in the absence of VAT revenue, fraudsters would not be interested, while the other side claims that fraudsters will always find ways to steal money. In my view, it is possible to steer behaviour, however there is a need for more complex changes. As human rationality underlines²²⁶ criminal behaviour,²²⁷ fraudsters will take advantage of every weakness of the system. This means that new and more advanced forms of fraud will be developed. It has already been proven that there is a network for VAT fraudsters in the EU. In 2005, the EU established a system for trading with emission allowances.²²⁸ After the change in treatment by applying zero-rate in few MSs²²⁹, fraud with a financial loss for the MSs of around 5 billion euros was committed at the EU level. The most striking factor is that it happened only a few months after the introduction of the new rules.²³⁰ It follows that fraudsters are well prepared and that there is no time for introductory period for new legislation.

²²⁵ In Sweden, for example, it is very easy to check, and usually every company checks the corresponding one for its financial status. During the past three years our company was involved in four insolvent procedures and, based on the available information from companies providing credit safe information, our customer were detected within the same month. See <https://www.creditsafe.se/>.

²²⁶ For rationality see Weber, Max, 1864-1920 - *Economy and society: an outline of interpretive sociology* / Max Weber; ed. by Guenther Roth and Claus Wittich; transl.: Ephraim Fischhoff – 1968, p.130 and its application in criminal law; Larry J. Siegel. *Criminology: Theories, Patterns, and Typologies*, Tenth Edition, University of Massachusetts, Lowell, 2010 pp. 394-413; Worley, R. - Crime Science Series : *Psychological Criminology : An Integrative Approach*, 2011, pp. 38-40; Brown, Stephen Eugene, *Criminology : explaining crime and its context*, 2015, p.194.

²²⁷ Larry J. Siegel., *Criminology: Theories, Patterns, and Typologies*, Tenth Edition, University of Massachusetts, Lowell, 2010 pp. 394-413.

²²⁸ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

²²⁹ Richard T. Ainsworth, *VAT Fraud Mutation, Part 1: “Pull” Missing Trader Fraud and Deutsche Bank*. Boston University School of Law & Economics Paper No. 16-13, 81 Tax Notes International 3706, 28 March 2016, p 2.

²³⁰ See Carbon Credit fraud causes more than 5 billion euros damage for European Taxpayer, assessable at <https://www.europol.europa.eu/newsroom/news/carbon-credit-fraud-causes-more-5-billion-euros-damage-for-european-taxpayer>. [accessed on 24 April 2017]

The conclusion from that organized EU fraud by top businesses in the EU²³¹ is that even players from other area of law are involved in VAT fraud. Within criminal law, white-collar crime is the most difficult to discover and subsequently fight.²³² As high officials or business classes with a broad knowledge of the system organize the crime,²³³ and with the background from the above mentioned fraud, one can legitimately doubt if authorities would have time to react. When a white-collar crime is a driving factor, the rules in the subsequent areas are of secondary importance. Criminals usually find the weakest point of each piece of legislation very quickly, and abuse it. The present work of the EC in that direction, by being willing to introduce a system to fight fraud to the EU's financial interests throughout the criminal law²³⁴ and the proposal for the establishment of a European Public Prosecutor Office,²³⁵ should not be overestimated and thus the VAT system will be exposed to more unknown and dangerous fraud. There are still promising possibilities to combat the majority of MTIC fraud by applying the GRCM. This topic will be discussed more extensively in chapter 6.1.

One satisfactory conclusion is that fraudulent practices first are a result of individual behaviour and second arise from the loopholes in any system, in this case the VAT system. Measures corresponding to correcting only the weaknesses of some systems will never produce the sought-after result, as other possibilities will be inherent in the single measure.²³⁶ In this case, the GRCM bears possibilities for far greater fraud and thus exposes to danger the VAT revenue of any MS.²³⁷ Such treatment is against the primary objectives in accordance with which the further work in the VAT field had to be carried out.²³⁸

Everyone involved in the process of the development of a future VAT system referred to a more automative system. In a summary of suggestions, R.A. Rolf recalled the statement made by the research group in 1962 from the ABS report. According to the report, the desirable solution to fraud is to make the deduction dependent on the valid payment. However, the technology could not offer a proper system at the time, but is very likely to be achievable today.²³⁹ Using modern credit card technology is seen as a possible solution to link the real payment to the deduction.²⁴⁰

²³¹ Ainsworth 2016, Deutsche Bank.

²³² Brown, Stephen Eugene, *Criminology : explaining crime and its context*, 2015 , pp.469-473.

²³³ Siegel 2010, p.396.

²³⁴ Proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law. 11.07.2012, COM (2012) 363.

²³⁵ COM (2013) 534, 17.07.2013, Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office.

²³⁶ Closing VAT GAP through Reverse Charge Mechanism, Collection of the tax conference of the Ministry of Finance with the support of International Fiscal Association, CR December 2015, Prague, .51.

²³⁷ The table is from Annex 7 of the Impact assessment shows the current forms of fraud and the new possible form of fraud under GRCM. SWD (2016) 457, Annex 7.

²³⁸ See discussion on COM (2011) 851.

²³⁹ "New information technologies - not available at the time of the earlier discussions - have the potential to overcome this obstacle". COM (2010) 695 final, p.7.

²⁴⁰ R.A. Wolf, 'VAT Carousel Fraud: A European Problem from a Dutch Perspective' (2011) 39 Intertax, Issue 1, pp. 26–37, p.36 and The proposal in Germany BNA, Multistate Portfolios, SALES AND USE TAXES, 1310-2nd T.M. 01.C., p.31.

If such treatment is possible, which has been proved to be the case on several online platforms²⁴¹, then the argumentation of the EC for excluding the possibilities for taxation at origin, that MSs would be dependent on the monthly transfer of other MSs²⁴² loses its grounds. In this case harmonizing of VAT rates would be the only thing left to do.

However, proper application of reporting times is the key to the taxation at the origin in immediate connection to taxation at the destination, in which a clearing mechanism will solve both the existing and the future problems of the VAT collection. The solution is probably the only one possible, not only as envisaged by the ancestors of the EU, but even from the work on a definitive system²⁴³, and the tool needed is the otherwise frightening revolution, technology. For all the costs involved in introducing a second transitional system and then shifting to an alternative definitive VAT system, a very advanced clearing system in line with the technology of the twenty-first-century can be developed. Such a system can secure both the MS and the EU resources.

5.2 Possible impact on the authorities and businesses

As can be seen from chapter 5.1, there is strong evidences that the introduction of the GRCM will increase both the compliance costs and the administrative burden for tax authorities and businesses. The extra VAT regime, with its new demands, will require not only more staff for both sides but also more time to adapt to the new rules.

In my view, one possible reason for the introduction of the GRCM was not included in the debates. Following the initial claim of the EC in the Green Paper that the future work on VAT must comply with the objectives set out by the Council and the European Parliament, and that even the derogations should not affect the VAT collection, neutrality and proportionality somehow vanished. The results of the assessment showed that the GRCM does not meet the objectives, but the EC proceeded with a proposal for the amendment of the VAT Directive. The fact that the EC had negative opinion about the RCM for many years and then, under the Councils instructions, continued with the idea of the GRCM seems to be suspicious. Political pressure, and not solely consideration relating to the arguments on how to stop fraud, appears to be an acceptable explanation²⁴⁴ for the dangerous idea of introducing a general derogation which is a "...[r]isk for the national budget because the collection would only take place at the retail

²⁴¹ There are automative online platforms that, when paying by card or online, deduct the VAT and produce correct invoice and correct records. See for example <https://www.swedbank.se/foretag/betala-och-ta-betalt/e-bokforing/>, https://www.wint.se/?gclid=CLvnh8y_ydMCFRctGQodmVcN-g, even reference could be made to "eTVA" system. [http://www.ey.com/Publication/vwLUAssets/New_Platform_for_the_e-filing_of_VAT_returns/\\$FILE/Tax%20Alert%20-%20New%20platform%20for%20the%20e-filing%20of%20VAT%20returns%20-%20April%202016.pdf](http://www.ey.com/Publication/vwLUAssets/New_Platform_for_the_e-filing_of_VAT_returns/$FILE/Tax%20Alert%20-%20New%20platform%20for%20the%20e-filing%20of%20VAT%20returns%20-%20April%202016.pdf). [accessed on 22 April 2017]

²⁴² COM (2008) 109 final p.7

²⁴³ See discussion in the end of chapter 3.4.

²⁴⁴ Quick look at the EU parliament plans reveals that there is a plan that need to be followed, however the plans are preceding any concrete consultation or assessments, which sends signals that there, predefined goals tha have to be reached no matter what the real situation requires. <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-vat-reverse-mechanism>.

stage.”²⁴⁵ Even some of the MSs that have already required the derogation have argued that the current rules on GRCM are not the ones sought by them.²⁴⁶ There is no source for the real reason, but as politicians are the actors of those reforms, certainty prevails over speculation and the introduction of an inaccurate change might be difficult to repeal. Despite clear arguments against politicians, the fact is that, in the end, politicians always decide.

From the history of the VAT system, it can be seen that derogations with a set period last far longer than initially intended. The temporary application of the GRCM, if adopted by the Council, might also last far longer as it will depend on further changes, which again need unanimous agreement. Therefore, one acceptable approach would be to research²⁴⁷ the characteristics of the GRCM as such and its compliance even with the long-term or definitive objectives. Only in such a way can smooth and consistent reform be achieved.

5.3 Effect of the GRCM on MSs and VAT fraud

As seen from the assessments, the GRCM would not be able to combat carousel fraud as initially envisaged. In addition, even unknown forms of fraud can occur. However, before considering in depth the possibilities for new type of frauds it is important to call attention to the problems within the legislative procedure.

If the EC has the right to decide on its own, then MSs’ sovereignty with regard to their revenue collection will be relocated to the EC. In the case in which fraud moves to a neighbouring MS, it would be up to the EC to decide whether the conditions for the right to apply the GRCM are fulfilled. As seen in the reports, the numbers showing the VAT gap and the proportion ascribed to MTIC fraud are only uncertain estimates that change every year (even for the preceding years) depending on the calculation method applied. It will be very difficult to secure objectivity and proportionality.

If the Council has the right to apply “reversed unanimity”²⁴⁸ the ‘decision-repeal of decision’ process and the different opinions on the GRCM within individual MSs²⁴⁹ would create long-lasting uncertainty.²⁵⁰ Furthermore, the estimates clearly show that, according to the numbers

²⁴⁵ SWD (2016) 457, p.65.

²⁴⁶ See the comments from the Austrian representative from the last Council meeting available on the link above.

²⁴⁷ See English proposal and Report on the future of VAT. Committee on Economic and Monetary Affairs, (2011/2082(INI)), p. 8, point 36.

²⁴⁸ The EC would have the right to propose a certain MS for the application of GRCM. If the Council based on majority principle accepts the proposal then the MS will be allowed to apply the GRCM. If the Council rejects the EC proposal with unanimity than the MS would not be able to apply GRCM.

²⁴⁹ See as example the difference of the Czech Republic, Austria, and the opinion of their representative in the council and in the tax authorities.

²⁵⁰ “However, the findings also highlight the potential trade-off between decision-making capacity and legitimacy particularly in an area considered to be traditionally part of the EU Member States’ national sovereignty.” pp.2,34. Wim Van Aken and Lionel Artige, *A Comparative Analysis of Reverse Majority Voting: The WTO’s Dispute Settlement Mechanism, the EU Anti-Dumping Policy and the Reinforced SGP and Fiscal Compact* (May 1, 2013). EUSA Thirteenth Biennial Conference, Baltimore, Maryland, USA (May 9-11, 2013). Available at SSRN: <https://ssrn.com/abstract=2202787> and Wim Van Aken. *Voting in the Council of the European Union Contested Decision-Making in the EU Council of Ministers (1995-2010)*. SIEPS 2012:2. pp.17-25. [accessed on 28 Maj 2017]

from 2014, only a few MSs would be able to apply the GRCM directly, while the rest would have to wait for the unclear decision process even though some of them are the original architects of the legislation. The time gap between acknowledging the right to require the GRCM and the actual application of it would create enormous possibilities for fraud.

In this relation the European Parliament stated that MSs are facing a situation of the “prisoner’s dilemma.”²⁵¹ Indeed, the status of all MSs is such as they are in the prison of the “obligation” to refund the VAT not collected and at the same moment have to cooperate at the EU level without a tool to track the entire transaction.

In my view, the GRCM as proposed today, with the uncertainties that stem from the “decision-repeal of decision” process will continue this state of the prisoner’s dilemma. As in the prisoner’s dilemma situation, if all MSs introduced the GRCM the overall negative impact would be lower, and if only certain MSs introduce the derogation, the negative impact for the rest would be enormous. The obscurity regarding who is to be able to take a decision, the EC or the Council, is seen as a deviation from the MSs’ proposals for the GRCM.²⁵² In my view there is a problem in both situations, and equal treatment is impossible if the derogation is not mandatory for every MS, as stated by the EC in 2008.²⁵³

By returning to the possibilities of fraud under the GRCM, it is important to state that this thesis does not aim to present variations of possible fraud under the GRCM. One example, in addition to the results from the assessments, is considered to be sufficient to prove that the GRCM does not provide for simple, robust and efficient VAT collection system. One possible fraud is illustrated in Annex 2 in which the output for the fraudsters could at times be higher than that from a known carousel fraud. The most interesting fact is that it is partly an MTIC fraud, and the MS applying the GRCM could be the one that suffers the most. That is only a simple example. Online platforms give enormous possibilities, and as EU online trade develops rapidly. Consequently, even manufactures selling to end consumer run the risk of having their VAT numbers hijacked by fraudsters and thus suffering from fraud.

5.4 Effect of the GRCM on the collection of VAT

The Collection of the whole VAT from last stage in the chain as in RST is seen as dangerous proposal. The majority of supporters and opponents consider the GRCM to be an incomplete

²⁵¹ “Considers that Member States in the current VAT system find themselves in a prisoner’s dilemma: the abolishment of fiscal border controls in 1993 has not been replaced by a sufficient degree of cooperation between Member States; notes that, as a result, they have lost a significant amount of potential income from VAT and other tax revenues because some legitimate businesses may refrain from entering the Single Market and because fraudsters exploit the existing fragmented VAT system;” European Parliament resolution of 13 October on the future of VAT. (2011/2082(INI)) p.2, point 4.

²⁵² See Austria’s and Germany’s view expressed on the last Council meeting.

²⁵³ See the EC conclusion on GRCM in COM (2008) 109 p.10.

solution and call for better solutions based on a one-stop shop.²⁵⁴ However, research concluded that collection under the RCM and one-stop shop is uncertain.²⁵⁵

When arguing about secure collection under the GRCM it should be observed that in Czech Republic, and even in other MSs²⁵⁶, no change in the VAT collection was seen after the application of the RCM,²⁵⁷ which means that the revenue from the VAT did not increase and that RCM did not have the envisaged effect. Many experts have asserted that applying RST with high rates, as in the VAT system, will cause evasion and fraud to increase.²⁵⁸ It has been submitted further that in absence of fraud VAT performs better.²⁵⁹ As there is no example of how fraud-efficient a RST system is, when taxes are levied at around 20%, the introduction of the GRCM will be the largest experiment in the world exposing the MSs' and EU's resources to danger. Another factor, which is impossible to regulate, will reinforce this unique experiment. Fraudsters from other MSs, even outside the EU, can use the freedom of establishment within the EU and run a business in another MSs without relocating. Thus, fraudsters from other MSs, throughout the rules on business holding, can abuse any MS without being directly involved. As improving registration procedures are not the aim of the proposed reform, it will be impossible for tax authorities to stop those practices or even control what exactly happens at the business owner's level in another MS. The great part of the results show future problems related to unknown impact on the MSs' revenue, and thus the EU's resources. VAT collection under the GRCM is impossible to predict.

²⁵⁴ See for example Han 2011, p.2 and English 2016.

²⁵⁵ Marie, Lamensch. Are «reverse charging» and the «one-stop-scheme» efficient ways to collect VAT on digital supplies? World Journal of VAT/GST Law. – 2012. – Vol. 1. – Issue 1. – pp. 7-13.

²⁵⁶ SWD (2016) 457 final, p.20.

²⁵⁷ Grasgruber M. *Impacts of the application of the reverse charge mechanism of the value added tax* / M. Grasgruber, M. Otavova, P. Semerad // Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis. –2913. – Vol. LXI. – N 7. – p.2140.

²⁵⁸ National Taxpayer Advocate's 2009 Annual Report to Congress. 2009 Annual Report to Congress. Volume II - IRS.gov- p.68.

²⁵⁹ Joel Slemrod. Show Me the Money: The Economics of Tax Remittance. Working draft, University of Michigan, 15 January 2007, pp 27-33.; Joel Slemrod, "The ABCs of the VAT," News & Media, Ross School of Business, University of Michigan, 25 Maj 2010.

6. Conclusion

The requirements by the EU legislator for any further work on derogations were lower compliance costs, the stopping of carousel fraud, and no negative impact on the internal market. In addition, the EC acknowledged that any further work would follow three objectives – a simple, efficient and robust VAT system. The thesis researched whether the GRCM complies with those requirements.

Firstly, it is evident that it would not be simple to comply with one more VAT regime.

Secondly, high compliance costs are expected for each MS willing to introduce the GRCM but without a guarantee of fraud proof VAT collection.

Thirdly, it is generally agreed that carousel fraud would continue. The fact that only certain MSs can qualify for the GRCM and that it can be applied only after approval by the EC shows that MSs would, in fact, give away their sovereignty in this situation to the EC. A situation might arise in which carousel fraud moves to a single MS, but the MS would not be able to apply the GRCM because of the requirements or at the earliest would be able to apply it three months after the request. When recalling the VAT fraud with emissions allowances rights, the speed with which it was performed, and the problem with the decision-making process in the Council, one wonders whether the rules are robust and efficient. The future harmonization will be at risk, as MSs will form their interest based on the system that they apply.

Lastly, it follows from the above that the impact on the internal market is unknown, and not as EC concluded, very low.

In my view, it will be more appropriate to use the high investment required by the introduction for the GRCM to make the current system more robust and, if the problems still occur to switch to the GRCM. By applying only the administrative changes required by the GRCM to the current VAT system, the fraud levels will be reduced.

The application of the GRCM would provide the sought-after result only if introduced sector by sector on a mandatory basis. Such treatment would be more appropriate with regard to the overall fraud situation in the EU and would avoid the non-proportional treatment resulting from the “decision-repeal of decision” process. Introducing the GRCM in a more vigilant manner would be the most appropriate method, as investments would be made in fractional stages, companies would have more time to adapt, and tax authorities would have more time to train their staff and implement the necessary corrections and IT solutions. This approach would give MSs possibilities to gather more precise information and based on it to identify the sectors that are the most vulnerable to fraud and help them to improve the rules for each following sector. Further, the information would provide possibilities to create permanent tools to fight the different types of fraud more efficiently. If such an approach was combined with the optimization of the cooperation between tax authorities, they would be able to follow the entire transaction chain and the results would be a more efficient and robust VAT system. The vital information acquired through the process would help for smooth return to fractional collection when (or *if*) the time for

the implementation of the definitive VAT system arrives. As the future VAT system will require a fully collaborative collection and exchange platform, half of the work would be completed.

The analysis shows that the EC, respondents, professionals, and academics agree that an online automative system is the best solution to many of the problems within the VAT system. In contrast, only PWC and EY offers a more defined solution as an option. In my view, if every author or group of respondents offered their own opinion on a future system, it would be easier to reach an agreement. It is, of course, questionable whether the MSs will agree to every offered solution, as they will preserve their sovereignty, but working modern systems are better than implementing only slight and costly corrections. Every solution of legislation bears minor problems, and when the problems are known in advance, it becomes questionable whether this is a real solution, only a political will in order to demonstrate activity, or there is another unknown motive²⁶⁰.

My conclusion is that general reverse charge mechanism as proposed today does not meet the requirements set out by the European legislator. Carousel fraud would still be possible and the compliance costs would be higher.

With reference to the facts, including the presented options and solutions, correctly designed algorithms would be a plausible alternative to solve the problem of relocation of the VAT due or paid. Combining the origin with the destination principle in one single automative collection-distribution platform is a promising possibility that needs to be researched in detail. The solution sought has to be a digital collection-distribution point at EU level, which would be possible to integrate at the national level. Such a system should and would be able to introduce the GRCM at any time and for any sector but without the risks, that the GRCM bears and while preserving the fractional collection.

²⁶⁰ It is unknown what kind of goals and future requirements international trade agreements include.

Bibliography

EU legal acts

The Single European Act of 1985 sets up a deadline for the abolition of borders and in 1987 The Commission proposed a system that would be adapted to the internal market.

Treaty establishing the European Economic Community of 25 March 1957.

Treaty of Paris constituting the European Coal and Steel Community signed on 18 April 1951 signed by the first six member states, Belgium, The Netherlands, Luxembourg, Germany, Italy and France.

Literature

Brown, Stephen Eugene, *Criminology : explaining crime and its context*, Routledge 2015 , pp.469-473.

Eemeren, F. H. van. *Topical Themes in Argumentation Theory: Twenty Exploratory Studies* [Elektronisk resurs]. – 2012.

Larry J. Siegel., *Criminology: Theories, Patterns, and Typologies*, Tenth Edition, University of Massachusetts, Lowell, 2010 pp. 394-413.

Lauré, La taxe sur la valeur ajoutée (1952); *Lauré, Au secours de la T. V. A.* (1957).

Terra, B. J. M.. - *A guide to the European VAT directives*. Vol. 1 and Vol. 2, Introduction to European VAT 2016, / Ben Terra, Julie Kajus. Online Resources– 2016.

Weber, Max, 1864-1920 - *Economy and society: an outline of interpretive sociology* / Max Weber ; ed. by Guenther Roth and Claus Wittich ; transl.: Ephraim Fischhoff – 1968, p.130.

Wortley, R. - Crime Science Series : *Psychological Criminology : An Integrative Approach*, 2011, pp. 38-40.

Academic articles

Ainsworth, Richard T. *VAT Fraud Mutation, Part 1: “Pull” Missing Trader Fraud and Deutsche Bank*. Boston University School of Law & Economics Paper No. 16-13, 81 Tax Notes International 3706, 28 March 2016.

- Alan A. Tait. *Value Added Tax: International Practice and Problems*. International Monetary Fund, 1988.
- Beca, Marusa. 'The Effects of the Reverse Charge for the Supply of Cereals and Industrial Plants on the Romanian Companies', "Ovidius" University Annals. Economic Sciences Series. – 2012. – Vol. XII. – Issue 1. – pp. 12671272.
- BNA, Multistate Portfolios, *SALES AND USE TAXES*, 1310-2nd T.M. 01.C.
- Daganova, Adriana. Priorities of the OP "Development of the Competitiveness of the Bulgarian Economy. *Analysis of socio-economic development and Competitiveness of Bulgaria* (2007-2013). Center for Economic Development. 2014. http://www.bmgk-bg.org/content/fm/14/935/Competitiveness_analysis_2014_NEW.pdf.
- English, Joachim. "Hybrid" forms of taxing consumption: A viable alternative to EU VAT?, *World Journal of VAT/GST Law*, 25 January 2016. p.119-131.
- Forssén, Björn. 'Omvänd skattskyldighet inom byggsektorn – Skapar den flera momsproblem än den löser?', *Svensk Skattetidning*, nr 4, 2007.
- Gravenh ge dr. A.A. Aronowitz mr. D.C.G. Laagland. G. Paulides mr. drs. J.M. Nelen, *Value-Added Tax Fraud within the European Union*. Pilot Study European documentation and research network 1995.
- Grasgruber M. *Impacts of the application of the reverse charge mechanism of the value added tax* / M. Grasgruber, M. Otavova, P. Semerad // *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis*. –2913. – Vol. LXI. – N 7. – pp. 2133-2141.
- Hemming, Richard and Kay, John. "The United Kingdom," In *The Value Added Tax: Lessons from Europe*, ed. by H. J. Aaron (Washington: Brookings Institution) 1981.
- Kogels, Han. 'Some Remarks on the Future of VAT' (2011) 20 EC Tax Review, Issue 6, pp. 260–262.
- Lamensch, Marie. Are «reverse charging» and the «one-stop-scheme» efficient ways to collect VAT on digital supplies? *World Journal of VAT/GST Law*. – 2012. – Vol. 1. –Issue 1. – pp.1-20
- Lind, Kaspar. Reverse charging: the best possible solution for preventing VAT fraud, *World Journal of VAT/GST Law*, (2013) vol2, issue 2, 97-115, DOI: 10.5235/20488432.2.2.97.
- Lisette van der Hel - van Dijk, Menno Griffioen, 'Tackling VAT-Fraud in Europe: A Complicated International Puzzle' (2016), *Intertax*, Issue 4, pp. 290–297.
- Michael, Keen and Stephen Smith. *VAT fraud and evasion: What do we know, and what can be done?* IMF working paper, WP/07/31. 2007.

- Norberg, Karin and Franciska Pettersén. 'Förfarandemissbruk inom mervärdesskatteområdet', Skattenytt, nr 1, 2008.
- Pashev, K. *Fighting VAT Fraud: The Bulgarian Experience*, Centre for the Study of Democracy, Working Paper 0606/2 En, June 2006.
- Quigley, Paul. 'Extension of French Reverse Charge Mechanism', International VAT monitor, January/February, 2007.
- Rendahl, Pernilla. Är mervärdesskatten en konsumtionsskatt eller företagsskatt? En rättsvetenskaplig studie av Mervärdesskattelagens ändamålsenlighet. Handelshögskolan, Gothenburg University. April 2015. p. 73 with reference to Skatteverkets rapport av den 25 mars 2010, dnr 131 213362-10/113, s. 2.
https://www.svensktnaringsliv.se/migration_catalog/Rapporter_och_opinionsmaterial/Rapporter/momsrapportpdf_621754.html/BINARY/Momsrapport.pdf. [Last accessed on 10.05.2017]
- Renström, Staffan. 'Mervärdesskatt – omvänd skattskyldighet mellan byggföretag', Skattenytt, nr 3, 2007.
- Serebriansky, Dmytro and Sokolovska, Olena. 'Strengths and weaknesses of the VAT reverse charge mechanism: A theoretical framework'. Research Institute of Financial Law, State Fiscal Service of Ukraine. 15 August 2016.
- Sijbren Cnossen, The Technical Superiority of VAT Over RST. Australian Tax Forum 4, 419-464, 1987.
- Slemrod, Joel. Show Me the Money: The Economics of Tax Remittance. Working draft, University of Michigan, 15 January 2007, pp 27-33.; Joel Slemrod, "The ABCs of the VAT," News & Media, Ross School of Business, University of Michigan, 25 Maj 2010.
- Swinkels, Joep. *Carousel Fraud in the European Union*. International VAT Monitor. March/April 2008. pp. 103-113.
- Tasev, Ivailo. The crisis may be gone, but not for the tax authorities. Institute for Market Economics, Sofia, 2011. <http://ime.bg/bg/articles/krizata-mai-si-trygva-no-ne-i-zadanynite/#ixzz4gBcm3Sn0>.
- Traikova, Evelina. Center for Police studies related to VAT evasion and prevention. /Research rapport/, Research Institute for Criminalism and Criminology. 2013. p. 27.
http://www.nikk.mvr.bg/NR/rdonlyres/52BA60FB-37B0-4F98-9BB3-949E9E4ADF15/0/052013_DDS_traikova.pdf.
- Tumpel, Michael. *A Hybrid VAT System in the European Union*. Draft 04/24/2007.

Van Brederode , Robert, F. and Pfeiffer, Sebastian. "*Combating Carousel Fraud: The general reverse charge*", IBFD, IVM, 03/2015; Robert F. van Brederode and Sebastian Pfeiffer, "Debate on general reverse charge", IBFD, International VAT Monitor, 05/2015.

Van Brederode, Robert F. and Pfeiffer, Sebastian. "*VAT's Superiority: Is the Emperor Dressed like Adam?*", IBFD, International VAT Monitor, Vol 6, 04/2015.

Van Aken, Wim and Artige, Lionel. *A Comparative Analysis of Reverse Majority Voting: The WTO's Dispute Settlement Mechanism, the EU Anti-Dumping Policy and the Reinforced SGP and Fiscal Compact* (May 1, 2013). EUSA Thirteenth Biennial Conference, Baltimore, Maryland, USA (May 9-11, 2013). Available at SSRN: <https://ssrn.com/abstract=2202787>.

Van Aken, Wim, *Voting in the Council of the European Union Contested Decision-Making in the EU Council of Ministers (1995-2010)*. SIEPS 2012:2.

Wolf R.A., '*VAT Carousel Fraud: A European Problem from a Dutch Perspective*' (2011) 39 Intertax, Issue 1, pp. 26–37.

Zubeldia, Gorka Echevarría. "*Turning VAT Inside Out*", IBFD, International VAT Monitor, 04/2015.

Official publications

20 measures to tackle the VAT gap

http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/tax_cooperation/vat_gap/2016-03_20_measures_en.pdf. [Last accessed on 15.04.2017]

2766th Council Meeting Economic *and* Financial Affairs Brussels, 28 November 2006.

2804th Council meeting. Economic *and* Financial Affairs. Luxembourg, Press: 126 Nr: 10319/07, 5 June 2007.

2836th Council meeting. Employment, Social Policy, Health *and* Consumer Affairs. Press: 270 Nr: 15698/07, *Brussels, 4 December 2007*.

A retrospective evaluation of elements of the EU VAT system. Final report TAXUD/2010/DE/328 FWC No. TAXUD/2010/CC/104.

Assessment of the application and impact of the optional 'Reverse Charge Mechanism' within the EU VAT system, Specific Contract No 6 TAXUD/2013/DE/333 implementing Framework Contract No TAXUD/2012/CC/117, Final Report, EY November 2014.

- COM (2004) 0260 final, Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud.
- COM (2005) 89 final. Proposal for a COUNCIL DIRECTIVE amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion and avoidance, and repealing certain Decisions granting derogations. 16 March 2005.
- COM (2006) 254 final , Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud, Brussels, 31.5.2006.
- COM (2006) 254, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud {SEC(2006) 659}. 31.05.2006.
- COM (2006) 404 final. Communication from the Commission to the Council in accordance with Article 27(3) of Directive 77/388/EEC. 19 July 2006.
- COM (2007) 758 final. *Communication from the Commission to the Council of 23 November 2007 concerning some key elements contributing to the establishment of the VAT anti-fraud strategy within the EU.* 13 August 2007.
- COM (2008) 0807 final, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee on a coordinated strategy to improve the fight against VAT fraud in the European Union. 7 August 2008.
- COM (2008) 109 final. Communication from the Commission to the Council and the European Parliament on measures to change the VAT system to fight fraud. 22 February 2008.
- COM (2010) 695 final, Green Paper on the future of VAT – Towards a simpler, more robust and efficient VAT system. 10 December 2010.
- COM (2011) 851 final, 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. 6 December 2011.
- COM (2012) 363. Proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law. 11 July 2012.
- COM (2013) 534, 17.07.2013, Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office. 17 July 2013.

COM (2014) 69 final. Report from the Commission to the Council and the European parliament. Seventh report under Article 12 of Regulation (EEC, Euratom) n° 1553/89 on VAT collection and control procedures. 12 February 2014.

COM (2015) 538. Communication from the Commission to the Council in accordance with Article 395 of Council Directive 2006/112/EC 28 September 2015. Pricewaterhousecoopers, 2007 (B), Study on new risks of fraud generated by the introduction of a generalised reverse charge system on an optional basis and the taxation of intra-Community supplies. (PWC B)

COM (2016) 148 final, Communication from the Commission to the European Parliament, The Council and the European Economic and Social Committee on an action plan on VAT Towards a single EU VAT area -Time to decide. 7.04.2016.

COM (2016) 811 final. 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 (87) 322 final/2. Proposal for a Council Directive completing and amending Directive 77/388/EEC - Removal of fiscal frontiers. 21 August 1987.

Consultation paper, Possible introduction of an optional reverse charge mechanism for VAT – Impact on businesses, 13 August 2007.

Council Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources, replaced by 88/376/EEC, Euratom.

Council Decision of 24 June 1988 on the system of the Communities' own resources. Euratom of 24 June 1988 L195.

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

Council Directive 2006/69/EC of 24 July 2006 amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion or avoidance, and repealing certain Decisions granting derogations, OJ L 221. 12.8.2006.

Council *Directive 2009/69/EC* of 25 June 2009 amending Directive 2006/112/EC on the common system of value added tax as regards tax evasion linked to imports. OJ L 175, 4.7.2009, p. 12–13. 25 June 2009.

Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment.

Council of the European Union, *PRESS RELEASE. 3167th Council meeting. Economic and Financial Affairs*. Brussels, 15 May 2012.

Council of the European Union, *PRESS RELEASE. 3167th Council meeting. Economic and Financial Affairs*. Brussels, 15 May 2012.

Council of the European Union, *PRESS RELEASE. 2836th Council meeting. Employment, Social Policy, Health and Consumer Affairs*. Brussels, 4 December 2007.

Council reference 15817/16 from 16 January 2016. EM 15817/16 - European Memoranda.

Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

Directive 91/680/EEC of 16 December 1991 and Directive 92/11/EEC of 14 December 1992.

EU VAT Expert Group adopted an opinion on the definitive VAT regime for the taxation of intra-community B2B supplies, 12 June 2014.

European Coal and Steel Community, High Authority, Report on the Problems Raised by the Different Turnover Tax Systems Applied within the Common Market, Tinbergen report 1953 turnover taxes on 1–53 of 5 March 1953, Official Gazette of the Community of 7th March 1953.

European communities press and information, The value added tax in the European community, Community topics 36, 1970, accessible at <http://aei.pitt.edu/34513/1/A682.pdf>. [Last accessed on 28.03.2017]

European Parliament Fact Sheets, section 4.19.2. Value Added Tax (VAT). http://www.europarl.europa.eu/facts_2004/4_19_2_en.htm. [Last accessed on 28.03.2017]

European Parliament resolution of 13 October 2011 on the future of VAT, P7_TA(2011)0436, (2011/2082(INI)).

EY, *Implementing the 'destination principle' to intra-EU B2B supplies of goods, Feasibility and economic evaluation study*, Final Report Contract: TAXUD/2013/DE/319, 2015.

EY, *Assessment of the application and impact of the optional. 'Reverse Charge Mechanism' within the EU VAT system*. Specific Contract No 6 TAXUD/2013/DE/333. November 2014.

First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.

Implementing the 'destination principle' to intra -EU B2B supplies of goods Feasibility and economic evaluation study. Inception report. TAXUD/2013/DE/319. 21 May 2014.

Meeting of the Council 21 March 2017. <http://www.consilium.europa.eu/en/policies/vat-reverse-charge/>. [accessed on 22.04.2017]

OECD, Consumption Tax Trends 2016, pp.22- 24. Available at, http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/consumption-tax-trends-2016_ctt-2016-en#.WPdkPGfYXIU#page24. [accessed on 19.04.2017]

Opinion of the European Economic and Social Committee on the Green Paper on the future of VAT — Towards a simpler, more robust and efficient VAT system COM(2010) 695 final,OJ C 318, 29.10.2011, p. 87–94.

PRESSE 342-12627/13 Council approves measures *to* tackle VAT fraud schemes, Brussels, 22 July 2013.

Proposal for a directive as regards the temporary application of a generalised reverse charge mechanism - Orientation debate at the Council, March 2017.

PWC. *Study in respect of introducing an optional reverse charge mechanism in the EU VAT Directive. Final Report to the European Commission.* TAXUD/2007/DE/305. 20 June 2007. (PWC A)

PWC. *Study on applying the current principle for the place of supply of B2B services to B2B supplies of goods. Place of establishment of the customer,* TAXUD/2011/DE/304, Final Report 8 February 2012. (On EC webpage under reports from 8.03.2013) (PWC B)

PWC-*Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries. Order no. TAXUD/2009/AO-05.* Price Waterhouse Cooper. 20 September 2010.

Regulation (EU) No. 282/2011 [Obligation to communicate VAT identification numbers].

Report on the future of VAT. Committee on Economic and Monetary Affairs, (2011/2082(INI))

SEC (2007) 1584. Commission staff working document - "Report on the state of play of the discussions on the conventional measures to combat VAT fraud proposed by Member States". 23 November 2007.

SEC (2007) 740. Commission staff working document—'Progress Report on the preparation of an anti-fraud strategy at EU level'. 25 Maj 2007.

SEC (2008) 0249. Commission staff working paper on measures to change the VAT system to fight fraud. 22 February 2008.

SEC (2010) 1455 final. *Commission Staff Working Document Accompanying document to the GREEN PAPER on the future of VAT. 1 December 2010.*

Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.

Standard VAT Return: Frequently asked questions, MEMO 13/8826 of Brussels, 23 October 2013.

Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report. TAXUD/2015/CC/131.

Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries Order no. TAXUD/2009/AO-05.

Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries Final Report – 20 September 2010.

SWD (2014) 338 final, Commission Staff Working Document on the implementation of the definitive VAT regime for intra-EU trade. 29.10.2014.

SWD (2016) 457 Commission Staff Working Document. Impact assessment - Generalised reverse charge mechanism. 21.12.2016.

The future of VAT. European Parliament resolution of 13 October 2011 on the future of VAT (2011/2082(INI)), OJ C 94E, 3.4.2013.

VIIES -Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud COM/2004/0260 final.

Case Law

CJEU judgment of 6 July 2006 in Joined cases C-439/04 and C440/04 - Kittel, ECLI:EU:C:2006:446.

CJEU judgment of 15 May 2014 in C-337/13 - Almos Agrárkülkeresk., ECLI:EU:C:2014:328.

CJEU judgment of 11 May 2006 in C-384/04 - Federation of Technological Industries and Others v. Commissioners of Customs and Excise, Attorney General, , ECLI:EU:C:2006:309.

CJEU judgment of 11 May 2006 in C-384/04 - Federation of Technological Industries and Others, ECLI:EU:C:2006:309.

CJEU judgment of 27 January 2011 in C-489/09-Vandoorne, ECLI:EU:C:2011:33.

Miscellaneous

Closing VAT GAP through Reverse Charge Mechanism, Collection of the tax conference of the Ministry of Finance with the support of International Fiscal Association, CR December 2015, Prague.

EU VAT Expert Group adopted an opinion on the definitive VAT regime for the taxation of intra-community B2B supplies, 12 June 2014.

Europol. <https://www.europol.europa.eu/newsroom/news/carbon-credit-fraud-causes-more-5-billion-euros-damage-for-european-taxpayer>. [Last accessed on 24.04.2017]

Group on the future of VAT. https://ec.europa.eu/taxation_customs/business/vat/informal-commission-expert-group-discussions-with-member-states_en. [Last accessed on 12.04.2017]

National Taxpayer Advocate's 2009 Annual Report to Congress. 2009 Annual Report to Congress. Volume II - IRS.gov

REFIT Platform - https://ec.europa.eu/info/law/law-making-process/overview-law-making-process/evaluating-and-improving-existing-laws/reducing-burdens-and-simplifying-law/refit-platform_en. [Last accessed on 3.05.2017]

Svenskt Näringsliv. Remissyttrande. Promemoria om omvänd skattskyldighet för mervärdesskatt vid handel med visst skrot. 2 Maj 2012. p.4.

VAT Expert Group. http://ec.europa.eu/taxation_customs/business/vat/vat-expert-group-0_en. [Last accessed on 12.04.2017]

VAT thresholds 2017-

http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf. [Last accessed on 14.04.2017]

Annex 1

Calculation for the first year cost and the ongoing compliance costs based on the study from Germany.²⁶¹ Then the coefficient resulted from the number of businesses in Germany and the estimated costs from the study is applied. The number of businesses per MS are extracted from the study on feasibility carried out for the Commission.²⁶²

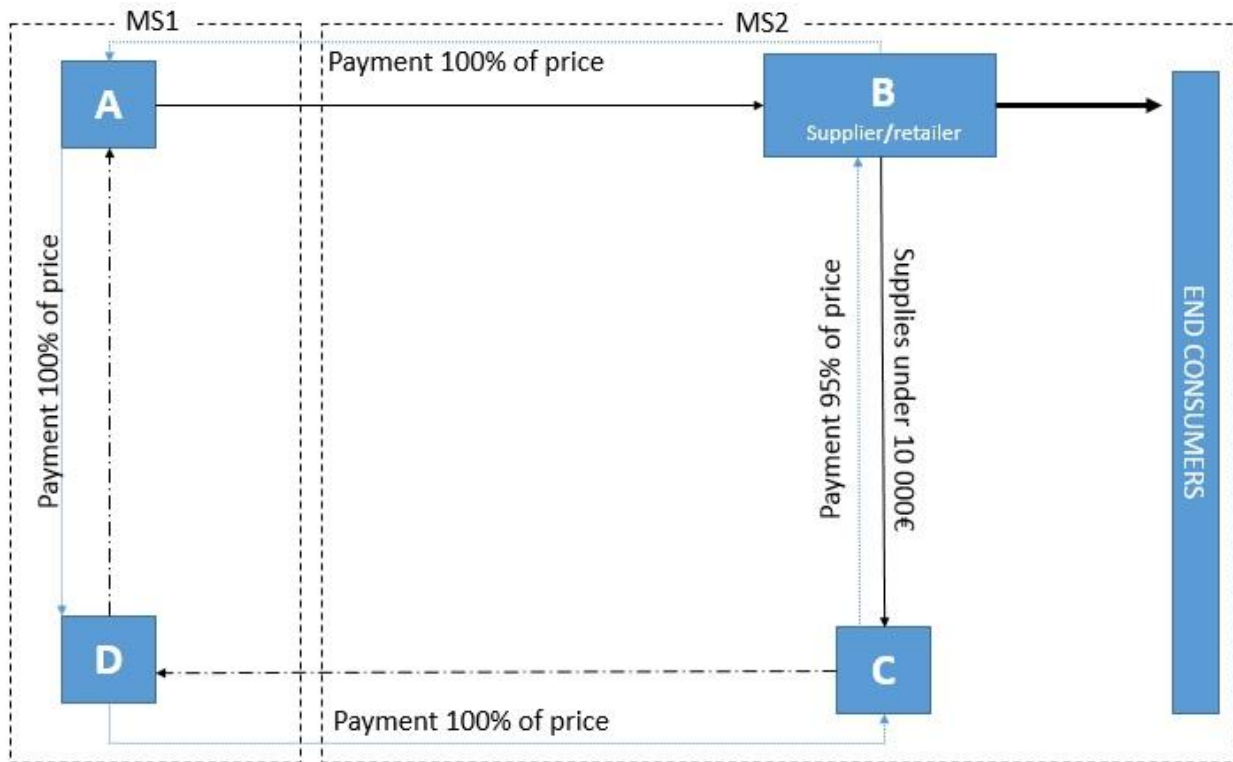
Member State	Estimated number of taxable persons in 2009	Cost for GRCM according to German study 1,7 to 2 billion.	First year cost based on coefficient from Germany	Ongoing costs per year based on coefficient from Germany
AT	797 886		257 717 178,00 €	27 819 604 €
BE	763 831		246 717 413,00 €	26 734 085 €
BG	172 796		55 813 108,00 €	6 047 860 €
CY	72 928		23 555 744,00 €	2 552 480 €
CZ	720 894	On average per year	232 848 762,00 €	25 231 290 €
DE	5 736 142	1,85 billion	1 852 773 866,00 €	200 764 970 €
DK	328 749		106 185 927,00 €	11 506 215 €
EE	64 432	Ongoing per year	20 811 536,00 €	2 255 120 €
EL	1 665 268	200 milion	537 881 564,00 €	58 284 380 €
ES	3 659 284		1 181 948 732,00 €	128 074 940 €
FI	569 877		184 070 271,00 €	19 945 695 €
FR	4 010 706		1 295 458 038,00 €	140 374 710 €
HU	570 723		184 343 529,00 €	19 975 305 €
IE	296 392		95 734 616,00 €	10 373 720 €
IT	5 847 559		1 888 761 557,00 €	204 664 565 €
LT	7 065		2 281 995,00 €	247 275 €
LU	57 589		18 601 247,00 €	2 015 615 €
LV	8 339		2 693 497,00 €	291 865 €
MT	5 563		1 796 849,00 €	194 705 €
NL	1 453 000		469 319 000,00 €	50 855 000 €
PL	2 363 500		763 410 500,00 €	82 722 500 €
PT	1 576 285		509 140 055,00 €	55 169 975 €
RO	720 894		232 848 762,00 €	25 231 290 €
SE	1 010 567		326 413 141,00 €	35 369 845 €
SI	92 699		29 941 777,00 €	3 244 465 €
SK	187 564		60 583 172,00 €	6 564 740 €
UK	1 946 688		628 780 224,00 €	68 134 080 €
EU-27	34.895.924		10 581 651 836,00 €	1 214 646 294 €

²⁶¹ COM (2008) 109 p.8.

²⁶² PWC 2010, p.115.

Annex 2

Possibilities for fraud



1. A sells goods to B.
2. B pays the price based on zero-rate rules.
3. B sells to C based on the GRCM rules applicable by MS2. B can sell at 95% of the price, as it is regular carousel fraud.
4. C pays to B according to the normal rules, thus price plus the VAT.
5. B sells even to end consumer and collects VAT. Online platform and national promotions would be used to make high turnover as they can sell the goods cheaper than the competition.
6. C sells to D at 100% price based on zero-rate rules as in regular carousel fraud.
7. D sells to back to A and the carousel is completed.
8. When B go missing, the VAT collected från C and from all the end consumers disappear.

Such scheme applied between November and December when the sales to retailers and end consumers are as highest would give much VAT to fraudsters. Disappearing at the beginning of January will give no chance for the tax authorities to react. In this situation, fraudsters do not need to use their businesses as they can acquire small and reliable businesses. It is far easier when using companies for only one purpose and for once than for committing similar fraud on numerous occasions.