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Combating VAT fraud in the European Union

A Study on recent changes within administrative cooperation

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Summary

The VAT system has become an increasingly important source of revenue for the European Member States over the past decade. But due to concerns about sovereignty and inability to come to a consensus on how to treat borders in relation to the VAT, the system is now imperfect, outdated, complicated to follow for those wanting to trade cross border while also being vulnerable to fraud.

This thesis will investigate the attempts made by the European Union member states over recent years to rectify the situation through administrative cooperation to update the system into a modern VAT. Problems of previous solutions and an organization set up to deal with the problems are investigated in order to reach a conclusion about what can be learned from them going forward.

Understanding various types of fraud is central to combatting the problem, so an examination of how fraud can be classified will help in grappling with this problem.

Lastly will be an outlook on what direction the VAT could take going forward, and some insight into what the future may hold.

Sammanfattning

Moms-systemet har blivit en allt viktigare inkomstkälla för medlemsstaterna i EU över det senaste årtiondet. Men på grund av oro över suveränitet och oförmågan att nå consensus över hur gränser ska behandlas i samband med moms har nu systemet blivit utdaterat, komplicerat att följa för de som vill handla över gränserna samtidigt som systemet är öppet för bedrägeri.

Denna uppsats kommer att undersöka försöken som gjorts av medlemsstaterna i EU under senare år för att korrigera situation och uppdatera till ett modernt moms-system. Problem med tidigare lösningar och organisationer som har skapats för att hantera problemen kommer undersökas och vad som kan läras från dess försök för framtiden.

Att förstå olika typer av bedrägeri är centralt för att bekämpa problemet, så en undersökning av hur bedrägeri kan klassificeras hjälper när det kommer till att brottas med detta problem.

Slutligen kommer en prognos om vilken riktning moms-systemet kan ta i framtiden och viss inblick i dess framtida karaktär.

Preface

During the final year of my law degree, I was away from the normal law faculty and instead studying at the faculty of economics. There I met the best group of people that I have ever had the privilege of studying with and I want to acknowledge their substantial assistance on my quest for knowledge and understanding.

First, to my classmates. Never before have I felt so welcomed by a group.

Second, to Martha. An excellent guide through the world of VAT. I am grateful for your acceptance of the role of supervisor for this thesis.

Third, to Oskar. For always bringing the subject matter into focus, with passion and debate like no one else could. The loss of you was too soon.

Finally, to Sofia. A good friend, and the very best study partner I could have asked for. I wish that we could have had more time together. I know you will succeed, wherever you go.

Abbreviations

BEPS	Base erosion profit shifting
B2B	Business to business
CIRCABC	Communication and Information Resource Centre for Administrations, Businesses and Citizens
EU	European Union
GDP	Gross domestic product
IFA	International finance association
MNE	Multi National Enterprise
MTIC	Missing trader intra-community fraud
OECD	Organization for European Co-operation and Development
OLAF	The European Anti-Fraud Office
VAT	Value added tax
VIES	VAT information exchange system

1 Introduction

1.1 Background

The core idea of the VAT is simple and elegant, a consumption tax on goods and services that shadows each step of the transaction chain, with the cost to be ultimately borne by the final consumer.¹ And yet, there are weaknesses within the current system². This thesis will focus on the problems and disruptions to the VAT system due to fraud. A heavy focus will be put on the relatively recent problems concerning intra-community trade and so-called carousel fraud³.

The problem of building a VAT system that is both easy to use for businesses while simultaneously being resistant to fraud will be a key aspect driving this work and at the same time as the core problem of VAT fraud is studied, some estimation of how much money that should be collected as tax is not collected due to various types of fraud. This is known as the VAT gap⁴ and there is dispute around which figure is more likely to be accurate.⁵

The practical problems that do appear around fraud, currently prevents the inter-union VAT system from being less complicated, creating instead a vast set of complicated rules that have to be updated, resulting in a multitude of versions, with major still flaws remaining.⁶ Thus, there are a multitude of topics of VAT that deserve further study, explanation and improvements. While there are many rules, must they be quite as costly to follow for traders? Or is the very nature of VAT something that necessitates hundreds of articles to govern?⁷

To look for solutions, the first step should be to identify the problem and what caused it to emerge. Since the VAT is structured on an EU level, understanding it is closely connected to the administrative cooperation between the member states. The VAT can only be as successful as their cooperation and learning from the mistakes of the past can provide valuable insights into the future.

The counter-measures deployed against fraud are a major source of interest and whether some types of fraud are being especially targeted, while others are lesser priorities. Are all frauds reduced by current and coming new control measures or are there types of frauds that will prove resistant to the currently suggested plans?

¹*Terra, Kajus*, chapter 7, the legal character of the VAT

² VAT Current Issues of Interest Workshop, European Parliament, 2008, page 8

³ IFA Cahiers 2013 - Volume 98B. Exchange of information and cross-border cooperation between tax authorities, page 28

⁴ Study to Quantify and Analyse the VAT Gap in the EU Member States, 2015, page 10

⁵ See: Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final Report and the different numbers used in Study to Quantify and Analyse the VAT Gap in the EU Member States, 2015 for the same time periods

⁶ For example, Directive 86/560/EEC is known as the thirteenth directive on VAT, and that was as early as 1986.

⁷ The current VAT Directive, 2006/112/EC, contains 414 articles, annexes and there are more directives such as 2009/132/EC that exists just to define terms in the original directive.

1.2 Aim

The goal with this paper is to get a better grasp at two concepts: VAT fraud and the administrative cooperation within the EU to stop fraud in general. There has been less written about both these concepts than one would expect. No case law deals with administrative cooperation in the sense it is meant in this context, and literature also tends to focus on areas of conflict between the Member States. Instead, this area is slowly guided by what functions in practice, and that which does not. Another factor that drives the development of administrative cooperation is whether the Member States have the will to cooperate.

The thesis intends to investigate these concepts and answer these connected questions:

- What types of VAT fraud exist and how do they arise?
- What steps has the EU taken regarding the administrative cooperation to combat VAT fraud?
- Are these steps sufficient?
- How extensive is the problem of VAT fraud?

The nature of the EU is fascinating and unique in its structure and as such administrative cooperation remains a hard topic to understand. It is for instance hard to pinpoint why a certain change took so long to implement or what was the driving force behind another change.

As for fraud, there seems to be trends about what authors write about. Today, most literature and articles are focused on carousel fraud, but 30 years ago, this was not the case at all. The coming segment about fraud classification aims to show the way people considered fraud just a few decades ago, and what they did not consider problems, that in some cases did end up as problems. To learn from past mistakes to try to anticipate the form the frauds of tomorrow will take, or at least be prepared that they may take forms that we did not expect.

1.3 Method and Materials

The disposition of the paper is such that a division has been made into four different areas.

First will be a short introduction to how the VAT functions. To do this, articles, examples and some highlighting of where the problem of fraud enters the picture will be used. Much of what the EU institutions such as the Commission, the Council and the Parliament publish are useful for seeing what plans are being made, where the problems are and whether their view corresponds with what other sources have to say on this topic.

The middle part contains details of how some types of fraud works, how types are classified and special cases where fraud has been especially harmful.

The later parts of the thesis will analyse how the Member States of the EU have acted against this problem, to find flaws and strengths in their approach. Eurofisc will take centre stage and the changing details of how this organization operates will be scrutinized. This section will go deep in Eurofisc and will analyse the current rules as well as coming ones and their impact, what problems may lie behind the changes and so forth. This segment will primarily rely on the regulation texts alone and will thus contain the least amount of footnote and reference density in the entire paper.

The final part will contain some analysis, outlook on the future of VAT, conclusion and discussion about all of the above.

1.4 Limitation of topics

Due to the complex nature of the VAT, when one studies one area, there are often interesting aspects that one encounters along the way. Many of these areas and questions could have, and indeed do have hundreds of pages written about them. Alas, thesis space is limited and several topics that intersect with VAT reform, fraud, custom procedures, the functioning of organizations, questions of fundamental freedoms and access to information cannot be delved further into.

One of the more interesting areas encountered concern the measures taken by the United Kingdom against VAT fraud. They seem fairly effective, but unfortunately a recent paper on this topic has been written. As such the decision to stay away from that topic altogether. If future VAT fraud researchers read this, do consider that topic. Much may be learned from it.

The legal consequences of VAT fraud have been subject to much debate and discussion.⁸ Some of the finer details have had to be resolved by the ECJ. However, these results fall outside of the primary areas of the thesis which is a study about the functioning and solution to the fraud and as such, there will not be an abundance of case law, either domestic or on ECJ level in this paper.

⁸ For example: C-439/04 – Kittel, for level of knowledge of criminal liability. C-131/13 Italmoda, for right of deduction in terms of fraud and C-80/11 Mahagében, for level of knowledge on criminal wrongdoing to be considered part of the carousel fraud.

2 VAT

In order to help introduce the reader to what the VAT within the EU is, this section will briefly explain the main concepts that concern this general tax on consumption. Various countries will have their own domestic laws that implement the VAT, but each of those laws are built around criteria that is decided on a Union level. The section is written with the intent that even those with no prior knowledge of the VAT can get a good understanding and use it to comprehend the more complex problems that will be introduced later.

2.1 The basic functioning of VAT

The process of determining how much, if any VAT a transaction is subject to is regulated in the VAT directive of the EU.⁹ The system is built up around several criteria that each influence the outcome.

2.2 VAT Criteria 1: Goods and Services¹⁰

This type of tax is only levied on goods and services. This may seem a trivial thing to say as realistically all commerce falls into goods or services. But keep that distinction in mind. Furthermore, there are many exceptions¹¹ that outright exclude the VAT mechanic of payment and deduction.

2.3 VAT Criteria 2: Territoriality

Since this is EU legislation, it concerns transactions within the union. There are, however, certain areas¹², such as the British Channel Islands¹² and the Greek religious centre of mount Athos where no VAT will be charged, and no deductions are applicable.

2.4 VAT Criteria 3: Taxable person¹³

In order for VAT to be levied and deductions to apply in the chain of transactions, the person involved must both carry out economic activity and do so independently. The exact nature of these terms could be the subject of an entire thesis, but to put it shortly, VAT generally applies to most business activity.¹⁴

2.5 VAT Criteria 4: Type of taxable transaction¹⁵

This is where the root of the problem of VAT fraud, that this thesis is centred around emerges. As mentioned above, VAT applies to transactions of goods and services. But those transactions are further divided into four different types. They are:

⁹Council Directive 2006/112/EC, on the common system of value added tax, article 168

¹⁰ VAT Directive, article 1

¹¹ VAT Directive, article 131-166

¹² VAT Directive, article 6

¹³ VAT Directive, article 9-13

¹⁴ European Commission, Taxable persons under EU VAT rules

¹⁵ VAT Directive, article 14-30

- Supply of (domestic) goods.
- Intra-community acquisition of goods.
- Supply of services (both domestic and intra-community)
- Importation of goods.

Goods are thus separated into three different categories while services can be wholly encompassed within one. When goods move across union borders, and continues the chain of transaction inside one country, a currently unsolved possibility for fraud emerges.

2.6 VAT Criteria 5: Place of taxable transaction¹⁶

This determines where, I.E what country gets to charge VAT on the transaction. The concept of where this should be done has been discussed extensively, with an origin-based system, I.E a system where the starting point of the goods is key, or a destination-based system¹⁷, where the final arrival and consumption of the goods determines where VAT is due to be levied. The current VAT system contains both origin and destination-based rules. For instance, a tourist from Sweden, shopping for chocolate in Amsterdam will pay VAT in the Netherlands, and not in Sweden, even if the final consumption was intended to take place in Sweden.¹⁸ That is a supply of goods, without transportation and it results in origin-based taxation.

A different VAT scheme emerges if our chocolate-starved tourist is in fact the owner of a Swedish chocolate store. After sampling the one chocolate bar (and paying Dutch VAT), she decides to enter into enduring business relations with the Dutch store, with the intent that large quantities of sugar-filled goods are to be transported from the Netherlands, to Sweden. In this situation, we are now dealing with a different type of supply of goods, the previously mentioned “intra-community supply of goods.” In this case, taxation rights will go to Sweden instead due to the overriding destination-based system.¹⁹

It should be noted that in some cases, where one would expect origin, it is instead destination that is applicable. For instance, a private person that buys a car in an EU country will result in VAT in the country of registration²⁰, I.E destination based rather than origin and focus on final consumption rather than the initial consumption of driving out of the country of purchase²¹. This example illustrates the complexity and need to carefully study the entire VAT system before making a definite statement about where, when and how much VAT is due.

¹⁶ VAT Directive, article 31-61

¹⁷ OECD, International VAT/GST guidelines on neutrality, 2011

¹⁸ VAT Directive, Article 31

¹⁹ VAT Directive, Article 40

²⁰ VAT within the European Union, Ministry of Finance, The Netherlands

²¹ FAQs - VAT when buying or selling a car, European Commission

2.7 VAT Criteria 6: When the VAT is to be paid²²

As a general rule, this is when the goods change hands.

2.8 VAT Criteria 7: How much VAT is to be paid²³

In order to calculate how much deduction is to be made later, it is vital to know the real price at which the transaction was made. The general rule is that the price paid for the goods or services is the real one, but in some cases, like transactions between family members, there are risks of under-price setting to avoid paying taxes through tax evasion or avoidance.²⁴ This is similar to the methods used within the field of transfer price setting, where the internal transactions of MNE:s also threaten to be set too low and result in reduced tax revenue.

Through various methods, a real price (called open market value) is determined and properly taxed, rather than the one proposed by the two entities that are closely connected. The field of international transfer pricing is outside of this thesis but in the fight against fraud, there is some overlap, because the various methods used there to avoid fraud are closely connected to the BEPS project²⁵ and the VAT.

This naturally leads to a question. What methods are allowed to be used to reach the true open market value, and are some methods used general within transfer pricing not allowed within the field of VAT? Unfortunately, that question falls outside the scope of this paper.

2.9 VAT Criteria 8: Rates of VAT²⁶

The percentage of the value of the transaction that is taxed. Each member state is free to set their own rates, which has resulted in Sweden having the highest standard rate at 25% and Luxemburg with the lowest rate at 17%.²⁷ There is also a possibility of applying a lower rate under some situations.²⁸

2.10 VAT Criteria 9: Exemptions²⁹

As mentioned above, some transactions are not subject to VAT. Examples of this are supply of human milk, public hospital services and the service of moving sick or injured people in special vehicles. It can be said that a theme of “common good” runs through this type of exemptions. There are also other types of exemptions that are not so closely linked to a “common good” such as leasing of immovable property, gambling and insurance transactions.

²² VAT Directive, article 62-71

²³ VAT Directive, article 72-92

²⁴ VAT Directive, article 80

²⁵ *Andersson*, page 651

²⁶ VAT Directive, article 93-130

²⁷ VAT rates applied in the Member States of the European Union, European Commission, 2018

²⁸ VAT Directive, article 98

²⁹ VAT Directive, article 131-166

With the exemption comes a loss of right of deduction if the goods or service is passed on. This can be economically preferable in some cases.

2.11 VAT Criteria 10: The deduction mechanic³⁰

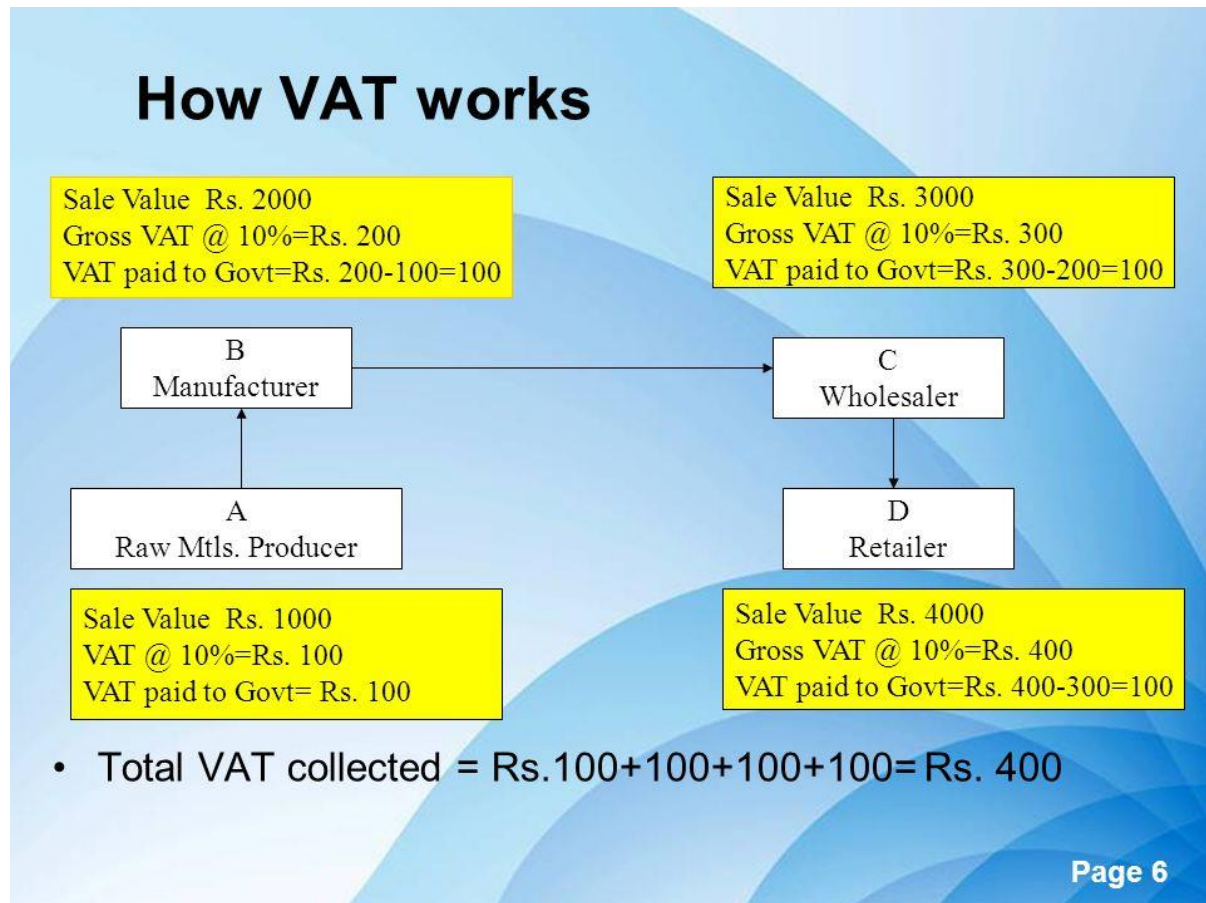
VAT may be daunting to get into, but the system is quite easy to understand, at least on a basic level. While the VAT is charged on each step of the transactions path, none of the cost is not meant to be paid by the businesses themselves, but rather the final consumer.

There are many special rules beyond these ten criteria, but they are the most important when it comes to understanding how VAT is calculated. With these basics out of the way, it is time to move on to a more practical example.

³⁰ VAT Directive, article 167-192

2.12 An illustration and explanation of the VAT chain

For a demonstration of how the VAT Chain for goods work, consider this picture:



Source: Induced/VAT.info

-A raw material producer, for instance a farmer harvests his crop.

-Transaction 1. This crop is sold to a manufacturer for 1000 Euro. The VAT rate is 10% so the state charges 100 Euro in VAT for the transaction.

-Transaction 2. The manufacturer works the product and sells the product to a wholesaler. The value of the goods has increased to 2000 Euro due to the work done to it. The VAT is still 10% so the wholesaler must pay 200 Euro to the state. Meanwhile the manufacturer gets to deduct the 100 Euro he paid in the previous transaction. The final effect for him is that no VAT is ultimately paid, but before he sold it on, he had to bear the VAT himself. In a sense, he was considered the final consumer, before moving the product.

-Transaction 3. The process repeats again, with the value of the goods going up and the wholesaler getting to deduct all the VAT he paid.

-Transaction 4. Finally, the retailer sells to a customer. This customer has no right to deduction and bears the whole cost of VAT, which is 400 on goods worth 4000 Euro. The retailer deducts 300 which is what he had to pay prior. This system keeps the business more

honest in that they have to rely on deductions. Additionally, the VAT does not actually increase the price of the goods by itself. It remained 10% along the way. Older systems of tax could cause price increases as the business chain got longer. That is one of the advantages and reasons the VAT has become accepted.³¹

³¹ *Terra, Kajus*, page 84

3 Types of VAT fraud

In this section we delve into the centre of where the VAT has gone wrong. Fraud comes in many forms and trying to sort these various types into some sort of ordered categorization is something that several authors have tried to do, without a consensus on how such a thing is best done. One of the most notorious types of fraud, the carousel will be explored in depth. The intent is to give the reader a solid understanding of carousel fraud and the reasons why it is possible and so harmful as well as inviting to thought about why classifying various types of frauds is not as easy as one might initially expect.

3.1 Missing trader and carousel VAT fraud

The VAT system was first introduced on an EU level on the 11th of April 1967³² and has grown to currently involve the collection of about 40% of the GDP of the EU.³³ With so much revenue involved, the VAT is probed for weaknesses by those who harbor ill intent and seek to unlawfully enrich themselves.

The current VAT system used in the EU is effective at raising revenue³⁴ and has proven to be a good choice for the member states of raising revenue in that VAT is part of each chain of business transactions without adding to the price through deductions. And yet, a major problem presents itself when the VAT system goes from a domestic to an international level within the union.

As it stands, the VAT is vulnerable to several types of fraud³⁵ and is currently insufficiently designed to counter this problem.

Fraud comes in many forms but is defined as “deliberate deception to secure unfair or unlawful gain”³⁶. The most notorious type of fraud is called missing trader fraud (Henceforth MTIC) and this type of fraud can be extended and repeated across borders and is then called carousel fraud. This type of fraud is potent and there is a report of a Scottish businessman using this method to earn 8 million euro in as short a time span as 4 months.³⁷

What makes carousel fraud possible is the current system of zero-rated intra-EU trade transactions and how payment and deductions work in the VAT chain in that situation. The system is built around the idea that the consumer bears the final cost of the VAT but that the tax is leveraged on each part of production, who in turn get to deduct the cost getting back what they paid in VAT, all the way to the retail stage.³⁸ Normally this works well, but the way the current system treats borders complicate the system and leaves it wide open for abuse.

³² Second Council Directive 67/228/EEC of 11 April 1967

³³ Tax revenue statistics, Eurostat, 2017

³⁴ *Crossen, Sijbren*, page 2-16

³⁵ *Keen, Smith*, page 1

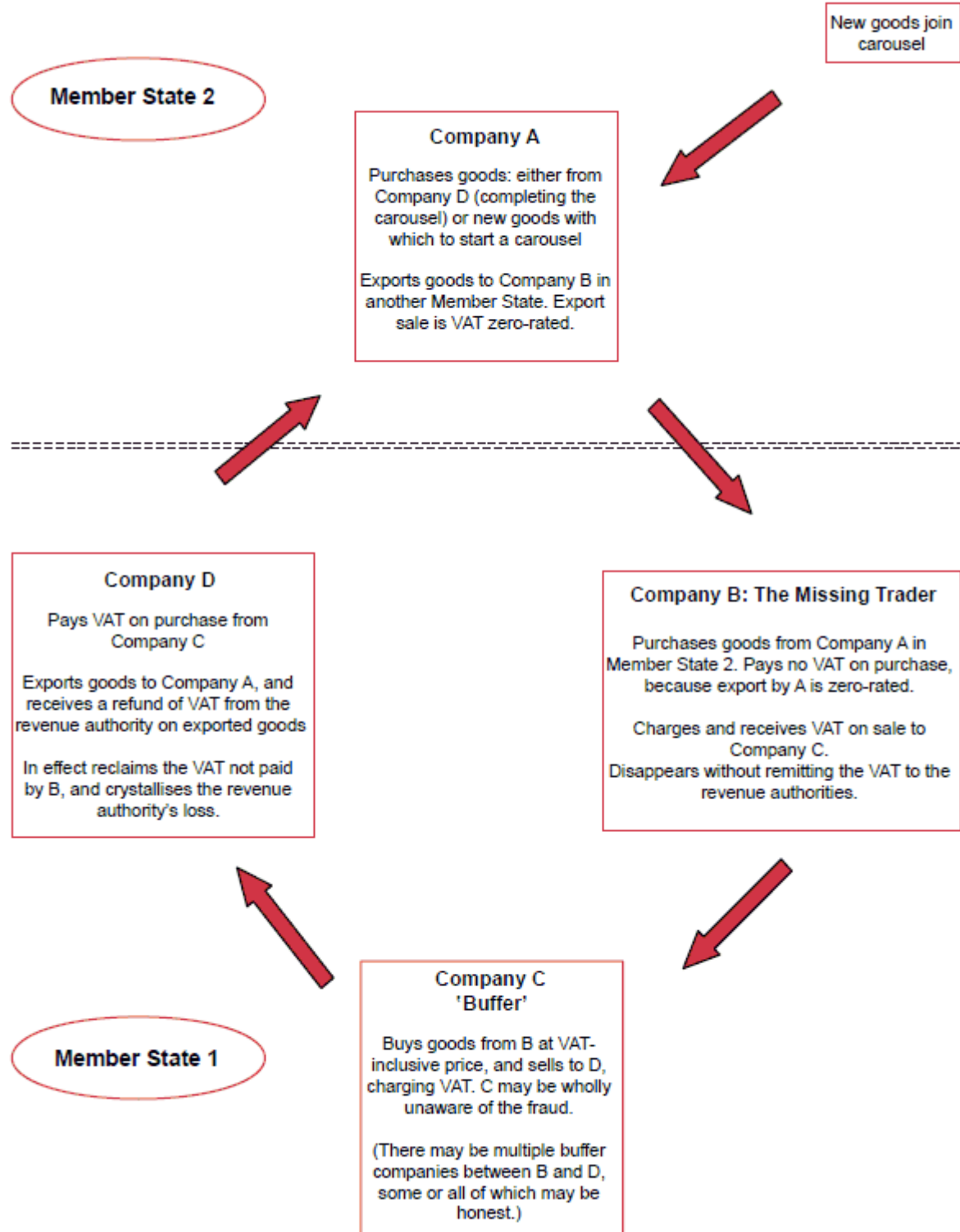
³⁶ Legal Dictionary: fraud. Law.com.

³⁷ *Keen, Smith*, page 3

³⁸ VAT Directive, article 138

This traces back to the implementation of what was intended to be transitional VAT rules in 1998. It is now 2018 and those same rules are still in effect. The rules were made in a period of discord and difficulty to reach a political agreement, were not as well put together as they could have been.

What follows is an image that illustrates how carousel fraud works.



Source: UK Parliament: Stopping the carousel: missing trader fraud in the EU, 2007

How this works is that a company, A trades with another company, B in another member state. This transaction is zero rated, no VAT is charged. Then company B sells the goods to company C in its own member state. This second transaction is subject to VAT as it is not intra-community trade. But instead of sending the VAT that company B receives from C in the transaction to the tax authorities, company B instead disappears and becomes a missing trader which gives this type of fraud its name.

If company C then sells the goods back to A with a tax credit and repeats this process on the other side of the border, the goods have gone full circle and become a so-called carousel repeatable many times, with the tax authorities cheated out of the VAT due to them. The key reason why this works is the special handling of borders, whereby B and C are left able to avoid paying to the tax authorities from their transaction while C can even ask for repayment of VAT that was paid to B and B kept rather than sending on to the tax authorities when C sells the goods back to A. In order to make this harder to detect, the fraudsters use so called “buffers”, legitimate businesses, often between B and C that are unaware or simply ignores the suspicious flow of the goods.

This flaw in the system exists due to a lack of control and verification. Therefore, several measures have been proposed to close the loop on this type of abuse. It should also be noted that prior to 1993, the system was more controlled and less vulnerable to fraud. Missing trader and carousel fraud are thus direct consequences of the implementation of the transitional VAT rules and the failure of reforming them. Action is needed to make sure the tax collection of the EU can function properly.

Another problem to consider is changes in technology and new opportunity for fraud. Due to inability to think ahead on the part of the Member States, the fraudsters can take advantage. For example, before 2009, carbon emission rights were not considered a risk for VAT fraud.³⁹ And yet, upon investigating, Dutch authorities found the same type of carousel in this area. For how long this scheme had operated and how much money the fraudsters had made is not known but the problem was found to be so widespread that Denmark, Spain, Belgium and Norway all acted⁴⁰. This shows that the types of fraud can spread fast and remains an international problem.

³⁹ *Wolf*, page 6

⁴⁰ A. Seager, “Copenhagen summit: Denmark rushes in laws to stop carbon trading scam”. Climate change summit host embarrassed as criminals make most of lax laws to pocket VAT on emissions trading, guardian.co.uk, Thursday 3 December 2009 19.52 GMT

3.2 Other types of VAT fraud

Carousel fraud is the type that the Commission targets the most. But in the 2007 report⁴¹, two other types are briefly mentioned, but are not given the same importance and focus. Those types are:

Type A: *“Invalid deductions of input tax – false input tax invoices, or goods/services obtained for non-business use.”*

Type B: *“Non-payment of output tax, including sales at lower than normal values.”*

Type A could be seen as an “accounting” fraud while type B is more directed at a specific fraudulent transaction that actually takes place between buyer and seller.

Type A is characterized by declaring the value of the goods to be lower than it is or by filing a higher VAT return claim than entitled to, or even going so far as not reporting the transaction altogether.

As for causation and what drives the occurrence of fraud, the Commission sees two reasons. They are the black economy and the unclear and unchecked circumstances around insolvencies.⁴² The black economy is rather straight forward. Those with no interest in following the law in order to save money, will commit fraud and not pay VAT. Such fraud would fall into type B fraud. Due to the large size of “shadow economics”, estimated as between as high as 30% in Bulgaria and as low as 7.8 % in Austria in 2016⁴³, there is no simple way to combat this problem. Consider this rather alarmingly high difference between two Member States of the EU. Perhaps this level of and perceived urgency or lack thereof is a contributing factor to why administrative cooperation is difficult within the EU.

Insolvencies are notorious for their ability to have materials and goods simply disappear. When a company goes bankrupt and enters the final state of liquidation, it stands to reason that security will be reduced and normal protocols on who will have access to the location can be disrupted. There will also be those who have an interest in obtaining as much as possible for themselves, to secure a stronger financial leg to stand on in relation to one chapter of life ending and a new beginning. In short, the old proverb: “The opportunity makes the thief” holds true. Perhaps this predictably ripe opportunity for fraud and theft could be countered by requiring a minimum of security measures around storage areas during insolvencies? This would also address those occasions when the entire insolvency was planned for the purpose of fraud by the owner/owners of the business.

Both type A and B fraud have a low chance of being detected due the possibility of fabricating documents while the tax authorities have no easy access to control mechanisms, especially cross-border.

⁴¹ Combating VAT fraud in the EU, the way forward, 2007, page 10

⁴² Commission Working Paper TAXUD/1804/06

⁴³ Estimating the Size of the Shadow Economies of Highly developed Countries: Selected New Results, 2016, page 48

3.3 How to legally classify fraud

It is worth to note that there is no official designation of what exactly each fraud entails. When researching VAT fraud, it is fairly common to encounter special terms such as: structural funds fraud, suppression fraud, bogus fraud, insolvency fraud, and of course missing trader and carousel fraud. Some of these terms will only appear in a single paper, with little explanation while others are synonyms for other types of fraud. One example of this is so-called “consumer fraud”. One site⁴⁴ defines this as:

“Individuals targeted through cons, bogus telemarketing, email, Ponzi schemes, phishing, ID theft and other schemes, are all victims of consumer fraud.”

Note the “bogus” part in there. Does this mean that all cases of “consumer fraud” are also “bogus fraud”? Is “bogus fraud” just a synonym for “consumer fraud” or is bogus a broader term? If so, how broad? And couldn’t one say that all attempts at fraud are all “bogus”?

Other types of fraud classifications are used, rather than the previously mentioned type A and B fraud distinction. One paper⁴⁵ that like the above commission report with the type A and B fraud, is also from 2007, rather goes a different way, with nine different types of general fraud, of which three are specific to VAT systems.

The six general types of fraud used by Keen and Smith are:

-Under reported sales. As it sounds, this is the failure to report some, or all sales to the proper authorities. This would classify as a type B fraud under the other system. This could never be type A due to that type requiring false additions, rather it resonates with the hiding real transactions, which characterizes type B.

-Failure to register. A clear type B fraud. Unlike the under reported type, here the entire transaction is kept hidden.

-Misclassification of commodities. The act of pretending that which is being traded is something else. This has clear tax advantages due to different rates of tax, or even exemptions on some goods. Interestingly, this could conceivably be both type A and B fraud. Consider a scenario where misclassification is used to get a higher deduction rate than in proper. Some fake documents later and type A fraud is achieved due to getting back more than what was actually paid.

Declaring the goods to be a type of exempt goods would be an easy way to type B fraud. No tax is paid.

-Omission of self-deliveries. This is when employees or management consume goods or services produced without paying taxes for it. Type B fraud.

⁴⁴ 5 Types of Fraud That Can Shake Your Organization To Its Core, Beenegarter, 2016

⁴⁵ Keen, Smith, page 8

-Tax collected but not remitted. Here the system is being abused by keeping the collected tax away from tax authorities. This is achieved primarily either via accounting fraud, a planned bankruptcy or by the party supposed to pass on the tax simply disappearing. So missing trader and carousel fraud fall into this category.

This raises the question: Does carousel fraud fall into type A or B fraud?

The answer seems to be that it is both A and B. The largest part of why the fraud works, I.E. the loss of tax revenue due by the missing trader is definitely type B. But if the entire carousel is considered and the loop is intended to continue by several parties, then some elements of type A are also present. Go back to the image on page 16. Company D is complicit in the fraud and reclaims the VAT not paid by the missing trader. That could be seen as a planned type A fraud and thus carousel fraud has elements of both type A and B fraud.

-Imported goods not brought into tax. Also known as “acquisition fraud”, refers to the B type fraud where tax is unlawfully avoided on import.

As for the three frauds specific to VAT, they are:

-False claims for credit or refund. Due to the way the VAT system works, with flow of money from business to the tax authorities and back through the process of deduction. If one forges a VAT invoice, it is possible to get money unlawfully. Indeed, already in the 80’s, the Netherlands suffered through this type of fraud and as much as 44% of all total reported VAT fraud came in this form.⁴⁶ This is class A fraud.

-Credit claimed for VAT on purchases that are not creditable. When classifying this, it would seem to also fall under the previously mentioned type of misclassification of commodities. Both rely on an exemption from tax on certain types of goods. Keen and Smith do not justify why this is its own type of fraud⁴⁷. Yes, different rules are used for when this fraud is done for general tax and VAT, but the overall functioning and mechanic behind the fraud seems identical.

-Bogus traders. Using fake invoices in large quantities, this type of trader uses type A fraud to try to get money in return that is not earned. This seems to be a variation of the false claim fraud, but with the distinction of the business being set up without any interest for doing legitimate business. Only the fraud is the goal in this type A fraud. In that sense, it would seem that classifying this as its own type of fraud is dubious and it would fit as just another false claim action.

To summarize the Keen and Smith classification: Some superfluous categories do exist, with all three types of VAT fraud mentioned seemingly being a variation of the same subset of fraud. Interestingly, their paper goes on to talk about carousel fraud⁴⁸, but that special problem is notably absent within the above categories of specific VAT fraud.

⁴⁶ *Tait*, page 307

⁴⁷ *Keen, Smith*, page 10

⁴⁸ *Keen, Smith*, page 13

Another system of fraud categorization was made by Tait in the 80's, here sixteen different types of just VAT fraud are mentioned.⁴⁹ Contrast that with the three types by Keen and Smith in 2007. Has the view on fraud classification changed in the last decade?

A more recent view was made by Dirk in 2017.⁵⁰ Unsurprisingly, a similar, yet different division of five types of frauds is made here. In short, the types are:

-Inflated refunds claims. As the name suggests, this is a type A fraud, using false invoices. It is the same category as Keen and Smith's false claim for credit or refund, but with a different name.

-Underreported sales. This seems to be a near identical description similar to type B fraud, but Dirk seems to imply that the goal here is to claim more refund than is deserved. This seems contradictory as the goal with normal type B fraud is to avoid paying tax altogether, not trying to claim that one is not entitled to which falls more into type A.

-Fictitious traders. Seems fully identical to Bogus traders. It speaks volumes on the lack of uniform language that different terms are used for the same phenomenon.

-Domestic sales disguised as exports. A new type of fraud where goods are being sold domestically while being claimed to have been exported and thus avoid paying VAT. Once again, fabricated invoices are used to achieve the fraud. This would be a subcategory of failure to register and false claims.

-MTIC fraud. The short version and step one of the carousel fraud is classified as its own distinct type of fraud by Dirk.

It is interesting to note that Dirk has moved on to making carousel fraud into its own subtype of fraud. As such, it seems the various authors are labelling things based on level and functionality, as well as giving specific popular types of frauds their own category without distinguishing between the levels. Each new fraud scheme conceived and slightly altered would then classify as its own new type. That is why more generic types such as type A and B seem to be a better type to start, and then working downwards from the functionality, to the specific. A major problem here seems to be a lack of interest in creating an organized table of various fraud types, and at first glance that may be justified, fraud is fraud after all and on catching law-breakers and convicting them, it may be tempting to simply end the process there. But a more organized international system with uniform term usages could aid in the global fight against fraud and may in fact be something that should be created.

As a final note on the disagreement of fraud classification, in 2004 the UK parliament published a paper that divided all types of fraud into only two groups.⁵¹ They call the two types income or receipt fraud and expenditure fraud. No further explanation is given in the publication as to what these terms mean. These types do not seem to correlate to type A and B fraud, and due to the shifting landscape of different meanings, trying to figure out what "expenditure fraud" is referring to at this time and in this context is an enterprise prone to miscommunication.

⁴⁹ Tait, page 128

⁵⁰ Dirk, page 1

⁵¹ House of Lords - European Union: Select Committee on European Union Twenty-Fourth Report

The above show the problems when it comes to talking about various types of fraud. Classification and definitions are difficult, with the author often not recognizing these problems. And this is probably the reason why most documents encountered so far on MTIC and carousel fraud are so targeted at that type of fraud while only giving a brief mention of other types. There simply are so many types of fraud, with different names, that saying something about them all is simply not practical. Today the goal remains to thwart all types of fraud, but carousel fraud is special due to the level of harm it causes.

3.4 Are the proposed measures on administrative cooperation sufficient?

In recent years, the EU project has stated that its current goals especially to be the promotion of a more united, stronger and democratic union.⁵² In the area of taxation and VAT, this goal is planned to be reached by making the system fairer within a single VAT area for the entirety of the EU. To this end, in June of 2018, the EU council agreed to jointly fight fraud more effectively⁵³. The primary target of this plan was to combat the type of prevalent cross-border missing trader fraud that is estimated to be a large part of the VAT gap.⁵⁴

To achieve this, several different types of measures were enacted⁵⁵. The first action was to improve the exchange and analysis of information between the member states tax administrations and law enforcements.

The second action was to improve Eurofisc, which is a network for tax officials to exchange information on fraud.

The third action was to create new instruments that the member states could use jointly to combat fraud. Such instruments include the possibility for two or more-member states to jointly carry out administrative enquiries.

This proposal is merely planned as a first step towards stopping the fraud, and more measures for the mid and long term are expected.

Designing an effective VAT system has long been a goal of the EU, but there have been significant problems in creating such a system. What characteristics should a good VAT system have?

-It should be easy to use for traders and at the same time effective at collecting the VAT. If the system is overly complex, it will serve as a hinderance for international trade. And without effective collection measures, it will be costlier to maintain for the member states who have the burden of collecting VAT.

⁵² Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, Council of the EU, 2018

⁵³ VAT fraud: Agreement on measures to boost administrative cooperation, Council of the EU, 2018

⁵⁴ Study to quantify and analyse the VAT Gap in the EU Member States, 2015 European Commission report, page 57

⁵⁵ VAT: European Commission welcomes adoption of new tools to combat fraud in the EU, 2018

-It should be capable of preventing, or at least greatly reducing fraud. The current VAT regime has extensive problems with fraud which both reduces tax revenue for the member states and distorts competition as the fraudsters do not pay VAT.

-It should be modern and be capable of adapting to new technologies and avenues of commerce. While the future is hard to predict, the system must be able to accommodate new versions of old goods or risk great confusion on both the part of enterprises, customers and member states. For instance, the current system has previously encountered a major problem when it comes to treating and classifying e-books.⁵⁶

-It should not vary to a high degree in its implementation between the member states. Fear of complicated rules in other states keep many enterprises from engaging in cross border trade. On the other side is the interests of the member states, who have diverse tax systems and societies which demand certain exceptions within their tax regimes. These two interests have clashed many times in court case law over what variation is acceptable, which is a core problem that goes back to the root problem of how intimate the EU cooperation should be.

With these characteristics in mind, we can study the proposed VAT changes and whether they will achieve a system more in line with the above statements.

The European Council starts off by affirming that the following proposal is only the first step in the work towards a definitive VAT system for intra-Union trade.⁵⁷ As such, the details of the definitive system are far from laid down. The exact nature of this imagined definitive system shall be discussed later.

Next comes an admission that it may be impossible, or at the very least impractical for only one-member state to tackle the situation when the fraudster is established in another member state. Without proper cooperation, this will lead to the same investigation being done twice or apathy due to the other state caring relatively little about a “foreign” crime. The council stresses that the member state of establishment must act against the fraud for effective control of the fraud.

⁵⁶ See cases C-479/13 Commission v France, C-390/15 RPO, C-219/13 K Oy

⁵⁷ Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, page 1

4 Eurofisc

When it comes to understanding the progress made against various types of frauds, it is important to investigate the instruments that are being deployed and how they function. Eurofisc is one such tool, and while there are others, this one has a special place in the administrative cooperation. The intent is for the reader to see how the cooperation in the EU against fraud has developed from 2010 to 2018 and to ponder on what the ideal structure of an international anti-fraud organization should be.

4.1 The creation of Eurofisc

A stepping stone towards international exchange of information was the IFA congress in 1990⁵⁸ and the 2008 global economic crisis. Secrecy, fraud and legal loopholes are on the agenda while also working to bring more information into the hands of tax authorities. In a meeting in 2008, the G20 even went so far as to say: “We agree [...] to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.”⁵⁹

On the EU level, this movement of anti-fraud measures and information sharing has, among other things, manifested as Eurofisc, an organization to promote administrative tax cooperation between the member states. Established in 2010⁶⁰, not much has been written about the work undertaken by Eurofisc in the eight years since its inception. What did this organization get right and what areas did it leave unaddressed?

Going back to 2010 and the administrative cooperation regulation⁶¹ that led to the formation of Eurofisc, reveals the problems stemming from fraud already at that time. The goals at that time were more aimed at tax avoidance and evasion in general, rather than one specific type of fraud, MTIC as the current climate is today in 2018. In the preamble, exchange of information was held up as a major goal, then as now, which speaks of the insufficient progress within that area since 2010.

Concern was raised about the member states receiving an undue burden because of the cooperation. Could such worries have resulted in less efficiency than needed to solve the problem?

Going deeper into the preamble, it becomes quite clear that the general problems faced in 2010 were the same as in 2018. Other than MTIC, has any other problems surfaced, or is this just a matter of deciding how we should carry out this cooperation and information sharing?

⁵⁸ FA Cahiers 2013 - Volume 98B. Exchange of information and cross-border cooperation between tax authorities - General Report, page 19

⁵⁹ PROMOTING TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES, OECD, A background Information brief, 2010, page 2

⁶⁰ Taxation: Anti-fraud network EUROFISC starts operational work, European Commission, 2011

⁶¹ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax

One thing brought up in 2010 was the need for tax administrators to move, even physically be able to be in another member state and simultaneously carrying out controls in both states. Since we have already seen that the 2018 proposal contains suggestions for instruments like joint inquiries, it's fair to assess that this area of cooperation did not achieve the levels planned in 2010. Why is that? The answer to that question is of critical importance to stop the MTIC fraud.

While more work remains to be done on the subject of VAT identification numbers, the way the 2010 proposal and 2018 proposal discuss the subject, it's clear that only more minor changes are needed. Here the administrative cooperation seems to work smoother, which makes sense due to the less sensitive nature of harmonizing numbers rather than intimately working with another member states when it comes to investigations. Is the member states concern on matters of sovereignty and difference between them the reason why it takes years to cooperate?

Point 23 in the preamble of the regulation points out an interesting obstacle towards cooperation: the need for all member states to communicate electronically. This implies a level of technological difference within some of the member states, that even in 2010 made communication and cooperation through electronic means less accessible.

Reading through the proposal, the impression of the intent of the document changes from what is more strongly expressed in the preamble. Article 29 specifically relates to what seems to be a more hands-off approach. It reads as follows:

“Member States may agree to conduct simultaneous controls whenever they consider such controls to be more effective than controls carried out by only one Member State.”

While at first glance this seems to be a measure against fraud, it lacks substance. Article 29 does not bind the states to do anything and it does not change anything by itself. No doubt several states already cooperated beforehand. So, this isn't a good step towards obligating the member states to cooperate. But perhaps some Member States used this opportunity to share data by relaxing domestic rules regarding accessibility classified information. Article 29 could be considered as a type of “letter of intent” that some, or perhaps several states acted upon. But the level of quantity of information sharing at certain times falls outside of the topic of this thesis.

Article 30 then goes on to further elaborate on the current system which only has optional cooperation between the member states. Rather than trusting each other and rapidly opening investigations into each suspected case of fraud in all affected member states, now each request for control must be submitted, studied, authorized and can be rejected by the other state without even a through motivation as to why. There is a lack of will to effectively fight fraud.

A more effective version of article 29 would have read something akin to:

“Member states shall conduct simultaneous controls, whenever another member state requests it and the request is reasonable in order to prevent fraud.”

Eurofisc is established in article 33 and onwards to article 37. The goal of this organization is strictly to facilitate the exchange of information, accomplished by sending out warnings and other information to member states. However, participation is explicitly optional, with article 34 giving member states the freedom both to only opt into the system as they want and opt out at the moment of their choosing.

Article 36 also brings up another area in which the member states restrict their cooperation. Those that work within Eurofisc as liaison officials are only responsible to their own member state, rather than to all member states that are affected by the cases they handle. A clear proclamation of Eurofisc being primarily about member states interests, and not primarily about the union.

The strongest commitment of 2010 to cooperation is expressed in article 54. It reads:

“The requested authority in one Member State shall provide a requesting authority in another Member State with the information referred to in Article 1 provided that:

- (a) the number and the nature of the requests for information made by the requesting authority within a specific period do not impose a disproportionate administrative burden on that requested authority;*
- (b) that requesting authority has exhausted the usual sources of information which it could have used in the circumstances to obtain the information requested, without running the risk of jeopardising the achievement of the desired end.”*

While the article goes on to give a few more exceptions for when a member state can refuse to share information, the general rule is clear. EU member states shall share information about fraud with one another. But a group knowing about fraud is not enough. That group must also act together, and the 2010 agreement leaves the parties with no such obligation.

4.2 Eurofisc examined

Eurofisc has been viewed as an important tool to prevent fraud, not just by the member states, but by the OECD⁶². So, in order to assess its initial success, in 2013, Hungarian and Austrian authorities published a joint report on how Eurofisc had been implemented in the member states for the first years of its existence, from 2011 to 2013.⁶³

Eurofisc works in four different areas, with three of them monitoring and exchanging data in different fields by examining certain supplying companies in the market. Those companies that come under scrutiny have their business partners examined, their VAT invoices, statements and VAT registration numbers checked. This data is then shared between the member states to examine if fraud is occurring.

The fourth division of Eurofisc works as an intelligence agency, keeping a close eye on the market and watching for new types of frauds as well as studying the details and execution of currently known frauds such as MTIC fraud. It is up to the member states whether they wish to participate in all, some or none of these four divisions. Even without any contribution, any member state is free to access the full information gathered by Eurofisc.

Eurofisc is not directly funded by the member states but by the Commission. Other than funding the project, the Commission is also responsible for secure communication and does so by providing a special network, CIRCABC.

As such, Eurofisc is an organization mixed between national and union structures. One which allows for the states that don't contribute to get a free ride in access to the information, while also allowing the officials of those nations that contribute to be free of responsibility to other member states for any serious errors they make in their professional duties.

This risks some member states taking a “much to gain, for no work” approach and ends up putting in less work to counter fraud, hoping the other states, especially their closer neighbors will do so instead. I worry that the whole structure is insufficient to fight fraud with all member states on a union level. Eurofisc is also a very small organization with limited reach, at the time of the report, despite Austria cooperating in all four divisions of Eurofisc, simultaneously a total of only five officials from Austria aided in the administrative cooperation.

To put the Austrian numbers into perspective: Germany has contributed six officials but was only working in three of the four fields.⁶⁴ Hungary sent four officials in total, working on all four divisions of Eurofisc.⁶⁵

⁶² Second meeting of the OECD global forum on VAT, Olofsdottir, 2014

⁶³ Joint report of the Austrian Court of Audit Bundesrechnungshof State Audit Office of Hungary, Eurofisc — A multilateral warning system of the Member States for combating VAT fraud, 2013

⁶⁴ Joint report of the Austrian Court of Audit Bundesrechnungshof State Audit Office of Hungary, Eurofisc — A multilateral warning system of the Member States for combating VAT fraud, 2013, page 15

⁶⁵ Ibid, page 16

When it came to deal with suspected fraud, a new problem with Eurofisc revealed itself. During the 2011-2013 period, several companies received hundreds and even thousands of warning signals that related to situations that Eurofisc monitored, indicating possible fraud.

This comes back to the structural problem of Eurofisc. Its role is merely to gather and share data. It has no function by which to force the member states to take prompt action and as a result, one company received 10,807 warnings over three years without being stopped appropriately.⁶⁶

And those warnings had to be processed, both by sender and receiver, creating unnecessary work. The system needs to get better to handle this type of repeat warnings so that one company that gets a few hundred warnings can be properly investigated and not clog up further space after that, with one thousand or more warnings going out to multiple member states on the same company. This type of repeated information dump could risk undermining the credibility of Eurofisc. We shall later investigate the 2018 proposal on Eurofisc to see if this type of improvement is in there.

Eurofisc did facilitate the exchange of data on fraud, but to improve, the system needs feedback from the member states on how useful the information was. Despite this, the feedback received was less than ideal. In one of the four sectors, as low as 67% of sent information resulted in no feedback from receiving member state. In the most responsive sector, 35% of sent information resulted in no feedback. And since the member states are not obligated to send feedback, there is currently no tool to push them to respond more in the future.⁶⁷

While Eurofisc can identify plenty of problems on their own, and over 100,000 instances of useful feedback have reached Eurofisc, there is still room to improve. While I understand that matters of sovereignty are of key importance to the member states, everyone benefits if we establish a harmonized response procedure for information from Eurofisc that is mandatory and must be sent back within a certain time. Even more alarming is the fact this report only concerned three-member states. No other states examined how well Eurofisc was implemented in their states and as such, there was no basis for the Commission to even evaluate how well Eurofisc was functioning.

And while the report did list some internal problems with procedures, meetings and data security, those problems are of less importance than making sure Eurofisc can communicate with and influence the member states to take proper action to prevent VAT fraud. Eurofisc must become a serious and integral organization of the EU, with which the member states interact with in an orderly, structured and mandatory system.

⁶⁶ Ibid, page 19

⁶⁷ Ibid, page 21

4.3 2018 improvements to Eurofisc

The Commission became aware of the shortcomings of Eurofisc and a large part of the 2017 proposal deals with improving the organization. The Council also agreed with these findings. In 2018⁶⁸, steps were taken towards strengthening VAT cooperation which includes Eurofisc.

The measures directed at Eurofisc start with the need for the member states to jointly process and analyze all relevant data that Eurofisc collects.⁶⁹ This might be connected to the previously examined lack of feedback for the data sent and received. And the inability for the member states to take appropriate action when possible fraud is detected.

One area of empowering Eurofisc comes in giving them automated access to vehicle registration data from the member states.⁷⁰ Cars and other vehicles are in particular risk of being used for cross border fraud and domestic fraud⁷¹, so seeing plans for a union wide data base for Eurofisc to use, that the member states have to contribute to is in my opinion a good step forward for the cooperation. The Commission will have oversight powers to ensure that states surrender this information in a complete and timely manner.

In addition to the mandatory vehicle information, further transfer of powers to Eurofisc are discussed. However, sovereignty of the member states remains in full, and no possibility to put pressure on a member state are enacted. What is new is more emphasis on the ability of Eurofisc to obtain further share information with other actors such as Europol and the European Anti-fraud office. This is a new dynamic, that shared information is not graciously given to Europol as a type of loan, it is now a quasi-duty to share and that information fully belongs to the collective of nations and organizations fighting fraud.

What comes next is of special interest. The proposal admits that rights and obligations, previously established in a 2016 regulation⁷² are incompatible with a functional fight against fraud. The affected rights concern the ability for data subjects to obstruct ongoing investigations.

Thus, the conclusion drawn in the agreement is that the following rights must be restricted⁷³:

- The right for transparent information.
- The right to receive personal data.
- The right to erase data.
- The right to object on how personal data is used, such as for profiling.

⁶⁸ VAT fraud: Agreement on measures to boost administrative Cooperation, Council of the EU, 2018

⁶⁹ Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, Council of the EU, 2018

⁷⁰ Ibid, page 9

⁷¹ VAT fraud puts luxury car traders in jail, Accountancy, 2015

⁷² Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data

⁷³ VAT fraud: Agreement on measures to boost administrative Cooperation, Council of the EU, 2018, page 10

The Council points out that these rights should only be restricted so far as necessary, I.E proportionally⁷⁴. That statement does however leave much room to be explored.

How much can the rights concerning access to information be restricted with the justification to fight fraud? That topic goes outside the discussion of this thesis, but such considerations could make for an interesting future thesis.

The motivation for why such restrictions are needed is motivated by the council in the frame of the VAT gap. At this time, they argue, the loss of revenue caused by VAT fraud is so large that this problem can no longer be ignored. Further they state that the information that these restrictions would concern is not sensible and that there will be a prohibition to use it for commercial purposes as well as a previous regulation⁷⁵ that prohibits unlawful access, transfer or abuse.

Of note is a new added article, 4a. This article has roughly the same content as the one I proposed earlier⁷⁶, on the topic of member states being required to participate in a joint action unless there was a good reason not to participate. Article 4a, added in 2018 reads:

“Where the competent authorities of at least two Member States consider that an administrative enquiry into the amounts referred to in the second subparagraph of paragraph 4 is required and submit a common reasoned request containing indications or evidence of risks of VAT evasion or fraud, the requested authority shall not refuse to undertake that enquiry except on the grounds provided for in Article 54”.

This is a major step forward from the optional agreements of 2010 that should respect state sovereignty while also being at least more effective at dealing with the fraud. The new limitations in article 28 2a that prevent one state from overreaching its authority inside another state is there due to the need for evidence to be able to demand a joint inquiry and if officials go the other state to oversee the operation, it follows that they are only allowed to do so with regards to matters directly tying to that one case.

Another change in the new article 13 makes information sharing mandatory and creates a standard form on how the information shall be sent:

“The information shall be forwarded by means of standard forms except in the cases referred to in Article 50 or in specific cases when the respective competent authorities deem other secure means more appropriate and agree to use them.”

While this creates a more uniform system, it still does not solve the previously mentioned problem of lacking feedback and does not per se obligate a feedback response to information.

⁷⁴ Ibid, point 16 of the preamble

⁷⁵ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax

⁷⁶ See. Page 24 of this paper, proposed adjustment to article 29 of the 2010 regulation.

In the new article 2a, Eurofisc gets more connected to the overall share of information. Remember that while the 2010 agreement did have an obligation to share information, Eurofisc was a much more separate and optional association. Now that is less so.

Further, article 17 from 2010 contained considerably less details about what information had to be stored and shared. For instance, no mention is made of net weight of the goods, the currency the transaction was made in or the commodity code of the goods. While it is reasonable to assume that most states did keep detailed information about the transactions of goods, the 2010 article 17 is short, vague and does not ensure good record keeping between the member states. It could slow down access to information.

With 2018, this list is expanded upon in depth as to the nature of information on the goods that must be shared. Less vague, more uniform to strengthen and harmonize the level of cooperation.

There is also a continuation of the need for technological equality across the union. In 2018, article 24, all member states are obligated to keep their systems up to date:

“Member States shall be responsible for all necessary developments to their systems to permit the exchange of that information using the CCN/CSI network or any other similar secure network used to exchange the information referred to in Article 21a by electronic means.”

This could be said to be in the same trend as the changes to article 17 about details on goods. An already existing obligation for the member states made more defined, detailed and harmonized.

When it comes to the role of Eurofisc, the 2018 proposal updates the old articles 33-37 that in 2010 governed Eurofisc. A more aggressive stance is adopted in 2018. Compare the old 2010 Article 33:

“In order to promote and facilitate multilateral cooperation in the fight against VAT fraud, this Chapter establishes a network for the swift exchange of targeted information between Member States hereinafter called ‘Eurofisc.’”

To the new version:

*“In order to promote and facilitate multilateral cooperation in the fight against VAT fraud, this Chapter establishes a network for the swift exchange, **processing and analysis** of targeted information on **cross-border fraud** between Member States and for **the coordination of any follow-up actions** (‘Eurofisc’).”*

Once again, we see the trend of stronger language and a more pronounced commitment to uniform action against fraud. While the new definition is stronger, it does make Eurofisc to be a more single problem organization. Before it appeared to be aimed at all fraud, even if it was necessarily not cross border. One could imagine for example, information gathering of a certain type of VAT fraud prevalent in Spain, but that fraud only happened in Spain. If that same method of fraud started appearing in other member states, Eurofisc could share all information on that type of fraud to the other country.

But the new version targets Eurofisc at only cross-border fraud. While this probably has no limiting impact on how Eurofisc is functioning, it does come across as a bit of overreaction against one type of fraud, albeit justified since it is likely that hundreds of millions of euro in tax revenue has been lost to this one type of fraud⁷⁷. In my mind, Eurofisc should also function as a data bank of information, gathered on domestic frauds, with data on how member state X has successfully implemented counter measures against that particular method, as well as less successful counter measures to member state Y can review them and not make the same mistakes as X did.

The fraudsters are communicating and moving across borders, so it is only reasonable that the member states do the same. And while MTIC is by most harmful fraud right now, it is far from the only type of fraud out there. And these frauds can spread like a disease from one state to another. Any information about new “outbreaks” of “strains” of fraud will be faster and easier to contain with more coordination. And that means less of the taxpayer’s money lost.

The most important change regarding Eurofisc comes in article 34. As previously mentioned, in 2010 it was up to the member states how much they wanted to contribute within Eurofisc:

“Member States shall participate in the Eurofisc working fields of their choice and may also decide to terminate their participation therein.”

With 2018, the same article now also reads:

*“Member States having chosen to take part in a Eurofisc working field **shall actively participate** in the multilateral exchange and the joint processing and analysis of targeted information on cross-border fraud between all participating Member States and in the coordination of any follow-up actions. ”*

Unlike joint enquiries, being part of Eurofisc is thus still entirely optional, but with 2018, if you sign up for working with it, you have an obligation to put serious effort into it.

Eurofisc is also given a new type of hierarchy with a head in charge of the organization. In 2010, the four sections of Eurofisc each had a coordinator in charge:

“The liaison officials of the Member States participating in a particular Eurofisc working field (hereinafter ‘participating Eurofisc liaison officials’) shall designate a coordinator (hereinafter ‘Eurofisc working field coordinator’), among the participating Eurofisc liaison officials, for a limited period of time.”

The head of Eurofisc will be known as the Eurofisc chairperson. This is slightly problematic, due to the details of the authority of the chairperson not being defined.

Article 36 of the new 2018:

⁷⁷ Study to Quantify and Analyse the VAT Gap in the EU Member States, European Commission report, 2015, page 16

“The liaison officials of the Member States shall designate a Eurofisc chairperson among the Eurofisc liaison officials, for a limited period of time.”

The article then continues to give the coordinators several more defined duties, continuing the trend seen elsewhere. However, this and a short mention in article 37, where the chairperson is responsible for writing an annual report, are the only times the office of chairperson is mentioned. As such, it leaves responsibility and authority vague, possibly creating conflicts on areas of authority which could be a weakness of the organization.

Eurofisc is also fairly unknown and I was even unable to ascertain who served as chairperson in 2018 as of the writing of this thesis.

Article 36 is long in its description of duties for the officials and I shall not paste all of it here. A sample that gets the general meaning across:

“The liaison officials of the Member States shall: (a) agree on the establishment and termination of Eurofisc working fields; (b) examine any issues relating to the operational functioning of Eurofisc. (d) submit an annual report on the activities of the working field to the liaison officials of the Member States.”

If there is a problem, the officials must “sound the alarm”. I would suspect this to be a direct response to the Austrian-Hungarian report which as mentioned highlighted the lack of feedback and investigation on Eurofisc. Since this proposal has yet to enter fully into force, no reports from Eurofisc on this topic yet exist.

Further on, the new article 36 enters into rules about Eurofisc cooperating with other organizations. The ones in question are Europol and the European-Anti Fraud Office.

“Eurofisc working field coordinators may request relevant information from Europol and the European Anti-Fraud Office (‘OLAF’). For this purpose and as agreed by the working field participants they may send them as much information as necessary in order to receive the requested information.”

Of note is that while Eurofisc may ask for information, the rules concerning what Europol and OLAF may give out require further study on the internal rules of those organizations. But this is a strong step forward towards fighting VAT fraud as a collective, and here Eurofisc is in this article encouraged to promote “trade” of information between these groups. This will form a more interconnected net of tax authorities, customs, international organizations and other groups. One large net that will catch more fraudsters than then small nets. And makes catching big fraudster “fish” a much less daunting task.

4.4 Summary of the 2010 rules on Administrative cooperation regulation and Eurofisc

-There is a general obligation to share information and administrative inquires with other member states. (Article 7)

-This obligation has restrictions, such as not complying due to “too high administrative burden” is a possibility. (Article 54)

-There is no obligation to act against fraud at the request of another member state. (Article 29)

-There is no obligation to contribute to Eurofisc or provide feedback on information received. (Article 34)

-Eurofisc has section coordinators, but no overall leader. (Article 36)

-Eurofisc has no control mechanism to evaluate how well it is functioning.

-There is no mention of cooperation with other organizations in the fight against fraud.

In summary, while this regulation contributed to more administrative cooperation, it lacked commitment.

4.5 Summary of the 2018 rules on Administrative cooperation regulation and Eurofisc

-There is an obligation to share information and join in reasoned administrative inquiries. The right to refuse is reduced. (New article 7)

-There is no exception to the obligation to share vehicle registration information (New article 21a)

-There is an obligation to contribute to Eurofisc after a member state has made the decision to take part. (New article 34)

-Eurofisc also has a chairperson who in some capacity will have influence over the organization. (New article 36)

-There is encouragement for cooperation with other organizations against fraud. (New article 49)

In summary, the 2018 regulation contains a series of commitments and more specific details in its language. The option to choose to not cooperate are either removed entirely as in Eurofisc and vehicle information, or greatly reduced.

With this understanding of the evolution of Eurofisc, we can make some observations. Eurofisc is still a relatively small organization, but that may change. It seems likely that the Member States of the EU will continue to seek ways to fight fraud. And the extensive changes in the 2018 proposal to Eurofisc indicates that they want Eurofisc as a powerful tool in their ongoing efforts.

If the 2018 changes to Eurofisc are implemented without any lasting problems, such as unclear authority and certain sections working in different languages such as French being standard in one field and English in another, then it would seem that the biggest problem facing Eurofisc is a lack of personnel. As mentioned in the joint report, less than ten people from each Member State is common⁷⁸. Going forward, more resources should be spent on Eurofisc to reflect its increasing importance, but the 2018 proposal contains no obligation on increasing personnel. Thus, it falls on each member state to individually increase their contribution which in turn increases its relevance and reliability of Eurofisc to combat fraud.

Looking at the massive numbers of data that Eurofisc is processing, perhaps advanced data systems can process and analyze all that information better than humans can. Taking fraud seriously and acting proactively seems to be something that the cooperation in the EU lacked previously. Eurofisc should be a pillar of the EU, with an official headquarter and a reputation for aiding in the proactive search for new types of fraud such as the previously mentioned, newly discovered carbon emission VAT fraud⁷⁹. But previously the organization lacked authority, prestige and resources. With 2018 comes more authority and possibly

⁷⁸ Joint report of the Austrian Court of Audit Bundesrechnungshof State Audit Office of Hungary, Eurofisc — A multilateral warning system of the Member States for combating VAT fraud, 2013, page 15

⁷⁹ Wolf, page 8

resources. Together they will hopefully bring the prestige and make Eurofisc a well-known place where various tax officials from all Member States hope to one day work. The EU remains a changing idea, with various interpretations from various people on what it should be in the future. Eurofisc was late to the party, but it is now a necessary part of the EU. As a consequence of our more globalized world, no one can effectively fight international fraud on a domestic level. It is unfortunate that it has taken years for the Member States to realize this.

Every million stolen in VAT fraud is one less million spent on healthcare, infrastructure or education.

Hopefully the new rules on obligation to share vehicle registration information in the new article 21a is not an exception, but rather a sign of changing attitudes and of things to come.

Yes, cooperation within Eurofisc represents an exchange of information between nation states that simply is not very common historically. But it is time to wake up to the reality of cross-border fraud and the fact that new problems require new solutions. The world has changed, and we must change with it. Even if carousel fraud gets greatly reduced in size, there are other types of fraud and there will be other types of fraud in the future. We need to be prepared so that the damage caused by carousel fraud is not repeated, again and again and again.

Eurofisc should be our lookout, rapidly gathering information and noticing new patterns forming. Then that data can be used to quickly identify the process the fraudsters use and prepare regulatory and other measures to prevent them. With a well-crafted system, a new type of fraud could be stopped before it even reaches some Member States.

5 The future of VAT

The following sub-section will reiterate some of the concepts prior and try to add the information together to investigate the harm currently being done by fraud and what the near future could hold. The intent is for the reader to absorb all that has come before and get a better understanding of the magnitude of the revenue lost to fraud.

5.1 European Parliament on the new changes and effect on the VAT gap

As part of the legislative process, not just the Commission and Council have opinions on the new VAT system, there is also the European Parliament. In its recent statement⁸⁰, it reaffirmed the problems with the transitional VAT system:

- Vulnerability to fraud, especially cross border.
- 11% higher compliance costs for the individual traders in cross border trade rather than domestic trade. This is directly linked to the VAT system.
- High administrative costs for the member states.
- A need to modernize to provide for certain goods.

The Parliament expects the new changes discussed in previous sections to drastically reduce the VAT gap, which is the difference between VAT supposed to be collected, and VAT that remains uncollected due to some sort of interference with the system. Currently the estimate of the parliament puts the gap at 150 billion euro⁸¹. This is only an estimate, and it is worth noting that the Commission estimates it to be 168 billion⁸² while another study puts the gap as high as 193 billion.⁸³ The VAT gap does not fall evenly on the member states of the EU, but it is prevalent to some extent in all of them.

The criminal nature of VAT fraud and other failure to collect VAT makes these figures hard to confirm. But even “just”150 billion euro of state and thus taxpayer money could go a long way towards whatever goal a member state sets in its budget. This is a union problem that has been brought on by weakening borders internally. There is no going back and as such the union member states must solve this problem together and not individually.

As for how much of the 150 billion was due to fraud, the parliament estimates 50 billion⁸⁴. The hope is that the new rule set will reduce the gap by 40 billion. This opens the question

⁸⁰ Stronger administrative cooperation in the VAT field, European Parliament, briefing 2018

⁸¹ Ibid, page 2

⁸² Study to Quantify and Analyse the VAT Gap in the EU Member States, European Commission report, 2015, page 7

⁸³ Second meeting of the OECD global forum on VAT, Olofsdottir, 2014

⁸⁴ Stronger administrative cooperation in the VAT field, European Parliament, briefing 2018, page 2

regarding how the 40 billion reduction will be allocated. Is it all related to the 50 billion in fraud or is some of it connected to other areas? It is worth remembering that the process to modernize VAT is being undertaken in many different fields, several of which are not covered by this thesis. But the Parliament offers no advanced model on how this 40 billion is calculated and in what field what percentage of it falls. Then again, the exact number may not be of key importance. What matters is that tens of billions of euro will be saved from disappearing into the pockets of criminals, and perhaps even in some cases, terrorists.

As its final opinion, the Parliament agrees with the VAT action plan and intends to move forward towards the new rules taking effect. In fact, the European Parliament called for the Commission to take this type of action to improve the VAT as early as 2011⁸⁵. The next step is for the Parliament to vote on the proposal in July 2019. After that, all that is left is for the adoption of the Council and then the new rules can enter into force.

It is worth noting that the problem of the VAT gap due to fraud may be decreasing with one estimate⁸⁶ of MTIC in the United Kingdom, during the period 2001 to 2010 shows a decline in the gap from 18% to 10%. If accurate then that implies that whatever measures employed there are highly effective. Unfortunately, what those measures are fall outside the subject of this paper. Further study on impact after that time period would benefit the fight against fraud.

5.2 VAT: What comes next?

As previously seen, the EU institutions are moving ahead with their plans for a modern VAT system. What could be the next steps after the likely event that the current reforms are implemented?

While the EU has a plan for the future, there are other suggestions for how to implement a type of consumption tax. One area of concern is that of potential problems left unaddressed, to be discovered by fraudsters and exploited. Such events have happened before as seen with the carbon emission fraud getting as high as to amount to 1.6 billion euro stolen in a year⁸⁷, false invoices and indeed, carousel fraud in general. When previously delving into the nature of fraud, false invoices remains a constant problem through several of the discussed possible types such as bogus traders, fictitious traders, false claims for credit and misclassification of commodities. Is there a way for a future VAT system to solve this consistent problem of false invoices?

An OECD article has also identified this problem of false invoicing.⁸⁸ As always, the numbers and size of criminal activities are hard to estimate, but false invoicing alone is estimated at 500 million euro a year, just in the Slovak Republic.⁸⁹ The methods used there would fall into misclassification of commodities and omission of self-deliveries due to businesses masking non-deductible personal expenses as legitimate and deduct them.

⁸⁵ Ibid, page 4

⁸⁶ *Sergiou*, page 12

⁸⁷ Trial of carbon tax 'fraud of the century' opens in Paris, France 24, 2018

⁸⁸ OECD report on how to fight fraud TECHNOLOGY TOOLS TO TACKLE TAX EVASION AND TAX FRAUD, 2017

⁸⁹ Ibid, page 17

Interestingly, Keen and Smith⁹⁰ implied that omission of self-deliveries is only a small problem and that it also is generally not a large problem in modern economies. And that:

“A VAT with a relatively high registration threshold will exclude many of the smaller businesses for which this is likely to be more of a risk.”

And yet, the data of fraud coming from the Slovak Republic indicates that this is not the case. It would seem that even types of fraud considered less harmful can grow to pose new problems, even in the EU.

But it is time to go back to possible solutions for false VAT invoicing. The first suggestion raised is that of mandatory electronic invoicing.⁹¹ This system would replace the current possibility for paper version only and would make sure of the identity of the purchaser and seller. Then the data can be checked to prevent creation of false ones. No downside of this method is presented, and it seems to be the way of the future, with a number of South American countries, Italy, Mexico and China among others having gone this way of collecting data. Electronic systems that are even automated are promoted not just by the OECD but by academics as well, primarily due to its effectiveness at gathering information for analysis.⁹²

It should be noted that the EU seems to have a bit of a problem with technological uniformity, which seems to make an appearance in several legislation documents.⁹³ The EU seems to be moving in the direction of electronic identification but seems to lag behind. When Mexico and Italy are toe-to-toe when it comes to implementing new methods, it seems clear that the EU is not a leader when it comes to modernization in this field. Why could that be?

⁹⁰ Keen, Smith, page 8

⁹¹ Ibid, page 18

⁹² Herbain, Lamensch, page 12

⁹³ One example would be the Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, which has the updated Eurofisc rules. Note such areas as point 5 of the preamble where electronic identification stressed

6 Conclusions

When it comes to dealing with fraud, there is no simple solution that any one-Member State can take to eliminate the problem. Indeed, there currently is no perfect solution and fraud will remain a problem, as it has since time immemorial.⁹⁴The current rate of reform⁹⁵ indicates restraint on the part of national governments, perhaps out of unwillingness to disrupt the free market.

The problem I see is that the changes are reactionary, rather than well thought out and implemented along with the VAT system as it went into effect decades ago. Yes, there are currently short to mid-term plans for reform up to 2021⁹⁶ and while some of the reforms are due to the ever-changing nature of technology, some new areas of the planned reform detail who is responsible for making sure VAT is collected:

“For the first time, make large online marketplaces responsible for ensuring VAT is collected on sales on their platforms that are made by companies in non-EU countries to EU consumers.”

Even with new types of trade, it seems like an error in vision when the system cannot predict where vulnerabilities to fraud lie. This one example of online non-EU trade to EU consumers is only one area, and the general confusion investigated in section 4.3 of this thesis seems to indicate that research around fraud is not as prepared and structured as it could be.

Preventing fraud should not be a politically sensitive issue, at least when it comes to closing loopholes and specific abuse of articles that for some reason are weak to fraud. And while the system will never be perfect, the current amount of problems and slow speed in dealing with them, indicate deeper problems in the administrative cooperation.

For instance, this paper is to the best of my knowledge the first one to evaluate Eurofisc, and yet, I can't interview the national delegates sent to participate due to the almost obscure nature of this cooperation. Are they overworked? The high number of alarms and low number of workers seems to indicate that, but it is not possible for me to ascertain whether that is actually the case. Another possible problem that affects Eurofisc in particular is language. Even in English, we can see the problem that comes with classifying fraud: Some types may be nearly the same but with different names. Since the Member States of the EU are devoted to protecting culture and language, there may be further translation problems which could negatively impact Eurofisc's ability to combat fraud. Thus, I believe that Eurofisc should have an official language in English that all work must be conducted in during day-to-day operations.

This may already be standard operating procedures, but I am unable to find out more. It seems strange that information on Eurofisc is not more available to the public. This should change.

⁹⁴ The earliest known case of fraud relates to a Greek merchant named Hegestratos, who in 300 B.C tried to carry out a type of insurance fraud. <https://www.investopedia.com/articles/financial-theory/09/history-of-fraud.asp>

⁹⁵ Introducing the definitive VAT system for B2B cross-border trade, Briefing, EU Legislation in Progress

⁹⁶ European Commission - Press release Brussels, 5 December 2017

The member states of the European Union have agreed to a common market, but when it comes to defending it from those that wish to subvert it for their own criminal benefit, the member states hold back on taking the necessary measures to protect the VAT system. It is time to work together and trust the judgment of another member state regarding the need to act against fraud. If member state A says a fraud is happening in A and via state B and C, then B and C needs to be obligated in joining A in its investigation. Only then can fraud be effectively negated.

The focus on carousel fraud is justified, it is clear the carousels are depleting member states tax revenue as well as distorting the free market. And the carousel can be stopped more easily than other types of fraud, by once again applying control when it comes to cross border transactions.

MTIC should be neutralized through a more robust VAT system, with well-designed cross border rules, and sound cooperation between the member states. The size of the VAT gap makes this an urgent matter.

Fraud is the concern of every taxpayer and should be brought more into the forefront of public policy. Especially now when the most harmful fraud appears to be the international carousel fraud. This study suggests that fraud is sometimes viewed as something best unspoken and ignored due to its persistent nature. That attitude is harmful and will only make fraud a larger problem. With the proper research, more public exposure and further international cooperation, it is possible to prevent future generations from having to deal with hundreds of billions being stolen from them.

I want to see a stronger system that acts pre-emptively against possible problems. A system that anticipates fraud problems within the carbon emission trade rather than is unaware until it stumbles in on these new types of multi-billion-euro frauds. And there remains much work to do in order to build a better VAT system.

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