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Missing Trader Fraud in European VAT

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Abstract

Sebastian Pfeiffer, Pavel Semerád: **Missing Trader Fraud in European VAT**

This article deals with various aspects of carousel frauds in which missing traders play a crucial role during intra-union transactions. The most important question is how to stop this kind of crime, which causes a huge tax gap in collecting value added tax. In this paper a detailed analysis of fraud patterns including model calculations was carried out. Very important for tax administration in the European Union are judgments of the European Court of Justice dealing with questions concerning the controversial parts and interpretations of the law in Member States and the Directive. Several judgments from Austria, the Czech Republic and Germany aimed at fraud in value added tax were used.

Special emphasis is devoted to the solution to tackle VAT and carousel frauds. The opinions of the authors and the European Union are discussed and new planned solutions to fraud are examined as well. Although QRM allows Member States to apply for an exemption to introduce reverse charge mechanism, the Czech Republic is used as a model example to show legal solutions after earlier unsuccessful application for reverse charge mechanism on fuel sale.

Key words

Carusel fraud, missing trader, value added tax, tax evasion.

JEL: H20, H26

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Introduction

The VAT system within the European Union (EU) is harmonized through the VAT Directive 2006/112/EC. VAT itself is a tax on consumption and therefore burdens the consumption of the consumer at the end of the supply chain. Although VAT is eventually paid by the consumer, it is charged and collected on a broad base on all transactions by businesses throughout the supply chain (Tumpel, 2007). In order to fulfill its aim to be a tax on consumption, VAT – within the chain of companies – has to stay neutral. Hence, neutrality is one of the pillars of the VAT system. In the European VAT system, neutrality is achieved through the possibility of deducting input VAT. The right of input VAT deduction arises one the one hand after the transaction has been completed and on the other hand when the invoice has been rendered (§12 m. no 58 in Ruppe and Achatz, 2011). Art 1 para 2 VAT Directive lays down the systematic of fractionated levying of VAT. "*On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT shall be applied up to and including the retail trade stage*" (Art 1 para 2 VAT Directive). It is that fractionated levying of VAT and the possibility to deduct input VAT that leads to carousel fraud (see Hülsberg and Engels, 2011): The right to deduct input taxes – to a wide extent – is independent from the actual payment of VAT by the supplying taxpayer.

This article deals especially with carousel fraud. As the term indicates, therefore, this article does not discuss the issues of avoidance and abuse which have to be separated from the terminology of fraud as such.[1]

1 Method and resources

A methodological approach is quite consistent with the problems solved. The theoretical background is the judgments of the European Court of Justice studying in detail the controversial questions related to the application of Directive 2006/112/EC and national laws on the value added tax. Each Member State has some experience with tax evasion. Austria, the Czech Republic and Germany were used as model countries because there is consistency between the Union and national interpretation of the law. Also the views of authors studying carousel fraud in VAT for a long time were used.

[1] For an overview of the latest EU case law dealing with abuse and anti-avoidance see ECJ 20 June 2013, Case C-653/11, *Paul Newey*, not yet published; 21 February 2006, Case C-255/02, *Halifax* [2006] ECR I-1609; 14 December 2000, Case C-110/99, *Emsländ-Stärke* [2000] ECR I-11569.

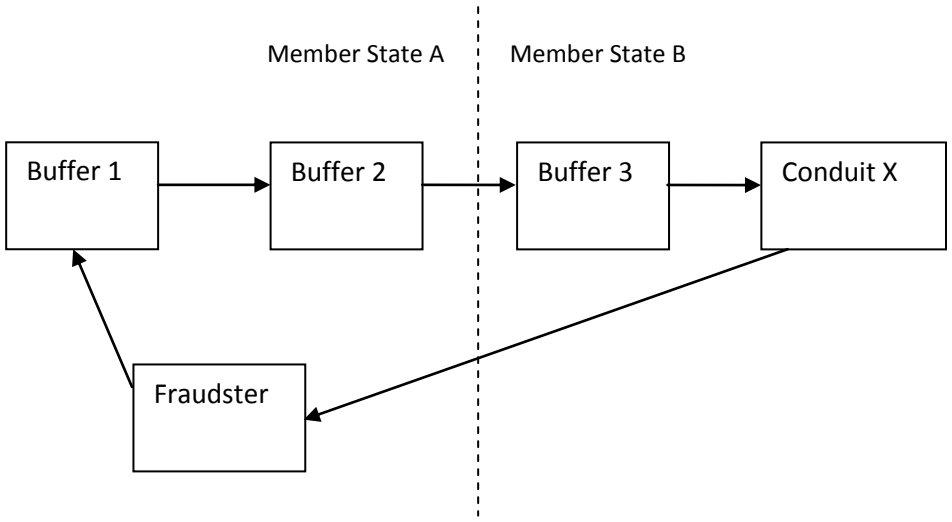
A separate chapter is devoted to finding solutions to tax evasion both in accordance with Directive 2006/112/EU and Directive 2013/42/EU. The Czech Republic is used as a model example to show its approach to tackling fraud on the fuel market after a negative opinion of the European Commission as to reverse charge mechanism.

2 Definition of Carousel Fraud

Carousel Fraud can take lots of different forms. In its most simple form, Advocate General Maduro in his opinion to the *Optigen* case stated: "*In its simplest form a carousel fraud works in this way. A VAT-registered trader ("A") in one European Union Member State sells taxable goods to a VAT-registered trader ("B") in another Member State. A's sale to B is zero-rated in A's Member State. B should declare the purchase and pay acquisition tax in its own Member State, and, upon the premise that it is intending to use those goods in order to make an onward taxable supply, then claim credit for the same amount as input tax. Usually, if it is a participant in a carousel fraud, it does neither. B then sells the goods to another VAT-registered trader ("C") in its own Member State, charging and receiving VAT on the consideration. However, it fails to account to the tax authorities for that VAT and effectively disappears; it becomes what [the Commissioners] refer to as a "missing trader". Nevertheless, at the time of making its sale to C, while it is still registered for VAT and before the Commissioners are aware that it is or might become a missing trader and have been able to intervene (for example, by de-registering B) it provides a VAT invoice to C, which claims the VAT it has paid to B as input tax. C (to whom the Commissioners refer as a "broker") then sells the goods to a registered trader in another Member State: the hallmark of the simplest fraud is that this purchaser is A, and it is this circularity which gives rise to the term 'carousel fraud'*" (I-483, para 8 in ECJ, 2006). However, this constellation is only the tip of the iceberg. In order to cover up the fraudulent structure, carousel-fraudsters have thought of new and more complicated structures in order to avoid detection. In the example provided for by the AG, the problem lies within the negative VAT return of party C. C, on the one hand conducting exempt intra-union transactions and on the other hand claiming input VAT from buying from the missing trader, attracts the attention of the tax authorities (Wolf, 2011).

By interposing buffer companies detection of intra-union carousel-frauds becomes more complicated:

Scheme I.: Carousel fraud example



Source: Author's own work.

For the example it is assumed that both member state A and B levy VAT in the amount of 20 %.

Fraudster supplies Buffer 1 for 500+100 VAT. Buffer 1 pays 600 and deducts input VAT. However, Fraudster does not pay the VAT on to the tax authority. Buffer 1 sells goods to Buffer 2 for 520+104 VAT. Buffer 2 pays 624 and deducts input VAT. Buffer 1 pays 104 to the tax authority of member state A. Buffer 2 conducts a VAT exempt intra-union transaction and sells the goods for 540. Buffer 3 is liable to VAT of member state B in the amount of 108 but at the same time eligible for input VAT deduction. Buffer 3 sells the goods on to Conduit X for 560+112 VAT. Conduit X is an agent of Fraudster and conducts an exempt intra-union supply back to him for 580. Fraudster will be liable to VAT which he is able to deduct as input VAT. Therefore, excess input VAT deduction does not exist. The overall profit of the VAT carousel sums up to 100. The net profit is therefore 20 (100 minus the margin of non-participating companies in the amount of 80).

3 ECJ Case Law

3.1 General remarks

Since member states are eager not to lose VAT revenue, some tax authorities tried to hold members of the carousel liable for the lost VAT. However, it is the key feature of the missing trader to either leave the market or go bankrupt. Therefore, the liability was shifted from the fraudster to the – often – uninvolved buffers of the fraud. Some cases were brought forward to the European Court of Justice (ECJ) for preliminary rulings. The ECJ's case law regarding carousel fraud can be split up in two

categories. Firstly, the denial of the right to deduct input taxes. Secondly, the abolition of the exemption for intra-union supplies. Accompanying, a recent judgment deals with the question whether the burden of proof lies with the tax administration or with the taxpayers themselves.

3.2 Denial of input tax deduction

In the case *Optigen* (ECJ, 2006) the ECJ had to deal with transactions within a carousel, which – without the applicants being aware of it, involved a missing trader. The tax authorities argued that the transactions by the applicant were outside the scope of the VAT Directive and therefore input VAT deduction was not possible. The referring court wanted to know whether transactions, which themselves are not afflicted with VAT fraud, but are part of the carousel constitute transactions within the scope of the VAT Directive and thus giving rise to input VAT deduction. The court reasoned that the VAT Directive itself implements a wide scope of taxable transactions (para 37 in ECJ, 2006). It covers every transaction which gives rise to the right to dispose of tangible property as an owner (para 38 in ECJ, 2006). Settled case law of the ECJ shows that the terms "supply of goods" as well as "taxable person acting as such" have an objective nature without regard to any purpose of result of the transaction concerned (para 44, in ECJ, 2006). The intention of the trader is irrelevant for the qualification of a taxable transaction (para 45 in ECJ, 2006). The ECJ came to the conclusion that transactions, which themselves are not fraudulent, constitute economic activities inside the scope of the VAT Directive, if they meet the criteria set forth both by the VAT Directive as well as the ECJ case law on supply of goods and services. The fraudulent intention of a trader, different from the person concerned, does not change the economic substance of a transaction if the person concerned had no knowledge and no means of knowledge. Following that reasoning, also input VAT deduction cannot be denied because of a fraudulent transaction within the chain if the person concerned has no knowledge and no means of knowledge (para 55, in ECJ, 2006).

In a second case – *Kittel* (ECJ, 2006a) – the ECJ confirmed this line of jurisprudence and concluded that for the question of the right to deduct input VAT it is irrelevant whether or not the VAT payable on prior or subsequent sales of goods has been paid to the tax authorities (para 49 in ECJ, 2006a). Tax payers, who took reasonable precautions to ensure that their transactions are not connected with fraudulent transactions must be able to rely on the legality of them without running risk of losing the right to deduct input VAT (para 51 in ECJ, 2006a). *Vice versa* this indeed means that taxpayers who took reasonable precautions to ensure that their transactions are not connected with fraud cannot be denied their input tax deduction (see Pernegger and Stöger, 2008). In other words, tax payers have the right to trust in bona fide transactions. However, a VAT-able transaction cannot be assumed, if the taxpayer himself acts fraudulently. The tax authority is permitted to demand

repayment of deducted input VAT retroactively where they can proof that the right of input VAT deduction has been exercised fraudulently (para 53 and 55 in ECJ, 2006a). Moreover, also taxpayers who knew or should have known that his transaction was connected with fraudulent activities are also regarded to be a participant in that fraud, irrelevant whether or not they profited by it (para 56, in ECJ, 2006a). However, the tax authority has to proof the fraudulent claim of input VAT based on objective criteria (para 55, in ECJ, 2006a). These objective criteria, however, are subject to the ruling of national courts.

3.3 Denial of the exemption for intra-union supplies

In another case, the ECJ had to deal with the VAT exemption of intra-union transactions in connection with carousel fraud (ECJ, 2010). The facts were the following: A Portuguese citizen was director of a German company trading cars. He manipulated invoices in order to generate a carousel fraud. One of the questions referred to the court dealt with the question whether or not an intra-union transaction is still VAT exempt if the goods supplied really were subject to an intra-union transaction. However, in invoices were substantially inaccurate. The court summarized that intra-union transactions are VAT-able if the criteria for intra-union supplies are indeed met but the trader issues false invoices in order to conceal the identity of the true purchasers to enable the evasion of VAT (para 47 in ECJ, 2010). Therefore, member states are free to treat the issuance of irregular invoices as amounting to tax evasion and hence not exempt intra-union transactions (para 49 in ECJ, 2010).

In summary, it can be deduced by ECJ case law that member states in the current VAT system are competent to counter VAT fraud on two different levels. Firstly, input VAT deduction may be denied in cases where the taxpayer himself acts fraudulently or knows or has the means to know that fraud is happening. Secondly, the VAT exemption of intra-unions transactions may be denied in cases of VAT fraud.

3.4 Procedural aspects

Indeed, the latest case in regard to carousel fraud may be qualified as a follow-up judgment of *Optigen* and *Kittel*. The ECJ's judgment in the joined cases *Mahagében and Péter Dávid* (ECJ, 2012) indeed reiterated the ECJ's conclusion that the denial of input tax deduction goes beyond what is necessary to avoid possible tax evasion "*in the form of refusing that right to a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior or subsequent to that transaction carried out by the taxable person was vitiated by VAT fraud*" (para 47 in ECJ, 2012).

More importantly, the court concluded that it is for the tax authorities to determine irregularities and fraud and consequently impose penalties on the taxpayer (para 62 in ECJ, 2012). On the contrary, however, the burden of proof may not be – completely – shifted to the taxpayer.

3.5 Interim result

The ECJ's case law makes clear that Member States indeed have the right to counter VAT fraud by either denying the input tax deduction or the application of the exemption for intra-union supplies. However, it needs to be considered that the application of these measures is subject to the criterion of the taxpayers' knowing or having the means to know of fraud within the chain of transactions. In order to determine this criterion, however, the Member States may not shift the burden of proof to the taxpayer. On the contrary, it is the tax authorities' duty to determine whether or not this criterion is fulfilled.

4 Austrian and German Case Law

4.1 Austrian case law

Austrian case law regarding carousel fraud is rare. The Austrian administrative court did not deal with carousel fraud with regards to content yet.[2] However, the Court of second instance issued a judgment regarding carousel fraud (Austrian Independent Tax Tribunal, 2009). A VAT carousel was built between Austrian and Cypriote companies. Computer hardware was used for this fraud since it was on the on hand costly enough to have "revenue" on the other hand simple to transport. The carousel itself contained buffer companies to avoid detection. The applicant to the case acted as the broker and thus claimed input VAT from the purchases from the missing trader. The court then referred to the ECJ case law (especially ECJ, 2006a). In reference to the criteria stipulated by the ECJ, the court held that input VAT deduction is denied if the taxpayer knew or had the means to know that by doing business he took part in a VAT fraud. The court reasoned that the taxpayer knew that computer hardware were especially prone to VAT fraud. Moreover, the taxpayer did not take all reasonable precautions in order to ensure that his transactions were not connected to VAT fraud. The ECJ himself did not elaborate on the term "reasonable precautions". However, the court reasoned that this criterion cannot be fulfilled in an overall view of following indications: the supplier of the taxpayer was a newly established company with only one manager and one employee. The taxpayer settled for very old proof of establishment of his customers. The taxpayer himself was not part of the actual export-transportation. Concluding, the court held that the taxpayer had the means

[2] However, a great deal of judgments were issued in context of procedural errors of the first instance in light of a VAT fraud in Austria. However, the Austrian Administrative Court eventually came to the conclusion that the EU legislation cannot be invoked as the facts of the case were realized before Austria acceded to the EU. See Austrian Supreme Administrative Court 30 September 2009, 2007/13/0068.

to know that he was part of a VAT carousel. Input VAT deduction was therefore denied. However, the judgment of the Austrian Administrative Court on that issue is still pending.

4.2 German case law

The number of German cases decided by the German Fiscal Court compared to the Austrian jurisprudence is rather high. A recently published judgment by the German Fiscal Court (2011) deals with the denial of the VAT exemption of intra-union transactions. A German company sells tires at wholesale to Belgium companies – amongst them company D. Company D's recorded business is the wholesale with sugar, sweets and chocolates. In order to ensure all reasonable precautions, the German company tried to confirm the VAT-number several times without success. However, D itself did not have any employees and the recorded manager was only a dummy person. In reality, company D was only interposed to establish a VAT carousel. In the light of the ECJ case *R* (ECJ, 2010) the German Fiscal Court held that an intra-union transaction is denied the VAT exemption if, although all objective criteria are met, the taxpayer issues wrong invoices in order to conceal the true identity of the customer. This result was based on following considerations. Firstly, company D's recorded business was the business with sweets. Secondly, D did not employ any staff. Thirdly, there was no contact between the management of D and the applicant of the case. Therefore, it stood to reason that the business itself only served to conceal the true supplies. In the light of ECJ jurisprudence, the VAT-exemption was denied. In its case V R 30/10, the German Fiscal Court had to decide on a similar case (German Fiscal Court, 2011a). However, the crucial question as well as the outcome was completely different. The applicant bought supplies of two different German companies while itself conducting intra-union transcations to Italy and Austria. The applicant was the last puzzle-piece within the carousel. It was questionable whether the VAT exemption for intra-union transcations has to grant by Germany if the supplier, without concealing the true identity of the buyer, know that the buyer himself does not fulfill his VAT obligations in the member state of destination. The German Fiscal Court distinguished this particular case from the ECJ case *R* (ECJ, 2010) and concluded that the ECJ did not answer this question (para 24 in German Fiscal Court, 2011). It stands to reason that one might draw the connection to the ECJ cases *Optigen* and *Kittel* where the ECJ stated that the right to deduct input VAT is denied if the taxpayer knows or has the means to know of the VAT fraud. However, the situation with intra-union transactions is quite different. However, in *R* the ECJ explains the denial of the VAT exemption on the basis concealing the true recipient. This deception and the issuance of false invoices is a severe breach of the regulations. Hence, the supplier cannot invoke the VAT principles of protection of legitimate expectations; legal certainty and neutrality (see Bülte, 2011).

5 Czech Case Law

Like in other European Union Member States, value added tax collection in the Czech Republic is hit by fraud. These scams try to claim excessive deductions from the state budget by declaring a higher tax on input than on output. Most excessive deductions are paid provided that the tax authorities have no doubt about the correct amount of input tax. However, there may be doubt about the proof of a taxable supply. Doubts may arise as a result of failure to prove the delivery of goods (the first case) or the credibility of the supplier - the problem of fictitious invoices (the second case).

5.1 The first Czech case law

The subject matter of the dispute (Supreme Administrative Court, 2011): The Tax Office in Nový Bydžov (hereinafter referred to as "tax administrator") in 2009 charged the plaintiff the value added tax by additional tax assessments. This was the period of May, June, July, October and November 2004. It failed to recognize the plaintiff's right to deduction for the purchase of scrap metal from INTOZ Ltd. Kadan. The defendant dismissed the entitlement to the deduction because the plaintiff failed to prove that a taxable supply was really carried out. The plaintiff stated that he proved the acceptance of a taxable supply by invoices, the inventory of goods, warehouse cards, and cash receipts and substantiated his claim by the testimony of the executive of the INTOZ Ltd. Kadan. He also substantiated the sale of delivered goods to the third parties and he properly taxed these sales. On the basis of these allegations the Regional Court in Hradec Kralove (Af 43/2010-31, 21 April 2010) rescinded the decision of the defendant on the ground that *the plaintiff submitted invoices, delivery notes, weight certificates, tax and accounting records. If the witness N. confirmed the delivery of goods, the plaintiff lived up to his responsibilities and there was a shift of the burden of proof to the tax administrator* (point 14 in Supreme Administrative Court, 2011).

The defendant challenged that decision and filed an appeal in cassation, which was justified by the fact that the formal invoice itself did not prove the receipt of the taxable supply from the declared payer. The delivery notes, mentioned by the District Court, were never submitted. Certificates of weight were the documents required for the delivery to the third parties, not for the purchase of goods from INTOZ Ltd. Kadan. With regard to the judgment made by the Supreme Administrative Court of the Czech Republic, relevant are not formal requirements, but the fact of the acceptance of a taxable supply from another payer. In the course of the case two substantial facts emerged. However, the Administrative Court challenged them and this led to the cancellation of the judgment. The first fact was related to the payments. The witness said that they were made in cash and sometimes the plaintiff gave him an advance on goods. However, the plaintiff did not charge them. This fact refutes the credibility, relevance and accuracy of entries in the records kept by the plaintiff.

The second fact was related to the delivery method. The tax administrator demanded that the plaintiff give the names of drivers and vehicle license plates. The plaintiff refused to do so with reference to the terms of delivery of the goods. However, there are differences in the testimony of the witness and the plaintiff. The witness stated that transportation was ensured by his contractors, whereas in a written statement (2007) he stated that in the years 2003 and 2004 the material was transported by the carrier of INTOZ Ltd. Kadan.

The Administrative Court had to decide whether these were really the supplies which the plaintiff charged and on which he claimed tax deductions. Metal waste is a relatively interchangeable commodity, which is further processed. For the opinion of the court the differences in a witness testimony about the delivery method were substantial.

5.2 The second Czech case law

The subject matter of the dispute: Supreme Administrative Court of the Czech Republic (2011a) discovered the following facts: The plaintiff filed a VAT return for the tax period the 2000. In it she filed a claim for overpayment. Part of the claimed input tax was also an invoice issued by J. Z. During the inspection she also submitted an offer and a contract of purchase made with J. Z. in May 2000. However, she failed to submit the proof of delivery of a taxable supply under the contract of purchase. A cross-check revealed that J. Z. did not have this document in his records. He also testified that he had not made any business transaction with the plaintiff; he did not issue and sign any invoice or offer or contract of purchase. The plaintiff testified that the person in question was not a person she had dealt with while negotiating a business transaction. The tax administrator, therefore, did not recognize the document and said that it could not be regarded as a tax document pursuant to § 12 Article 2, Act No. 588/1992 Coll., on value addend tax. Further, it stated that the plaintiff in the proceedings had not proved that it was J. Z., who made a supply to her.

As it was impossible to find out who issued the document and it was still uncertain whether he was a VAT payer or not, the condition for the deduction of input tax was not satisfied. *The defendant told the plaintiff that if the tax was really paid to any person, it was VAT fraud committed by that person. This caused her to suffer a VAT-related loss which, however, could not be compensated for from the government budget (*Supreme Administrative Court, 2011a). The Regional Court held that there was no taxable supply between the plaintiff and J. Z. The plaintiff herself felt deceived and aggrieved. The Regional Court further pointed out that the tax authorities were not obliged to identify from whom in fact the plaintiff received the supply. The plaintiff herself did not ensure that the supply was not a scam. She did not verify the identity of the adverse party; she did not even reveal any information about him. The plaintiff cannot be looked on as a person acting in good faith who took all measures

that could have been reasonably required. This is in agreement with the conclusions of the European Court of Justice in the cases of Optigen (ECJ, 2006) and Kittel (ECJ, 2006a). Good faith was applied by the Supreme Administrative Court of the Czech Republic in the following statement: *For entrepreneurs it means to pay increased attention to internal control mechanisms so that in the case of detection of fraud there is no doubt as to their knowledge of the fraud. No doubts should arise that they knew or with regard to all circumstances should have known about the fraud. It is the entrepreneur's responsibility, in an effort to minimize the business risk, to adapt their business activity to specific conditions and when negotiating business contracts to prefer, if possible, reliable and responsible trading partners (*Supreme Administrative Court, 2008).

6 Solutions to tackle VAT and carousel fraud

6.1 General remarks

VAT fraud, especially carousel fraud, was dealt with by a number of legal scholars (e.g. Cnossen, 2009; Kemper, 2009; Bürger and Paul, 2011; Pourzitakis, 2012). Indeed, the proposed measures to tackle VAT fraud can be differentiated twofold: Such measures which are possible without amending the VAT Directive and such measures which call for a new legislation. In the following, a short summary of the proposed measures to tackle VAT fraud will be given. However, the main focus will lie on the current proposals by the EU.

6.2 Proposed measures to tackle VAT fraud

6.2.1 Measures possible under the current legislation

One of the first proposed measures to tackle VAT fraud which could be implemented without changing the current EU legislation uses information technology to balance the traders' input and output VAT (Mattes, 2006). In B2B-transactions, the invoice will still be issued with VAT. However, by identifying seller and recipient via electronic means, the transaction will be effected without VAT as long as the identification process shows that the recipient of a supply is a taxpayer himself (Mattes, 2008). A second proposed measure is joint liability on the basis of Art. 205 VAT Directive (Kindl, 2010). By enacting such a general joint liability both the supply's recipient and supplier are liable for VAT thus making it harder, or even impossible, to engage in carousel fraud (Kindl, 2010). Thirdly, a number of authors put forward ideas of special VAT audits (Leitl, 2010; Jochum, 2005) or an enhanced exchange of information.[3]

[3] Such as Council Directive 2008/117/EC of 16 December 2008 amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions;

6.2.2 Measures demanding a revised VAT Directive

A number of other authors proposed measures which cannot be implemented without changing the VAT Directive as such. The most prominent ones include the general abolishment of the fractionated levying of VAT connected with a general switch to a reverse-charge mechanism in context of B2B-transactions (e.g. Matheis and Groß, 2006; Tumpel, 2007; Melhardt, 2008; Tumpel 2010). Austria filed an application to the Commission in order to implement such a general reverse-charge mechanism in 2005. However, this motion was denied by the Commission in light of a number of reasons (European Commission, 2006). Other proposals deal with the point of time of taxation (see; Lohse, Parsche and Gebauer, 2006; Bergemann, 2008). However, due to missing consensus, these proposed measures did not find their way into EU legislation thus far.

6.2.3 Developments in the EU

In 2006, the Commission issued a communication to the council, 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 (European Commission, 2006a). In this communication, the Commission estimates that fraud within the European Union accounts for approximately 2% to 2.5% of the total GDP of the European Union (European Commission, 2006a). In its communication, the Commission proposes several fields of advancements of anti-fraud measures within the European Union comprising amongst others the administrative cooperation between the member states, assistance in the field of recovery as well as the increased cooperation with third countries (European Commission, 2006a). Moreover, the protection of revenue should be a shared responsibility of the member states. Therefore, member states should take comparable measures against fraudsters, regardless whether the fraud leads to losses of revenue in the member state concerned (European Commission, 2006a). Especially the last demand by the Commission sounds surprising. The current system of VAT is characterized by the principle of territoriality. While conducting intra-union transactions, the place of origin exempts the supply while the state of destination taxes it. Would – for the sake of anti-abuse – the state of origin in situations of fraud unilaterally deny the VAT exemptions, it would lead to the conclusion that the state of origin tax a

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Council Regulation (EC) No 37/2009 of 16 December 2008 amending Regulation (EC) No 1798/2003 on administrative cooperation in the field of value added tax, in order to combat tax evasion connected with intra-Community transactions; Proposal for a Council Regulation on administrative cooperation and combating fraud in the field of value added tax, COM(2009) 427 final.

transaction which should have been taxed in the state of destination. Thus, it would infringe the principle of neutrality.[4]

Very recently, VAT fraud gained a new impetus in EU legislation (Council of the European Union, 2013). Indeed, the Council reached agreement to adopt two directives which enable the Member States to tackle VAT fraud quicker. The first directive deals with an optional and temporary application of the reverse-charge mechanism to certain goods and services which are subject to fraud. The VAT Directive in its current form already allows the application of the reverse-charge mechanism to certain goods and services: Art. 199 VAT Directive 2006/112/EC Estipulates an exhaustive list of supplies which Member States may subject to the reverse-charge mechanism, such as the supply of construction work. Furthermore, Art. 199a VAT Directive provides for a list of supplies which – until 30 June 2015 – may for a minimum period of two years be made subject to the reverse-charge mechanism as well. Art. 199a VAT Directive will be amended by one of the new directives in light of the context: Member States will be allowed to provide for a reverse-charge mechanism on certain supplies which are prone to fraud, such as mobile phones, certain telecommunication services and the supply of game consoles, laptops or tablets. This optional application of the reverse-charge mechanism is additionally supplemented by a number of procedural obligations of the Member States, including reporting obligations to the Commission and the VAT Committee.

Moreover, and not yet to be found in the current legislation, the second directive deals with the introduction of the Quick Reaction Mechanism (QRM). A new provision was inserted into the VAT Directive to be found in Art. 199b. The QRM gives the Member States the possibility to apply the reverse-charge mechanism to specific supplies for a short period of time under an accelerated procedure (Council of the European Union, 2013). Indeed, Art. 199b(1) will stipulate that "*[a] Member State may, in cases of imperative urgency [...] designate the recipient as the person liable to pay VAT on specific supplies of goods and services by derogation from Article 193 as a Quick Reaction Mechanism ("QRM") special measure to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses*". The QRM is contingent on an application to the Commission and certain time thresholds. Indeed, if the Commission cannot find any objections against the Member State's application, it has to notify the applying Member State within one month. Upon receipt of such a confirmation, the Member State may introduce the derogation, i.e., apply the reverse-charge mechanism to the specific transaction (Art. 199b(3), VAT Directive 2006/112/EC).

[4] See for example opinions of the AG *Cruz Villalón* on case *R* (FN **Chyba! Záložka není definována.**) or ECJ 4. 4. 2006, case C-254/04, *EMAG*, ECR 2006, I-6227, para 40.

It needs to be borne in mind, however, that both instruments for countering VAT fraud may only be used in an interim period until 2018. From there on, an evaluation process will show whether or not these measures are reasonable to counter VAT fraud as such. This becomes even clearer when looking at the Council's draft statements to the two directives: Both directives constitute a "*temporary and exceptional measure to address serious VAT fraud*" (Council of the European Union, 2013a). In addition, the minutes make clear that the changes to the VAT Directive do not represent "*in any way a move towards a general reverse charge system*" (Council of the European Union, 2013a).

While on first glance the QRM seems to offer Member States a quick way to counter severe fraud constellations, it is clear that in light of a harmonized internal VAT system, derogations – which furthermore vary from Member State to Member State – cannot be the optimal course of action.[5] Melhardt (2013) is arguing that the scope of application of the reverse-charge mechanism steadily increases which leads to more complex cross-border transactions: To a great extent, the application of the reverse-charge mechanism is subject to Member States' options or individual derogations.

Quite on the contrary, a system needs to be incorporated which, on the one hand, makes sure that fraud is as hard to achieve as possible, while on the other hand, honest traders are not unreasonably burdened with administrative extra burdens. Optional provisions to be exercised by Member States cannot fulfill such aim, especially where Member States remain legislative freedom to lay down the conditions of applying such options.[6]

6.3 Czech solutions to tax evasions

In the Czech Republic there has been a great deal of pressure for transferring liability for unpaid VAT to the recipient of a taxable supply as a result of unsuccessful application to the European Commission for introduction of reverse charge mechanism in fuel sales. Some other measures were recommended to use.

[5] This is also represented by the ECJ's longstanding case law that derogations to the VAT Directive as such need to be interpreted narrowly and strictly. See for example and amongst others ECJ 16 May 2013, Case C-169/12, *TNT Express Worldwide*, not yet published, para. 24; 14 March 2013, Case C-108/11, *Commission/Ireland*, not yet published, para. 42; 17 January 2013, Case C-360/11, *Commission/Spain*, not yet published, para. 20; 19 December 2012, Case C-549/11, *Orfey Balgaria*, not yet published, para. 27; 6 May 2010, Case C-94/09, *Commission/France* [2010] ECR I-4261, para. 29; 8 May 2003, Case C-384/01, *Commission/France* [2003] ECR I-4395, para. 28;

[6] Which exactly will be the case with the revised application of the reverse-charge mechanism. See Art. 199a(3)(1a): "*Member States may lay down the conditions for the application of the mechanism provided for in paragraph 1*".

Liability for unpaid VAT[7] is a measure of transferring liability on condition that the recipient knew, should and could have known that the tax would not be paid. Good faith of the purchaser is protected e.g. by the judgment of the European Court of Justice in *Optigen* case. Thus, liability for unpaid tax is extended also to cases when the going price was apparently different from the going price without any economic reason. As there could have been circumvention of supervision by the tax authorities when payments for taxable supplies were sent to accounts of collection agencies, Para 109 Section 2(b) which requires that payments for a taxable supply should be sent to accounts held in the home country was added to the Clause. Vendors have to register their bank accounts in a publicly available database similar to that which enables to verify VAT payers in the Member States of the European Union. If the payments were made to other than the registered accounts, the purchasers would also be liable for unpaid VAT.

An amendment to VAT Act is a change in the tax reporting period from a quarterly period to a mandatory monthly period. In accordance with this regulation each new payer must be first registered as a monthly payer. Only then, if they do not exceed the limit for a mandatory monthly tax reporting period, can they ask the tax authorities for a change to the tax reporting period (but no earlier than two years). The legislation responds to the fact that the purchaser (a monthly VAT payer) can deduct input tax before the supplier (a quarterly payer) pays the output tax. In some commodities such as fuels this procedure is quite common. Subsequently, the seller may become insolvent and go bankrupt and will not pay VAT to the state.

An unreliable payer is the name of the VAT payer who does not comply with the obligations in relation to tax administration. If the buyer trades with such a payer, he also runs a risk of being liable for unpaid VAT. The unreliable payer should not be permitted to change the tax period.

7 Conclusion

Indeed, the question arises whether there can be a solution for carousel fraud within the internal market. To quote a German public official from 1994: "As long as money is paid out by the state in certain situations, there will be successful methods to access this money illegally" (Ammann, 1994; Heller, 2013).[8] The current system of VAT in force in the internal market, especially with its general principle of the fractionated levying of VAT, leads to the possibility to make use of VAT carousels.

[7] It is in compliance with Art. 42 and 44 of Council Directive 2006/112/EC.

[8] On the contrary, however, see International VAT Association 2007, p. 45: "*As a consequence we believe that any changes to the existing system to fight against tax fraud, must not call into question the fundamental principles of VAT: it is a matter of preserving the rules of a game that are equitable for legitimate businesses but at the same time ensure the continued improvement in the efficiency of the revenue services*".

Many proposals were made by legal scholars how to tackle this problem. However, they mostly fail due to the fact that they entail a change in the current EU legislation. The EU legislator made clear that a general switch from the fractionated levying of VAT to a general reverse-charge mechanism is not wanted. Nevertheless, the current developments, especially in light of the Quick Response Mechanism, allow for a broader application of the aforementioned. Indeed, a concrete solution may not be easy to find. However, it is clear that solutions to be found in time need to take into consideration that honest traders must not be over-burdened with administrative obligations.

It is necessary to mention that VAT was established as a new tax. While almost 50 years ago, VAT was an unknown tax, these days it has an important role in many tax systems in the world. Some authors (e.g. Ebrill, Keen, Bodin, Summers, 2011) describe VAT as the most important tax in 20th century. Because it generates significant revenues, its impact on collecting cannot be underestimated. A growing number of states which implemented VAT increase also the number of fraudsters who attack it. The future will be dependent not only on legislation but also on the speed of adaptation to changes. In the last decade increasing VAT fraud could be observed (Tumpel, Wurm, 2011) and continuation can be expected.

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