

The „Carousel” Tax Fraud

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Abstract. *Through this article I aimed to undertake an analysis of illicit tax evasion, a term that I have taken as "tax fraud" and which I have considered as the "real" tax evasion, insisting on "tax fraud carousel". This can be considered the newest form of fraud that our national fraudsters have applied with much "professionalism" right after Romania's accession to the European Union. This is why I will focus on the carousel fraud mechanism and describe the measures proposed to combat this phenomenon at EU level.*

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1. Introduction

The carousel fraud refers to "(...) the VAT evasion and is largely linked to the secondary effects of the VAT regime in the European Union since 1993 when, at the level of the Single Market, it were added the "four freedoms": the free movement of goods, services, persons and capital"¹. In this way, in intra-Community trade, goods and services are exempt from VAT by applying them to a transitional regime. This means that intra-Community trade in goods and services is taxed in the member state where they arrive, known as the "Member State of destination". This system also contains the possibility of VAT fraud either in the supplier country or in the country of destination, generating significant losses to both the national budgets and the Union budget.

The sectors where this type of fraud is most present are the trade in electronic products and components (due to the difficulty of monitoring physical flows due to the high volume of these exchanges and the high profitability rate), trade in mobile phones and textile trade (in the latter case due to lohn practices).

Dragoş Pătroi states, in relation to this practice, the following: "the Carousel fraud concerning value added tax on intra-Community acquisitions is an undeniable, albeit undesirable, presence in the community space. The mechanism itself is structured under the current transitional arrangements for the taxation of intra-Community trade, which implies, as a general rule, the taxation of intra-Community trade in goods effected between taxable persons in the member state of destination. With the integration of our country into the European Union, a part of the Romanian economic agents sought to assimilate "on the go" the criminal practices of tax evasion, experienced "for many years in the community space and, very often, even with "success"².

¹ Pătroi, Dragoş; Cuciureanu, Florin; Benta, Adrian, *TVA naţional versus intracomunitar. Cazuri şi necazuri*, Publishing House C. H. Beck, Bucharest, 2013, p.p. 13

² Pătroi, Dragoş, *Frauda de tip carousel privind taxa pe valoarea adăugată aferenta tranzacţiilor intracomunitare*, Curierul fiscal Journal, 2015, p.215,

<http://www.curierulfiscal.ro/wp-content/uploads/2008/10/d-patroi.pdf> accessed on 15th of August 2015.

2. The Mechanism of Carousel Tax Fraud

The carousel fraud is based on a relatively simple mechanism - the home economic operator invoices without VAT (because it carries out an intra-Community supply, which falls into the category of VAT exempt transactions) and the economic operator in the country destination will apply the reverse charge scheme for this transaction, on the ground that it is making an intra-Community acquisition by calculating and recording VAT on intra-Community acquisitions at the tax rate of its country, both VAT collected and VAT deductible but not paying it effectively. Following the intra-Community acquisition, the economic operator "disappears" without registering, declaring and paying the VAT collected on subsequent deliveries made on its domestic market.

These firms are also called, "phantom" firms due to their volatile behavior in the practice of investigating carousel fraud and the "missing link" - in intra-Community trade. The VAT carousel fraud related to intra-Community transactions involves a chain of cross-border sales and purchases within the Community market (without excluding, however, the possibility of interposing non-EU firms), made by a group of operators which sometimes seek to exploit, under an apparent legality, the differences in tax rates applied by EU member states.

Just to sum up, we can say that the main methods of the carousel tax evasion are the following: declaring intra-community deliveries, while the goods are kept for sale on the domestic market, without VAT; non-payment of VAT due on arrival of goods in the country of destination; actual fraud with "phantom" company. Although we only needed a few lines to present them, these fraud mechanisms are very sophisticated and complicated as they engage with many EU countries and many companies.

The "ghost" or the "missing trader" is the main "actor" of the fraud and is a firm without activity or just a minimal just to be able to legally survive. Romanian fraudsters have focused on homeless or very poor people who "easily" rent their identity for some material advantage either because they do not understand anything or have nothing to lose. This company purchases goods from a member state without paying VAT, sells them in the country or countries of destination, with VAT, without paying the amounts thus collected. For another layer of security, the transaction can engage a chain of „ghost” firms.

In the practice of fraudsters, there are two types of "ghost" firms. The first type refers to 100% fictitious firms that are not registered with the Trade Registry, their "existence" being a total false: false identity, false financial documents, false headers, false stamps. Most often, these firms attribute names and logos very similar to well-known commercial companies on the market. The second type, which is the most numerous, are companies registered with the Trade Register, so 100% legal. They have legal identity, have their headquarters and maybe work points, they have bank accounts, have legal administrators. Obviously, their statements contain false data and when the danger of detecting their illegal activity is at the peak, when the state budget debts are dangerously big, these firms are transferred to foreign citizens who can not be found or to irresponsible people, who can not be held accountable.

The carousel fraud mechanisms take into account the tax laws of each country, which makes fraud patterns somewhat different from one country to another.

A first method, commonly found in our country and named from this reason, "the classical method", refers to intra-Community acquisitions made by an economic operator in Romania. For example, company X, from Romania, registered as a VAT payer makes an intra-Community acquisition from Y, located in a Member State. On the basis of this transaction, it appears that company X could very well carry out that intra - Community acquisition, as it would be an honest economic agent, in good faith, and would consent to the registration of its VAT tax obligations. In fact, to circumvent these tax obligations,

X's decision-makers will set up another "arrow" firm, Z, whose sole associate and administrator is an interpus, a person without decision-making, willing to take over with the possible negative consequences, Z being in fact controlled by the representatives of X. At the establishment of Z, it is declared as a VAT payer by option but declares an annual turnover below the expected value threshold in order to benefit from the possibility the quarterly submission of the VAT return. Subsequently, company Z performs intra-community acquisitions from company Y, firm Z applying the reverse charge regime for these operations. The goods thus acquired are subsequently invoiced to their respective beneficial owner, namely company X. For these internal delivery operations, Z collects (hypothetically) the related VAT and company X will deduct it, using as evidence, the bills drawn up by Z.

The above described operations have a precisely determined "lifespan", respectively

up to 3 months, by the due date for Z's obligation to file the VAT return; shortly before this deadline, Z "disappears" and can no longer be identified and without registering, declaring and paying the VAT collected as a result of internal deliveries to company X. Practically, Z has as a "unique object of activity" to provide supporting documents to company X for the purpose of deducting VAT from the latter. Certainly, the fraud company is Z. Having the VAT registration code assigned to it, the question arises as to whether X can deduct VAT on supply invoices from its supplier or directly, Z? "In this respect, the European judicial practice governs the fact that if a taxable person participates involuntarily in "a carousel" fraud (without being aware of this fact), he has the right to deduct (and, implicitly, to compensate or to reimburse VAT on upstream operations,.. From this perspective, each company in the chain of transactions related to intra-Community transactions will be analyzed individually, especially since, in practice, between Z (the intra-Community purchaser) and X (the factual intra-community purchaser and the "brain" of the whole mechanism) can be interposed (obviously only at the script level of the document circuits) a number of other companies to disassociate the illicit nature of the facts and to break the causal link between Z and X. In view of the above, it follows that participation in the fraudulent carousel mechanism is not presumed, but must be proved, starting from to the correlation analysis of cash flows, the scripted circuit of documents and the actual route of products.

Concluding indices in this regard could be the following:

- correspondence on the terms of delivery and payment is routed, from the beginning, between the representatives of X and Y;
- the goods are actually transported directly from company Y to company X (where otherwise, it is also received at the time of the transport) and the payment of the counter value is made directly to company Y by firm X "at the order" of Z;
- data related to transportation or delegations, included on the invoice made by the firm Z to firm X does not reflect a real situation;
- the amounts earned in Z's bank accounts from customer X or company X will return to X, directly or through other companies, based on bills for services that do not reflect actual economic transactions (usually, service provision).

A second method of a "carousel" fraud is in fact a "refinement" of the one described above, in the sense that the products ultimately come from company X to Y, their original sender. This method can be identified as the self-generating mechanism of "carousel" fraud, with visible effects in cheaper products that are the subject of these transactions. This mechanism is structured on the fact that the delivery price of X to Y (and we mean the delivery price without VAT because, when X sells to Y, the company X makes an intra-community delivery, entering into the category of VAT exempt transactions) is lower than the sale price initially practiced by firm Y to Z; Firm X can

"support" this delivery price from the "VAT gain" resulting from the upstream transactions with Z. In addition to the unfavorable tax implications of consolidated general government revenue, this method causes distortions (through prices) and economic competition, so that fair firms become uncompetitive on the market due to real market prices) in favor of companies with fraud (because of the "trick" price on the market).

A third method of this type of fraud relates to simulated deliveries by an economic agent in Romania registered for VAT purposes to an economic agent from another member state registered for VAT purposes under the specific legislation of the member state of which he is a member. In this respect, the Romanian company performs an intra-Community delivery, invoices VAT-free, based on the VAT code belonging to an external economic agent from the community space, but actually sells these products on the domestic market. This can be done either through the complicity of the external partner (who communicates his VAT code) or without his knowledge (for example, by purchasing the VAT code from various sources of information). Of course, the so-called "intra-Community delivery" in question will have to be highlighted by the Romanian economic agent in the VAT return, the recapitulative statement and the intrastate statement (in the latter case, depending on the value threshold, as we have shown previously) and the data reported to the Romanian public authorities will be subsequently confronted with those reported by the external partner to the public authorities in its country. However, during this time, the economic agent concerned will demand VAT reimbursement and will subsequently "volatilize" (through the change of registered office and the transfer of shares to persons hard to identify and which are not usually found anymore in the country at the time of tax checks). We do not exclude the fact that the reverse situation, billing by an external economic agent, from the community space, to a Romanian firm, either with its complicity or without its knowledge, can also arise.

A fourth method, which is extremely sensitive between legal and illegal (from the point of view of probation force) refers to the situation where a Romanian economic agent registered for VAT purposes carries out an intra-Community acquisition and declares all operations in this respect, from an absolutely legal point of view. Later, it records a modest commercial value-added and simulates retail sale through electronic fiscal cash registers. In fact, those products are marketed on the "parallel market" at prices much higher than those recorded in the accounting records (but below the market price for those products); the injury, in this case, is located both at the level of the corporation tax and the VAT level (obviously, according to the undeclared price difference). The "classic" example of this is the intra-Community acquisition of flour, simulating its commercialization in detail (by means of fiscal electronic cash registers, to individuals, whose subsequent identification is not required by any law, and, on the other hand, nor can they can be identified from a practical point of view), but in reality being sold to various bakeries and / or pastries (which in turn will sell the finished product outside the scope of taxation).

3. Methods to Control the „Carousel” Fraud

In order to establish the best and most effective measures to combat the carousel fraud, we have to know its causes, the etymology of the phenomenon, which is complex, considering all the economic, social, financial and moral implications resulting from the evasion legal tax obligations. Hence, the effectiveness of combating the "carousel" fraud process lies in the ability to remove the causes that produce or this mechanism.

On March 17, 2008, the European Commission adopted a proposal to amend the VAT Directive and the Administrative Collaboration Regulation in order to accelerate the collection and exchange of information on intra-Community transactions from 2010 to enable the member states to identify very fast every carousel fraud. On that occasion,

László Kovács, Commissioner for Taxation and Customs Union at that time, said: "The measures proposed today are the first steps towards a more effective fight against the VAT fraud. They have the advantage that they can be implemented very quickly and that they can not impose administrative costs on economic agents."³

When an intra-Community transaction takes place, it is between three and six months before the Member State where VAT is due to receive transaction information. It is proposed to reduce this period to between one month and two months, thus allowing for faster identification of frauds.

To this end, the Commission has proposed and adopted the following measures, in force:

- harmonize and reduce by one month the period during which taxable persons must declare intra-Community transactions involving the supply of goods or services within the Community;
- the reduction from three months to one month of the period for the transmission of this information between Member States;
- monthly collection of information on intra-Community acquisitions of goods or services where the buyer has to pay VAT to facilitate verification of the information provided by suppliers. Buyers or customers making transactions greater than € 200,000 per year will be required to submit monthly VAT returns. This threshold was set in order to avoid imposing additional obligations on undertakings which only occasionally or for small amounts of intra-Community acquisitions take into account the significant amounts for fraud.

Along with these, other measures have been taken. Thus, the service that verifies the VAT registration information on the Europa website will obtain confirmation of the name and address of the trading partners established in other Member States and will issue personal consultancy certificates. This measure aims, on the one hand, to strengthen the legal certainty of the right operators and, on the other hand, to carry out more effective controls by the tax authorities.

Considerable progress has also been made in discussions with national authorities on the following issues:

- automatic access to certain non-confidential information that member states hold about the persons who have to pay VAT (sector of activity, certain turnover data, etc.);
- harmonizing the procedures for enrolling people who have to pay VAT to ensure that people who do not have to pay VAT are quickly identified and erased. The expert group is studying the introduction of minimum standards.

Regarding the effectiveness of these measures, "(...) from which more than 7 years have passed, without noticing a significant decrease in the phenomenon"⁴, we subscribe to the doubts formulated by Dragoş Patroi as follows: „ Did we started again from the effect, and not from the cause? It is time to provide answers in these directions, but for our part, we consider that the cause of the phenomenon has to be considered, namely by the radical change of the current taxation system by changing the taxation system at the destination with the taxation at the origin of the transaction. But for the implementation of this goal, the unanimous agreement of the member states is needed,

³ ***The European Commission, Romanian Office, the European Commission proposes measures to effectively fight against VAT fraud, http://ec.europa.eu/romania/news/17_03_08_tva_ro.htm, accessed on 27th of August 2015.

⁴ The Report of the EU Parliament's Committee on the International Trade, rapporteur Sander Loones, 2014 Report on the Protection of the EU Financial Interests - Combating Tax Fraud;, file:///D:/Downloads/s-2014_2019-plmrep-COMMITTEES-INTA-PA-2015-11-30-1073917RO.pdf, accessed on 23rd of March 2016.

and from this point onwards the discussion becomes much broader, given that some member states are reluctant to do so".⁵

We can also say that the change in the current VAT and excise system in the sense of reinforcing the principle of shared responsibility for paying taxes and introducing the "reverse charge" system, supported by the United Kingdom, Germany and Austria, through which European companies will apply VAT on their one for services from other member states or from third countries, would have beneficial effects in reducing the tax fraud.

Last but not least, we believe that harmonizing EU-wide penalties for comparable fraud cases would prevent situations where less stringent legislation or less efficient audit systems make it possible to create genuine "criminal paradises" for income from criminal activity.

From the point of view of the taxpayer, which we must also take into account in the sense of not disadvantaging it by abusive taxation, an important problem is the avoidance of double taxation. "Double international taxation occurs when the tax authorities of two or more states simultaneously collect taxes with the same incidence, in a way that a person has a heavier tax burden than if he had been subject to a single tax authority." In other words, double taxation is the taxing of the same taxable matter for the same period of time by two tax authorities in different countries.

The emergence of double international taxation is determined by the diversity of tax systems, the particularities of fiscal policies as well as the use of taxes and duties as levers to stimulate or limit economic activities. This fact has only negative effects on society in general because it produces a higher fiscal pressure and, last but not least, stimulates the tax evasion. In order to avoid being subject to two distinct taxes, the taxpayer seeks to avoid being subject to any kind of taxes and for this reason he is fled to tax-protected areas.

4. Conclusions

I believe that, in the current economic context, in order to combat carousel fraud more effectively at intra-Community level, it is of particular importance to improve administrative cooperation between member states by improving investigative techniques, introducing new administrative mechanisms and legislative initiatives. Administrative cooperation plays a key role in combating VAT fraud because such frauds are committed by chains of companies from different Member States.

The problem of tax fraud must be analyzed both at national and European Union level, given the quality of Romania's member state, where the most widespread method which is generating the largest amount of evaded funds is the "carousel fraud". We believe that the cause of the phenomenon, namely the radical change of the current taxation system by changing the toll system at destination with the original toll system, needs to be addressed. But to achieve this, the unanimous agreement of the member states is needed, and from this point on, the discussion becomes much broader, as some member states show reluctance in this direction.

Although the member states have established an information exchange system through appropriate instruments based on the Treaties, we believe that this information exchange is far from being a standard practice because of cultural differences, different levels of computerization, and the lack of adequate legislation. Therefore, a culture needs to be formed at the level of the whole of the European Union to accept that requests for cross-border exchange of information should not be regarded as

⁵Pătroi, Dragoș, *Frauda de tip carusel privind taxa pe valoarea adăugată aferenta tranzacțiilor intracomunitare*, Curierul fiscal Journal, <http://www.curierulfiscal.ro/wp-content/uploads/2008/10/d-patroi.pdf>, accessed on 25th of August 2015.

exceptional and isolated, but rather a standard practice within the investigative process whenever necessary. To achieve this goal, obstacles to an administrative culture of the European Union must be overcome by encouraging the full use of existing cooperation instruments and the respect of deadlines and procedures so that the investigative bodies have the necessary information in time for their work investigation.

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