BRIEFING

Requested by the CONT committee

Missing Trader Intra-Community Fraud

KEY FINDINGS

Value added tax (VAT) fraud has an extensive impact on the European Union (EU) budget. As missing trader intra-community (MTIC) fraud is the biggest kind of VAT fraud it would be beneficial to fight this kind of fraud to a larger extent. MTIC and carousel fraud both use the zero-rate VAT system on intra-community trade. The missing trader disappears with the VAT that has been charged in the country of destination of the goods and services sold. In the case of carousel fraud the goods or services are being redirected back to the initial seller.

MTIC has been estimated to cost revenue authorities EUR 60 billion on an annual basis. The exact amount is difficult to calculate as sufficient data is lacking and the fraud schemes are very complex. There is also not enough information available on the actual amount recovered from committed fraud cases. The problem is that Member States are responsible for the investigation and prosecution of potential fraud. The Member States do not always use the same definition of fraud and sometimes only label a case as fraudulent after a court ruling. The European Anti-Fraud Office (OLAF) can only conduct investigations and send an advice to the Member State affected. The Member State needs to carry out their own research before prosecution. With the establishment of the European Public Prosecutor's Office (EPPO) this could change as EPPO will be able to conduct their own investigations and prosecutions.

A solution to the problem would be to improve the current VAT system or replace it with a permanent single EU VAT system. The current system is still the temporary system of 1993 which was introduced with the establishment of the Single Market. It was meant to be replaced in 1996 by a permanent system but this has not happened so far. The European Commission (EC) has proposed an 'action plan on VAT' in 2016 with the intent to replace the current system with a permanent VAT system. This can only be implemented after a unanimous vote by the Council. Nevertheless, a common VAT system would have significant influence in the fight against MTIC fraud.

Introduction

Missing trader intra-community (MTIC) fraud has a significant impact on the budgets of both the European Union (EU) and the Member States. The exact amount involved in this kind of fraud is difficult to determine because of the scale of the schemes. It is very complex to detect the committed fraud and to reclaim the value added tax (VAT) that was stolen. MTIC can be described as a company who sells a product or service, charges the VAT and afterwards disappears without forwarding the VAT to the national tax authorities. The 'missing traders' make use of the gaps within the VAT system of the EU.[1] This briefing will give an overview of the existing rules concerning VAT, an explanation of MTIC and possible solutions to the problem.

[1] Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472 and Europol, MTIC (MISSING TRADER INTRA COMMUNITY) FRAUD (2021), https://www.europol.europa.eu/crime-areas-and-trends/crime-areas/economic-crime/mtic-missing-trader-intra-community-fraud

Policy Department for Budgetary Affairs
Author: Alexandra Pouwels
Directorate-General for Internal Policies
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VAT policy in the EU

VAT is an indirect tax on goods and services. The tax is applicable to all stages of the distribution and production process.[2] VAT is a consumption tax which is paid by the final consumer. The tax is paid by the consumer to the seller of the goods or services. The seller is the one who needs to forward the VAT to the tax authorities. 'VAT is collected fractionally via a system of partial payments where taxable persons (i.e. VAT-registered businesses) deduct from the VAT they have collected ("output VAT") the amount of tax they have paid to other taxable persons on purchases for their business activities ("input VAT").'[3] This system applies within all the Member States of the EU.

With the creation of the internal market (1 January 1993) barriers to intra-community trade were set aside. The rules that were introduced in 1993 were meant to be a temporary system. The initial idea was to replace the taxation system with a permanent one before 31 December 1996. Nevertheless, a provision was added to extend the system in case a permanent arrangement was not yet in place by then.[4] This temporary system is still valid today. The current system has been under review for a couple of years. In 2016, the Commission introduced an action plan concerning VAT. To change the taxation system, a unanimous decision needs to be taken by the Council after consultation with the European Parliament and the Economic and Social Committee.[5] In 2019, the Commission proposed to shift to an ordinary legislative procedure when voting on taxation policy. An important element of the proposal is the shift from unanimous voting to qualified majority voting.[6] Articles 110-113 of the Treaty on the Functioning of the European Union (TFEU) are the basis for the legislation on indirect taxation policy. Article 113 also states that harmonisation is needed for the proper functioning of the internal market.[7]

VAT is an important source of revenue for both the Member States and the EU.[8] In 1993, an intra-community system was developed in which business-to-business (B2B) transactions are taxed in the country of destination. The rate of VAT of the destination country applies to all goods and services. When the goods or services are crossing the border a zero tax rate applies. If the goods or services are sold afterwards internally within the Member State VAT is charged to the consumer.[9] The idea behind this is that the taxes are paid in the country of consumption. The current system is complex and the compliance costs are high.[10]

The intra-community taxation system is vulnerable to fraud as the system relies on the honesty and declaration of the VAT-registered businesses. Fraud is described by the European Court of Auditors (ECA) report on 'Fighting fraud in EU spending: action needed' (2019) as 'any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and the perpetrator achieving a gain'.[11] Protecting the EU financial interest is a shared competence between the EU and the Member States. For example, 'the Customs Union is fully within the competence of the EU but the national customs authorities are responsible for duty collection and tackling any fraud schemes'.[12] The detection and prosecution is within the competence of the Member States. The European Anti-Fraud Office (OLAF) is the responsible body to

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2 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.

3 European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018), P.7.

4 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.and Remeur, Cécile, EPRS, 'Detailed technical measures for the definitive VAT system for cross-border goods trade December (June 2019).

5 Treaty on the Functioning of the European Union, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12016E113

6 Karaboytcheva, Miroslava, EPRS, 'Addressing the VAT gap in the EU' (December 2020).

7 Treaty on the Functioning of the European Union, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12016E113

8 Remeur, Cécile, EPRS, 'Detailed technical measures for the definitive VAT system for cross-border goods trade' (June 2019).

9 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.

10 Karaboytcheva, Miroslava, EPRS, 'Addressing the VAT gap in the EU' (December 2020).

11 European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019), P. 5.

12 Van der Paal, Johan et al, 'Protection of EU financial interest on customs and VAT: cooperation of national tax and customs authorities to prevent fraud' (2019), P. 7.

perform independent investigations to detect fraud on EU level.[13] The results of the administrative investigations will lead to recommendations that OLAF sends to the affected Member State.[14] OLAF does not have the powers to sanction or prosecute subjects of suspected fraud nor do they have the power to oblige Member States to initiate sanctions or investigations on the basis of the recommendations.[15] This situation could change with the establishment of the European Public Prosecutor's Office (EPPO). An additional problem is that Member States have a different way of approaching the combat against fraud. There is a difference in the reporting of fraud and the definition of fraud. Some Member States only report on fraud after a Court ruling. The ECA report states that 'Member States have their own systems for recording cases under investigation and nearly half of them do not differentiate between financial crimes affecting national interest and those affecting EU interests'.[16]

Missing Trader Intra-Community Fraud and Carousel Fraud

MTIC fraud and carousel fraud are two forms of fraud in which a business disappears without paying the VAT due to the tax authorities or requesting a VAT refund from the government. In both cases the VAT can be seen as a profit for the 'missing trader' who disappears with the money. For MTIC and carousel fraud cross-border trade is important as intra-community trade has a zero-rate VAT taxation. There are many different and complex versions of MTIC. For this briefing we are focusing on the simplest version of MTIC and carousel fraud.[17][18]

Missing Trader Intra-Community fraud

Since the introduction of the single market, MTIC fraud has become an increasing problem which is a 'large-scale organised criminal attack on the EU VAT system'.[19] Businesses committing MTIC fraud are using the zero-rate concept for goods and services crossing the borders from one Member State to the next. VAT only applies when the goods or services are sold again in the Member State of destination to another buyer.[20]

The Commission describes a 'missing trader as a trader registered as a taxable person for VAT purposes who, potentially with a fraudulent intent acquires or purports to acquire goods or services without payment of VAT and supplies goods and services with VAT but does not remit the VAT due to the appropriate national authority'.[21] A missing trader could potentially only exist on paper and does not necessarily be an actual functioning company.[22]

MTIC works as follows: company A (supplier) in Member State 1 sells goods or services to company B (missing trader) in Member State 2. As this is a cross border transaction the zero-rate applies to the selling of the goods or services. Company B thereafter sells the goods or services to company C (customer) in Member State 2. Now the VAT rate of Member State 2 applies. After the sale company B disappears without remitting the VAT due to the authorities of Member State 2. See the visual presentation of MTIC fraud below.

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13 Van der Paal, Johan et al, 'Protection of EU financial interest on customs and VAT: cooperation of national tax and customs authorities to prevent fraud' (2019).

14 Ibid.

15 Ibid.

16 European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019), P. 20.

17 For more information on the diverse complex versions of MTIC read 'The Concepts of Tax Gaps' from the FISCALIS 2020 Tax Gap Project Group, subgroup VAT fraud (FPG/041, November 2018).

18 European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).

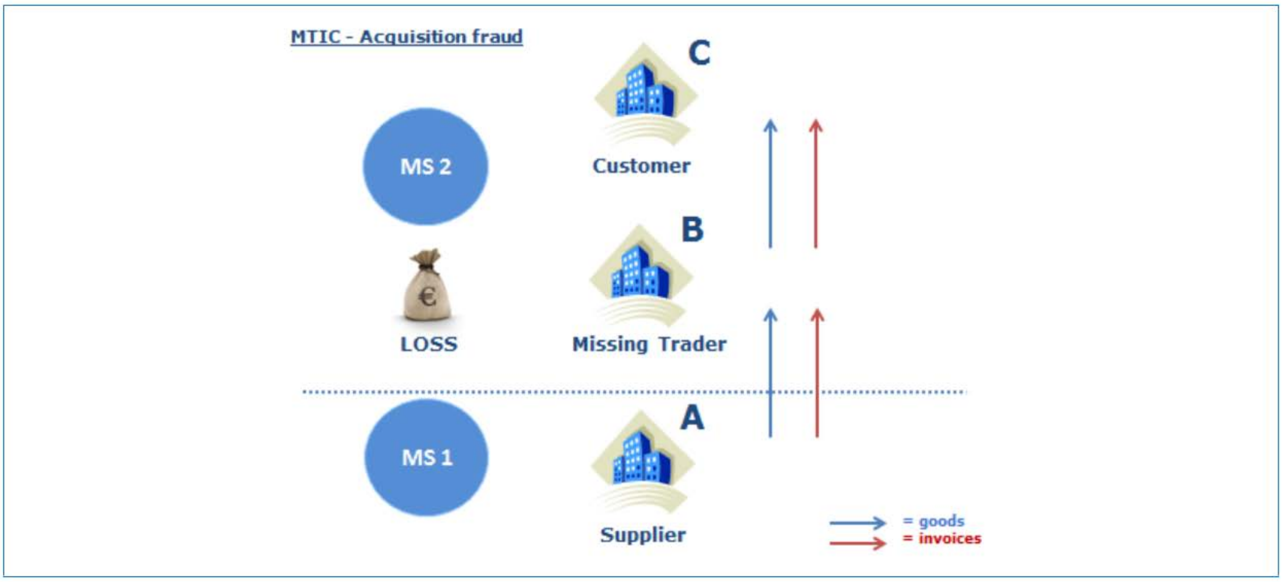
19 Garner, Viktorija, 'Missing Trader Intra-Community fraud: European E-VAT' (2009), Academic Conferences & Publishing International Ltd., P. 283.

20 Europol, SOCTA, 'European Union serious and organised crime threat assessment' (2017), file:///C:/localdata/apouwels/Downloads/report_socta2017_1%20(1).pdf

21 Commission Regulation (EC) No 1925/2004 of 29 October 2004 laying down detailed rules for implementing certain provisions of Council Regulation (EC) No 1798/2003 concerning administrative cooperation in the field of value-added tax, Article 2, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32004R1925

22 European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).

Missing Trader Intra-Community fraud



Source: The concept of tax gaps, November 2018.[23]

In the case of simple MTIC fraud the loss is for the budget of Member State 2. In the case of carousel fraud the scheme becomes more complex.

For a while MTIC VAT frauds were mostly committed in specific industries. The industries most commonly targeted were mobile phones and computer chips as these were transactions with high value and low weight.[24] These specific industries were targeted as the products were easy and inexpensive to transport.[25] 'Since then, frauds have shifted to the sales of other goods (new and used motor vehicles, wood, alcohol and tobacco products, oil and oil derivatives, gas and electricity) and even to tradable services sector (software, licensing, data provision, emission trading) which unlike goods, do not need to be moved, because they are immaterial'.[26] This shows that the fraudsters are becoming increasingly advanced in committing MTIC.

Carousel fraud

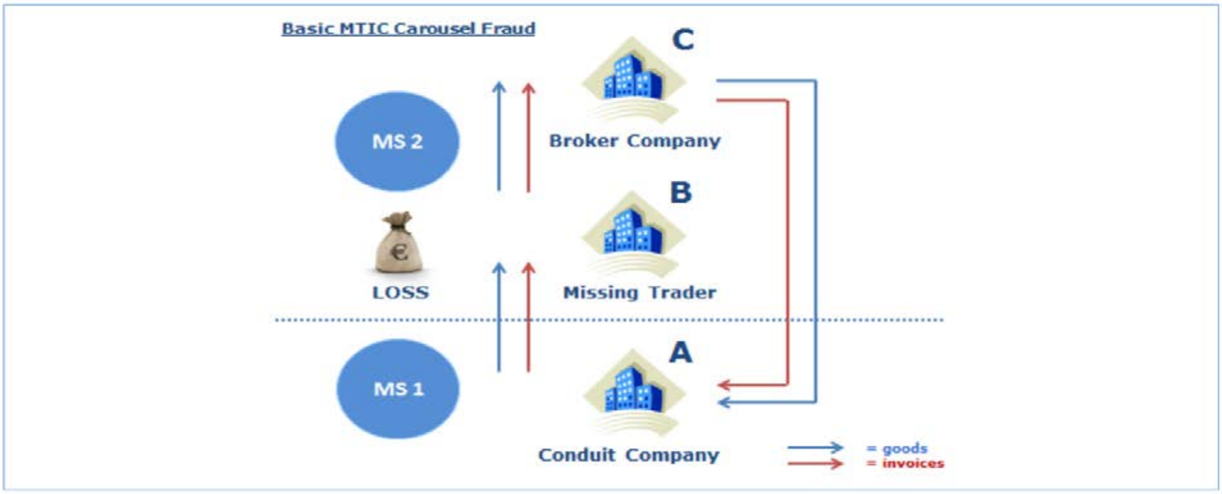
In the case of carousel fraud the same goods and services are sold by a group of companies in a circle.[27] These companies receive and claim reimbursements of VAT that have never been paid.[28] The main difference between simple MTIC and carousel fraud is that the goods and services arrive back at the original seller and therefore concluding the circle.[29] This circle can be very extensive with the inclusion of buffer companies. These buffer companies serve to hide the fraud from the authorities. Often the buffer company is located in the chain behind the missing trader to make the investigations of the fraud scheme more

23 European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).
24 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.
25 Ibid.
26 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 458.
27 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.
28 Europol, SOCTA, 'European Union serious and organised crime threat assessment' (2017), file:///C:/localdata/apouwels/Downloads/report_socta2017_1%20(1).pdf
29 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.

difficult.[30] Carousel fraud could extend to more than ten companies and over multiple Member States.[31] VAT-registered companies are allowed to claim VAT on their cross-border purchases often resulting in a request for a VAT refund.[32] 'The purchaser not paying VAT to the supplier must declare an intra-community acquisition (ICA) in the Member State of destination. This VAT is deductible.'[33]

Carousel fraud works as follows: Company A (Conduit company) in Member State 1 sells goods or services to company B (missing trader) in Member State 2. Here the zero-rate VAT tariff applies. Company B sells the goods and services to Company C (Broker Company) in Member State 2 and here the VAT rate of Member State 2 applies. Company B then disappears. Company C then sells the goods or services back to Company A in Member State 1. As company C bought the products on the domestic market of Member State 2, it had to pay VAT to company B. The sell between Company C to company A in Member State 1 is an intra-community sell and therefore Company C can ask for a refund of the VAT paid to company B. Therefore, a double loss occurs for the budget of Member State 2 as the missing trader (company B) never remit the VAT due and the broker (company C) requests for a refund of the VAT paid to the missing trader. See the visual presentation of carousel fraud below.

Missing Trader Intra-Community fraud



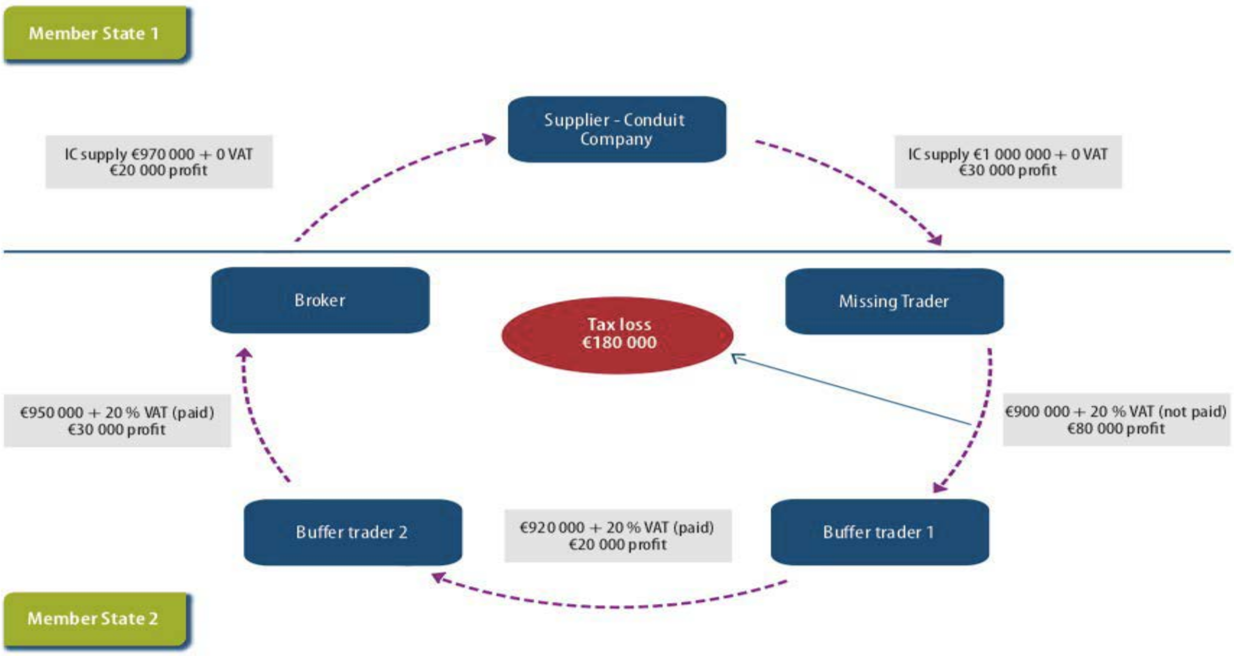
Source: The concept of tax gaps, November 2018.[34]

It needs to be said that the conduit company (company A), the missing trader (company B) and the broker (company C) are the ones that plan the fraud.[35] This means that there could be more buffer companies in between who could be involved in the fraud or are not aware of the fraud being committed.

The ECA drafted a special report on 'Tackling intra-Community VAT fraud: More action needed' in 2015. In their report they used a carousel fraud scheme with real amounts. See the visual presentation of the amounts gained by conducting carousel fraud below.

[30] European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018). and Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.
[31] Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.
[32] European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).
[33] Ibid., P. 9.
[34] European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).
[35] Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.

Example of carousel fraud including real amounts



Source: European Court of Auditors, special report on Tackling intra-Community VAT fraud: More action needed (2015).[36]

Possible solutions for Missing Trader Intra-Community Fraud

MTIC fraud is the most common and largest form of VAT fraud[37] and has therefore a significant impact on the budgets of the Member States and the EU. MTIC fraud loss has been estimated at EUR 60 billion per year.[38] It is very difficult to identify the size of the VAT lost through MTIC fraud as the schemes are so complex.[39] Therefore, the actual amount lost to the budgets is unknown and can only be estimated. It is not possible to just add all the figures of the Member States together due to the likelihood of overlaps. This has to do with the potential difference between the invoices trail and the actual supply trail.[40]

As the EU budget is financed by three sources of income, traditional own resources, statistical VAT based contribution and an own resource based on Gross National Income (GNI) by the Member States,[41] every euro lost to MTIC fraud needs to be made up by other sources of income. The relative share of customs and VAT duties to the EU own resources has reasonably decreased whereas the GNI contributions have substantially risen, to 70% of the total funding.[42] This shows that any loss because of VAT fraud would need to be made up by the GNI contribution.[43] It would therefore benefit the EU Member States to solve the problem of the VAT system and actively contribute to detecting and prosecuting MTIC.

According to the ECA the Commission's 'analysis of fraud patterns and fraud risk is insufficient'.[44] The Commission does not have extensive information regarding the scale, nature and causes of fraud. There is

36 European Court of Auditors, special report on Tackling intra-Community VAT fraud: More action needed (2015)
37 Europol, SOCTA, 'European Union serious and organised crime threat assessment' (2017), file:///C:/localdata/apouwels/Downloads/report_socta2017_1%20(1).pdf and Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.
38 Karaboytcheva, Miroslava, EPRS, 'Addressing the VAT gap in the EU' (December 2020).
39 European Commission, 'The concept of tax gaps; Report III: MTIC Fraud Gap estimation methodologies' (November 2018).
40 Ibid.
41 Van der Paal, Johan et al, 'Protection of EU financial interest on customs and VAT: cooperation of national tax and customs authorities to prevent fraud' (2019).
42 Ibid.
43 Ibid.
44 European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019), P. 22.

also a lack of assessments of undetected fraud.[45] Detection of fraud is necessary to recover the losses to the national and EU budgets.[46] Nevertheless, it is not clear how much money is recovered in the cases where fraud was detected.[47] The problem with investigating and detecting fraud is that the main investigations and prosecutions are carried out by the Member States. OLAF can only indicate that fraud has been committed and needs to refer the case to the Member States. The Member States will carry out their own investigation and decide if they move on to prosecution.[48] The special report of ECA on 'E-commerce: many of the challenges of collecting VAT and customs duties remain to be resolved' of 2019 states that 'the controls carried out by the national tax authorities are weak and those of the Commission are insufficient'.[49] With the introduction of EPPO this might change but still EPPO does not have a mechanism to force the Member States to allocate resources and to investigate the potential fraud.[50] Another risk for EPPO could occur as translation and consultation is needed on all the documents for the EPPO Chambers to work and this could take too long for criminal procedures where time is of the essence.[51]

There are different solutions to tackle MTIC fraud. Some are targeting the VAT system where others are pointing towards the fraud prevention strategy. A possible solution to detect and recover fraud is the introduction of a common EU VAT system. In 2016, the 'action plan on VAT' was published by the Commission. This document aims at creating a single EU VAT area.[52] To establish a single EU VAT system the Council needs to vote on it unanimously. According to the Commission a single EU VAT system would be decisive in the fight against fraud.[53] The EP adopted the resolution (24 November 2016) 'Towards a definitive VAT system and fighting VAT fraud' which called for more cooperation with the Member States in the fight against fraud, modernising of the current system but also improving the system that is already in place.[54]

The system that is in place now could be improved in order to prevent MTIC. For example by 'the performance of tax inspections, cooperation between tax authorities in different Member States, imposing liability on persons participating in frauds and refusal of VAT deduction'.[55] To reinforce this, system checks need to be carried out when businesses register for VAT, for example by on-site visits, review of contracts or examination of business plans. Organisational measures could also add to the detection of MTIC, e.g. by creating special departments that will only deal with detecting and investigating MTIC.[56][57]

Another possible solution within the current system would be the use of the flat-rate system. VAT would be charged at a single rate for all cross-border intra-community trade despite the VAT rate applicable in the Member State. Nevertheless, this system would not completely prevent MTIC fraud as the trader could still disappear.

This shows that still more can be done in the fight against MTIC fraud.

45 European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019).

46 Van der Paal, Johan et al, 'Protection of EU financial interest on customs and VAT: cooperation of national tax and customs authorities to prevent fraud' (2019).

47 Ibid.

48 Ibid.

49 European Court of Auditors, 'E-commerce: many of the challenges of collecting VAT and customs duties remain to be resolved', (2019), P. 5.

50 European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019).

51 Ibid.

52 European Court of Auditors, 'Collection of VAT and customs duties on cross-border e-commerce' (2018).

53 Karaboytcheva, Miroslava, EPRS, 'Addressing the VAT gap in the EU' (December 2020).

54 European Parliament, 'Towards a definitive VAT system and fighting VAT fraud' (24 November 20216), https://www.europarl.europa.eu/doceo/document/TA-8-2016-0453_EN.pdf

55 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 465..

56 information on improving the current system please read 'Missing trader intra-community and carousel VAT frauds - ECJ and ECTHR case law'

57 Podlipnik, Jernej, 'Missing Trader Intra-Community and Carousel VAT Fraud - ECJ and ECTHR case law' (2012) Croatian yearbook of European law & policy, Vol. 8, p. 457-472.

ECA recommendation to the EC

The ECA has provided four recommendations to the EC in its report on 'Fighting fraud in EU spending: action needed'. These recommendations are targeting the fight against fraud. The recommendations are as follows:

Recommendation 1: put in place a robust fraud reporting system providing information on the scale, nature and root causes of fraud;

Recommendation 2: achieve better coordination in tackling fraud within the context of collegial responsibility for fraud prevention and detection; ensure that strategic fraud risk management and fraud prevention would be clearly referred to in the portfolio of one Commissioner; and adopt a new comprehensive anti-fraud strategy based on a comprehensive analysis of fraud risks;

Recommendation 3: intensify its fraud prevention activities.

- *ensure that Directorates-General use the early detection and exclusion system in direct and indirect management and call on the Member States to identify and flag fraudulent economic operators and the private individuals linked to them;*
- *urge all Member States to make active use of the ARACHNE database to prevent fraudulent and irregular use of EU funds.*

Recommendation 4: reconsider OLAF's role and responsibilities in combating fraud in EU spending in light of the establishment of the EPPO, in particular the European Commission should propose the European Parliament and the Council measures to give OLAF a strategic and oversight in EU anti-fraud actions.

Source: European Court of Auditors, 'Fighting fraud in EU spending: action needed' (2019).

Conclusion

The current VAT system is still the same as the temporary system of 1993. As described MTIC and carousel fraud take advantage of the zero-rate percentage and disappear with the charged VAT money. The best way to fight this kind of fraud is the introduction of a common EU VAT system. To be able to introduce this system a unanimous vote is necessary in the Council. Another solution would be to improve the current system. This would require Member States to work together more intensely. With the action plan on VAT of the Commission the first step has been made to change the current system. It is important to change the system as it has a significant impact on the national budgets and through the own resources also on the EU budget. If the VAT could be recovered from MTIC fraud the EU would receive more money through the VAT contributions. This would mean that Member States have to contribute less through the GNI-based contribution. Therefore, addressing MTIC would benefit both the EU and its Member States.

Administrator responsible: Alexandra POUWELS Editorial assistant: Lyna PÄRT

Contact: Poldep-Budg@ep.europa.eu

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