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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE EUROPEAN
ECONOMIC AND SOCIAL COMMITTEE**

**concerning the need to develop a co-ordinated strategy to improve the fight against
fiscal fraud**

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concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud

1. INTRODUCTION

In 2004, fiscal receipts, i.e. the total amount of taxes and compulsory social contributions, represented 39.3% of GDP in the European Union, or €4 097.7 billion. On the other hand, there are only very few estimates available on the amount of taxes not collected due to fiscal fraud. In general, the economic literature mentions that fraud accounts for approximately 2 to 2.5% of GDP.

Therefore, the interests at stake in the case of fiscal fraud are extremely important. The functioning of fiscal systems is, and should remain, primarily the responsibility of the Member States. While fiscal administration, tax auditing and the recovery of taxes is in the hands of the Member States, however, the Commission has the duty to stimulate and facilitate cooperation between Member States in order to guarantee the proper functioning of the internal market and to protect the financial interests of the Community¹. Fiscal fraud undermines the smooth functioning of the internal market in that it leads to distortions of competition between those that pay taxes and those who do not.

The Member States express strong concerns regarding the extent of the fraud. The free circulation of goods, services, persons and capital within the internal market since 1993 has meant that Member States are increasingly incapable of fighting fiscal fraud in isolation. This difficulty is further compounded, at international level, by the globalisation of the economy. This is why the Commission believes it has to intervene in this area by presenting some material for discussion.

In its Communication "The Contribution of Taxation and Customs Policies to the Lisbon Strategy" of 25 October 2005, the Commission called for closer cooperation and the co-ordination of efforts at Community level in order to render the Member States' fight against fiscal fraud more effective.

The objective of the current Communication is to launch a debate with all the parties concerned on the different elements to be taken into account in an "anti-fraud" strategy at European level.

¹ Member States contribute to the Community budget through the VAT-based "own resources".

2. THE FIGHT AGAINST FRAUD: STATE OF PLAY

2.1. VAT

VAT fraud takes different forms within the Member States, ranging from the black economy to internal fraud (false returns, unauthorised deductions). One typical form of fraud, termed “carousel” fraud, is where transactions within a Member State (on which VAT is charged) are fraudulently combined with intra-Community transactions (on which no VAT is charged between the contracting parties)². A growing involvement of traders in third countries has been observed in such cases recently.

VAT fraud affects the financial interests of the European Community within the meaning of Article 280 of the EC Treaty³.

Although the common legal framework for administrative cooperation⁴ was reinforced some years ago, the Member States do not make sufficient use of the new possibilities offered and the level of administrative cooperation is not commensurate with the size of intra-Community trade.

2.2. Excise duties

After 1993, concerns were expressed about the weaknesses of the “paper-based” system designed to follow up the movement of goods under an excise duty suspension system and about fraud committed outside the suspension regime by exploiting the differences in rates between the Member States.

The computerisation of the duty suspension system constitutes an important step forward in making the system secure. The Decision of the European Parliament and Council of 16 June 2003 calls for the creation of an automated system within 6 years. In the short term, certain measures have already been taken, one of which is the adoption of a new regulation aiming to strengthen administrative cooperation specifically on excise duties.

Nevertheless, other types of fraud completely outside the duty suspension regime, such as the smuggling and counterfeiting of alcohol and tobacco, are likely to emerge despite the automated system and other measures will need to be considered.

2.3. Direct taxes

Mutual assistance between Member States is regulated through Directive 77/799/EEC⁵, which provides for the exchange of all information needed by Member States to correctly assess taxes on revenue and wealth.

² For a more detailed description of carousel fraud, see COM(2004) 260 16.4.2004, point 3.2.2.

³ The distortions caused by VAT fraud affects the overall balance of the own resources system which has to be “fair and transparent” in order to guarantee the well functioning of the Community.

⁴ Council Regulation (EC) No 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax (OJ L 264 of 15.10.2003, p. 1).

⁵ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums (OJ L 336 of 27.12.1977, p. 15) last amended by Directive 2004/106/EC of 16 November 2004 (OJ L 359 of 4.12.2004).

In addition, Directive 2003/48/EC⁶ puts in place an automated system to exchange certain types of information in the field of interest payments. Measures equivalent to those in the Directive have been adopted in agreements concluded with Switzerland, Andorra, Liechtenstein, Monaco and San Marino.

2.4. Evaluation of the existing legal framework

The Community legal framework in the field of administrative cooperation on VAT and excise duties as such appears to be satisfactory from the Commission's point of view. Even if improvements on specific points may be necessary, it offers real possibilities for cooperation between Member States.

From a practical point of view, on the other hand, Directive 77/799/EEC is not as efficient as could be expected, due especially to the insufficient use made of its legal provisions. In its report of 22 May 2000⁷, the ad hoc group on tax fraud carried out a complete analysis of fraud systems and made several recommendations aimed at strengthening the mechanisms for administrative cooperation between Member States. In addition, the Commission presented in 2004 its Communication "Preventing and Combating Corporate and Financial Malpractice"⁸, which also emphasised the need to improve administrative cooperation, proposing initiatives to promote collaboration both between fiscal authorities within the European Union and with those in third countries.

The findings of this report, the Communication and subsequent discussions between the Commission and the Member States indicate that Directive 77/799/EEC should be given more efficient tools, based on what already exists for indirect taxation (revision of Article 8 of the Directive, limiting the deadlines for replying, presence of officials of other Member States during on-the-spot checks, etc.).

AVENUES TO EXPLORE

3. ADMINISTRATIVE COOPERATION BETWEEN THE MEMBER STATES

3.1. Improving the functioning of cooperation

Member States cite several reasons to explain the insufficient use of the cooperation instruments: language problems, lack of human resources and limited knowledge of the cooperation procedures among staff, etc.

These shortcomings are not new, as they have already been pointed out and reiterated in the various Commission reports, without the situation improving significantly. In addition, the Council's ad hoc group on tax fraud has identified the absence of a Community administrative culture as an obstacle to the fight against fraud.

However, it is no longer sufficient to take note of the problem: there is now a need for a political commitment on the part of the Member States to remedy it. Therefore, the

⁶ Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments (OJ L 157 of 26.06.2003, p. 38).

⁷ FISC 67 – CRIMORG 83 of 22.5.2000.

⁸ COM(2004) 611 final of 27.9.2004.

Commission considers that the moment has come to set up a monitoring system, on the basis of quantifiable indicators, in order to ensure that each Member State is able to and actually does provide efficient assistance to other Member States.

In addition, multilateral audits should become the rule in view of the Community dimension of trade.

As regards VAT, Member States should also make more coherent use of the structures for support and operational assistance at Community level, specifically the resources of the European Anti-Fraud Office (OLAF), which acts as a service platform (providing operational assistance and "intelligence") for the operational units of the Member States.

Fiscal fraud is often linked with organised criminal structures in different criminal sectors. The proceeds of fiscal crime (e.g. VAT fraud or cigarette counterfeiting) are normally re-invested in other criminal activities. It is therefore important to adopt a common and multidisciplinary approach to the fight against fraud.

This is why the Commission has put forward its proposal for a Regulation on mutual administrative assistance for the protection of the financial interests of the Community against fraud and any other illegal activities⁹.

This proposal seeks to clarify and strengthen the legal framework for such operational assistance, to enable already at the administrative mutual assistance stage the use of information on suspect financial transactions obtained from the anti-money laundering sector, and to specifically put into place a detailed framework for operational assistance and intelligence provided by the Commission (OLAF).

It is useful to recall that Article 10 of the EC Treaty obliges Member States to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising from Community acts, which include administrative cooperation, and that Article 280 obliges Member States to co-ordinate their actions in order to protect the financial interests of the Community.

3.2. Assistance in the field of recovery

Alongside the strengthening of the means to detect tax fraud, reinforcement of the existing legislation on assistance in the recovery of taxes should improve the collection of unpaid taxes.

Consideration should therefore be given to ways of facilitating procedures and providing assistance for tax officials. In addition, the success of mutual assistance also depends on the resources available to the national authorities and on the instruments they have for recovery under their national legislation.

Moreover, other measures could be envisaged, such as incentives and/or penalties.

⁹ COM(2004) 509 final of 20.7.2004.

3.3. Improved risk management

A guide on risk management for the tax administrations has recently been finalised in cooperation with the Member States. The Commission calls for the results of this work to be put into practice by the Member States.

Also worth examining is to what extent the taxation field could benefit from the experience gained in the customs area, where risk management is more advanced. There, Member States exchange information electronically using a standard computerised form.

In a single market, the tax administrations may find it useful to obtain information rapidly on the potential risks that particular companies may represent, as determined using a common methodology, in particular where one already operating in other Member States starts an activity within their territory.

3.4. A permanent forum for discussion at Community level

At present, the Standing Committee for Administrative Cooperation in the field of VAT, the Committee on Excise Duties, the Working Party on administrative cooperation in the field of the direct taxation, and the Recovery Committee are the bodies in which Member States and the Commission discuss technical questions in the respective fields. This is essentially a compartmental approach.

The Commission thinks therefore that it would be appropriate to create a forum for high-level discussion or even consultation where issues relating to fraud and to cooperation between Member States could be examined at an overall level. This forum could play an important role in monitoring the actions described above and in particular could provide guidelines for the work to be carried out by the individual committees and working party.

4. INCREASED COOPERATION WITH THIRD COUNTRIES

As tax evasion does not stop at the external borders of the European Union, it is becoming increasingly important to develop the external aspects of administrative cooperation.

The increased involvement of companies established in third countries in carousel fraud, the expansion of electronic commerce and the globalisation of the services market underline the need for international cooperation on VAT. Although the scope of Article 26 of the OECD model convention has been extended to VAT, the situation is unsatisfactory, especially as the cooperation mechanism is still bilateral.

A coordinated approach at Community level should be examined in order to enhance the ability of Member States to take action. The possibility of a convention could be envisaged.

As regards direct taxation, ways of increasing fiscal transparency in some third countries (and dependent and associated territories), in order to enable Member States to obtain useful information, and strengthening oversight of the application of their tax laws need to be examined, in particular in conjunction with other international organisations.

In the Member States, cooperation with third countries is primarily under bilateral agreements. This approach does not ensure the necessary effectiveness. The Commission is looking into proposals to develop a Community approach to cooperation with third countries.

The inclusion of tax cooperation clauses under the economic partnership agreements that the Community concludes with its partners could be a way of supporting this objective. The incorporation in forthcoming trade agreements of provisions concerning good governance, in particular with respect to taxation, will be examined on a case-by-case basis. In addition, the Commission is currently looking to promote technical assistance to help third country partners increase the transparency of their taxation systems. An incentive allocation related to good governance, notably in the financial, tax and judicial areas, will be foreseen in the 10th EDF.

5. OTHER ASPECTS

5.1. The protection of revenue: a responsibility shared between Member States

Frauds with a Community dimension (in particular carousel frauds) often include participants in Member States where no loss of revenue is actually incurred. This is mainly to make the fraud circuit more obscure and thus to make tax collection more difficult, or even impossible.

In order to protect the fiscal revenues of all the Member States in an internal market, Member States should take comparable measures against fraudsters, in particular in terms of sanctions and criminal proceedings, regardless of whether the fraud leads to losses of revenue in the Member State concerned.

5.2. Improving the exchange of information

As regards VAT, given that rapid access to information is crucial in combating fraud, more efficient methods of exchanging information, taking account of recent technological developments and the equipment used by traders, should be envisaged. More frequent and more detailed automated exchanges between Member States, or even direct access to national databases, should to be considered for this purpose. The required modernisation of the VIES system presents an opportunity for implementing some of these improvements.

As regards direct taxation, standard forms and computer formats should be envisaged for the exchange of information and for collaboration as provided for in the directive should be envisaged, in particular through taking over and adapting the automatic system for the exchange of information set up under the Savings Directive. Similarly, it would be useful to provide Member States with comments, handbooks, guidelines, country profiles, etc.

5.3. Reinforcement of the tax declaration obligations

A general reinforcement of the tax declaration obligations could be examined, while possibly lightening the obligations for companies that obtain an authorisation by entering into a partnership with the tax administrations, as is currently the case in the customs field. The objective is to maintain detailed tax compliance obligations only for parties considered to represent a risk.

6. MODIFYING THE COMMON VAT AND EXCISE DUTY SYSTEM

As regards VAT, the Commission considers that the weak points of the current system need to be analysed in the light of the fraud opportunities it creates. These include in particular the taxation of distance selling, the rules for the taxation of new and second-hand vehicles, and even the rules for the taxation of intra-Community trade in general.

Without wanting to exclude alternative solutions, the Commission recalls that the definitive VAT regime supported by the Community institutions could remedy these weaknesses as well as eliminate certain types of fraud.

Moreover, the Commission could envisage the possibility of strengthening the principle of joint and several liability for the payment of tax. This principle has been the subject of lively discussions between tax administrations and economic operators. Any such examination should remain within the parameters laid down by the Court of Justice, which, in its judgment of 11 May 2006¹⁰, raised the general question of the proportionality and legal certainty of measures intended to combat fraud.

In addition, some Member States consider that the VAT system should be amended in order to reduce the losses of VAT income due to fraud. They call for the reverse charge mechanism to be extended to domestic transactions in a Member State, thus challenging the principle of fractionated payment, which has hitherto been regarded as a key element in a VAT system. This topic has already been discussed in various fora. In particular, it has been debated by a technical group of the Commission with the Member States.

As it supports the objective of combating fraud, the Commission is examining the need for such a step with an open mind at this stage. However, the precondition for any change to the current VAT system is that it has to:

- reduce considerably the possibilities for fraud and exclude new important fraud risks;
- generate no disproportionate administrative burden for traders and the authorities;
- ensure tax neutrality;
- ensure non-discriminatory treatment in a Member State of both national operators and operators established elsewhere.

The Commission recognises that the reverse charge mechanism has proved its effectiveness in specific sectors such as construction. In theory, a more generalised application could reduce certain types of fraud, but it also entails other problems, such as the risk of new types of fraud.

In addition, Member States that promote broader use of the reverse charge mechanism consider that such a system has to be accompanied by additional tax compliance obligations, compared to the current system, in order to avoid new risks of fraud.

Such a change raises a number of important questions, requiring an in-depth discussion with all the interested parties, first and foremost with the operators who would be affected. This would cover primarily:

- the level of legal certainty for operators applying the reverse charge system in good faith (the VAT treatment of operations being dependent on the customer's status);
- the advantages and the costs of implementation.

¹⁰ Case C-384/04, Commissioners of Customs & excise, Attorney general v Federation of Technological Industries and Others.

If optional application of the reverse charge mechanism were to be considered, strict conditions should be implemented at Community level in particular to ensure proper functioning of the internal market and to comply with the simplification policy (divergent regulations, in particular as regards invoicing and complementary obligations).

In examining possible changes to the VAT system to fight tax fraud, the taxation of intra-Community transactions should be considered, either at a single rate, which should high enough to rule out any incentive to set up a carousel fraud, or at the rate of the receiving Member State.

As regards excise duties, it is obvious that the current structure of tax on tobacco prevents the proper functioning of the internal market, in particular by partitioning markets (price fixing) and thus generating trade diversions. Consequently, these distortions should be eliminated.

7. CONCLUSION

This Communication does not contain "one" single and global solution to the problems. Its objective is to present some realistic and pragmatic actions that could be taken in the short term but it is essential that this would be done in a coordinated and integrated manner to respond better to the Community or even international dimension of economic markets.

Moreover, it is important to recall that this Communication must be seen within the broader context of realising the Lisbon objectives. The simplification of the fiscal environment is a key element in this policy and any measures to fight tax fraud more efficiently cannot go against these objectives.

As regards VAT in particular, the debate on important changes to certain elements of the common VAT system has already started.

The Commission has an open mind in the debate, but initial discussions with the Member States and the operators show that a change in the VAT system raises a number of important questions requiring an in-depth analysis, in particular in relation to its effects for all parties concerned.

The Commission considers at this stage that fraud could better be controlled through joint action by the Commission and Member States and through an efficient and modern organisation of the control system, accompanied by strong and rapid cooperation between the Member States and, where appropriate OLAF, on the basis of suitable legal instruments.

Considering the seriousness of the situation, the Commission invites the institutions concerned, notably the Council, the European Parliament and the European Economic and Social Committee to debate this document at their earliest convenience in order to provide clear indications and to allow the Commission to launch a targeted action programme as soon as possible.