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Karolina Daszyńska-Żygadło



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Malgorzata Magdalena Hybka

Uniwersytet Ekonomiczny w Poznaniu

VAT EVASION IN THE EUROPEAN UNION – MODI OPERANDI AND THEIR COUNTERMEASURES

Summary: The article explores the topic of VAT evasion. Its incidence is a problem to the European Union tax authorities. Annual revenue loss due to VAT evasion on EU territory equals nearly 100 billion euro. The basic aim of this article is to overview and evaluate anti-evasion measures being applied both nationally and internationally. Moreover, it presents the typology of VAT fraud and its scale in the European Union Member States.

Keywords: VAT fraud, European Union, administrative cooperation.

1. Introduction

VAT belongs to the most quickly spreading and the most efficient taxes ever invented. Some authors even indicate that it is unquestionably the most successful fiscal innovation of the last half-century [Bird 2010, p. 363]. In the countries that adopted VAT it accounts, on average, for 19% of total tax revenue and nearly 6.4% of GDP [*Consumption Tax Trends...* 2012, p. 64-65]. It constitutes one of the major sources of revenue for national budgets of all the European Union Member States. In addition it plays an important role in the European Union financial system.

Due to its design, it is also vulnerable to fraud. Opportunities for evasion are especially created by the zero-rating of exports, application of destination principle in international trade, staged collection process and rate differentiation. Moreover, the scale of VAT evasion depends on both institutional and behavioral factors. Certain studies emphasize the importance of such variables as rigorousness of penalty system, certainty of enforcement and audit rules. Other authors indicate that corruption in the country, society's trust in public institutions and social norms are the most important factors influencing tax evasion.

The issue of VAT evasion has been the subject of a wide debate in the European Union since the mid-1990s. So far, no efficient methods of limiting its scale have been developed. It causes the annual losses in the public revenue amounting to billions of

euro. Evasion schemes are becoming more and more complex, as dishonest VAT payers try to circumvent any new regulations introduced to counteract VAT fraud.

The basic aim of this article is to overview VAT evasion schemes in the European Union and the main methods of VAT evasion detection or prevention. The article is composed of three sections. The first considers the typology of VAT evasion and its incidence in the European Union Member States. The second examines mutual assistance procedures and information exchange system and evaluates their efficiency. The third one is dedicated to the selected national anti-fraud measures.

2. Schemes and scale of VAT evasion in the European Union

The main reason for VAT evasion is the complicated design of the tax itself. One of the authors who takes into account the impact of this design on various evasion schemes is A.A. Tait [1988, p. 306-313]. He lists 16 categories of VAT fraud, most of which are related to tax exemptions, reduced tax rates, deducting the input VAT from the output VAT, VAT registration rules, accounting duties and simplified tax procedures. A long list of the types of turnover tax evasion is also included in the article by M. Keen and S. Smith [2006, p. 861]. They introduced a division into evasion in the case of a gross turnover tax, such as the American sales tax, and in the case of a net turnover tax, including the value added tax. They analyze fraud types that can arise under every turnover tax, such as: under-reported sales, failure to register, misclassification of commodities, omission of self-deliveries, tax collected but not remitted, imported goods not brought into tax, and the following evasion types distinct to the VAT: false claims for credit or refund, credit claimed for VAT on purchases that are not creditable, setting up of companies solely to generate invoices (bogus traders or invoice mills).

The review of VAT fraud schemes makes it possible to divide them into two groups – those related to domestic transactions and those related to international transactions. In the European Union the latter type of schemes is an especially serious problem; it includes the so-called “missing trader” fraud. It arises basically on the grounds of the rule introduced on January 1, 1993, for transactions concluded between VAT registered enterprises from different EU Member States, according to which the tax is paid in the country of destination. Pursuant to this rule, the supply of goods in the country of the supplier is exempt from tax while, at the same time, the right to the refund of the input tax is maintained in the country of a buyer where the supply of goods is taxed in accordance with the rate applicable for a given kind of goods.

There are three main types of “missing trader” fraud usually analysed in the literature [Ainsworth 2012, p. 2]:

- acquisition fraud – in which case goods are supplied by an enterprise from one Member State to an enterprise in another Member State; the latter enterprise, having collected the goods, sells them to a consumer on the domestic market and then “disappears” without supplying a tax return or an recapitulative statement and without remitting the tax in the country of destination, (figure 1),

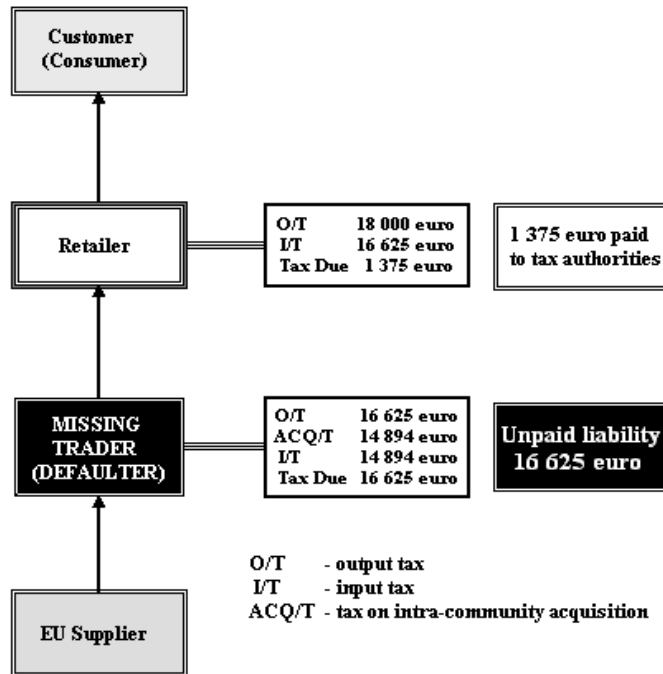


Figure 1. Acquisition fraud scheme (UK example)

Source: [Examples of different... 2012, p. 4].

- carousel fraud – as with acquisition fraud, goods are acquired zero-rated from an enterprise located in one of the European Union Member States and sold in the country of a purchaser. The acquirer goes missing without accounting for the VAT imposed on both the intra-community acquisition and supply of goods to another national trader. However, the goods do not become available for consumption in the country of acquisition, but are sold through a series of companies in that country and then exported or supplied to an entrepreneur from another European Union Member State. This procedure can be repeated over and over again using the same commodities (so goods are circulating in a carousel).
- contra trading – the fraud involves two carousels (one fictitious and one legitimate). The so called “contra trader” participates in two separate types of transaction chain during the same VAT period. Within the first – tax loss chain – the taxable person incurs input tax on purchases from enterprises located in the same EU Member State and makes zero-rated supplies of those goods to customers in other EU Member States and within the second – contra chain – the same taxable person acquires goods from another EU Member State and sells them in his home Member State, generating an output tax liability from the onward sale. The first chain will trace back to a missing trader or another contra trader.

Table 1. VAT gap compared with other tax gaps in the United Kingdom (2008/2009–2010/2011)

Type of tax	2008/09		2009/10		2010/11	
	Tax gap (£ billion)	Tax gap (%)*	Tax gap (£ billion)	Tax gap (%)*	Tax gap (£ billion)	Tax gap (%)*
VAT	14.6	15.5	8.6	10.8	9.6	10.1
Spirits duty	0.1	2.0	0.1	4.0	0.2	5.0
Beer duty	0.4	10.0	0.4	9.0	0.4	10.0
Cigarette duty	1.4	13.0	1.2	11.0	1.0	9.0
Income taxes	13.9	5.2	14.1	5.6	14.4	5.5
Corporation tax	5.0	10.3	3.8	9.6	4.1	8.8
Indirect taxes	18.9	12.7	12.3	9.0	12.9	8.4
Direct taxes	19.8	6.0	18.7	6.2	19.3	5.9
Total tax gap	39.0	8.1	31.0	7.1	32.0	6.7

* Tax gap (TG) as a proportion of theoretical liability (TL). $TL = TG + TR$, where TR – tax revenue.

Source: [Measuring Tax Gaps 2011, p. 6-7, Measuring Tax Gaps 2012, p. 4-5].

Table 2. VAT receipts and VAT gap in selected European Union Member States in 2000, 2006 and 2011

Member State	2000			2006			2011		
	VAT receipts (billion EUR)	Tax gap (billion EUR)	Tax gap (%)	VAT receipts (billion EUR)	Tax gap (billion EUR)	Tax gap (%)	VAT receipts (billion EUR)	Tax gap (billion EUR)	Tax gap (%)
Austria	16.8	2.5	13.0	19.7	3.1	14.0	23.5	3.5	13.0
Belgium	18.1	2.1	10.0	22.6	2.8	11.0	26.0	5.0	16.0
France	105.9	5.2	5.0	131.0	9.8	7.0	140.5	32.2	19.0
Germany	140.0	18.5	12.0	147.2	17.0	10.0	189.9	26.9	12.0
Greece	9.8	3.1	24.0	15.2	6.6	30.0	15.0	9.8	39.0
Italy	77.5	22.4	22.0	92.9	26.3	22.0	99.0	36.1	27.0
Netherlands	28.8	2.0	7.0	39.9	1.4	3.0	41.6	4.0	9.0
Romania	no data	no data	no data	no data	no data	no data	11.4	10.4	48.0
Spain	37.6	3.9	9.0	61.6	1.4	2.0	56.6	15.2	21.0
United Kingdom	64.2	12.3	16.0	87.8	18.4	17.0	130.6	19.5	13.0
EU-25 (2011– EU 26)	bd.	bd.	13.0	801.0	106.7	12.0	903.9	193.0	18.0

Source: [Study to Quantify... 2009, p. 23-46; Study to Quantify... 2013, p. 29].

Only in few countries, including Great Britain, Germany, Denmark, Belgium, Sweden and Italy, tax authorities conduct research into the scale of the problem of VAT evasion. In Great Britain there is the HM Revenue & Customs, which estimates the annual scale of tax fraud. According to these estimates, in the fiscal years of 2008/09–2010/11 the loss of public revenue due to VAT fraud amounted from 8.6 to 14.6 billion pounds (table 1). In the first of these years it was lower and in the latter two higher than the losses due to the income tax fraud.

Also, research conducted by the European Union indicates the significant scale of VAT evasion in Great Britain (table 2). Among other EU Member States the

losses are the most significant in Greece, Romania, Germany and Italy¹. In such countries as: France, Spain, Germany, Italy, Great Britain there are many instances of carousel fraud, especially in the sector of the sale of mobile phones, passenger cars, computer parts, metal scrap, real estate and even CO₂ emission rights.

3. Mutual assistance and information exchange – effective methods of fraud detection?

Detecting and counteracting VAT evasion is supported by the administrative cooperation between the Member States of the European Union. The rules of the cooperation are regulated by Council Regulation (EC) No 1798/2003 supplemented by Council Regulation (EU) No 904/2010. The cooperation includes such legal measures as the exchange of tax information, simultaneous controls and participation in administrative proceedings.

The exchange of tax information may take place on the request of a EU Member State or without it. In the first case, Member States are obliged to share information requested by another EU country not later than within three months from the date of receiving the request, but should the relevant information be available at the moment of issuing the enquiry – not later than within a month from the date of receiving the request. Information sharing without prior request involves:

- automatic exchange – in which predefined information is communicated to another Member State at pre-established intervals (e.g. information on VAT identification numbers given to taxpayers),
- spontaneous exchange – which means irregular communication of information to another Member State (e.g. when there is a risk of tax loss).

EU Member States have also been given the right to conduct simultaneous controls in a situation when they are expected to be more efficient than controls conducted by the authorities of a single state. The authorities of a state which requests such a control must give reasons for it and propose the time to conduct it. As for an enquiry about tax information, it is also possible that officials from one Member State take part in tax proceedings conducted by authorities in another Member State.

An instrument aimed at improving the functioning of the system of indirect taxes, the value added tax in particular, in the EU Member States through enabling public administration officials to better understand the community's legislation and its applicability, ensuring efficient cooperation between Member States and securing constant improvement of administrative procedures is the programme called *Fiscalis* [Decision No 1482/2007/EC...]. The programme is aimed at: ensuring efficient functioning of systems of communication, organising multilateral controls, seminars, exchange of officials, training courses and meetings.

¹ According to the report published by PricewaterhouseCoopers the VAT gap in Poland amounted in 2012 between 36 450 and 58527 mln PLN [*Straty Skarbu Państwa w VAT...* 2013, p. 14].

Since 1993 the administrative cooperation of the EU Member States with respect to the value added tax has been made easier thanks to the implementation of the computerised system VIES – VAT Information Exchange System. The system consists of national subsystems in each of the Member States connected with the head office. The system stores current and archival information on registered VAT payers conducting transactions within the European Union and information on the size of intra-Community trade turnover. In order to improve the cooperation aimed at limiting the number of tax fraud instances a network has been created to facilitate efficient exchange of targeted information between Member States. The network is called Eurofisc. It is to perform the role of an early warning system, detecting new forms of tax fraud.

Table 3. Discrepancies related to exchange of information on tax matters and late replies in 2006 (selected EU Member States)

Member State	Late replies		Number of requests received	
	Number	% of all replies	According to receiving by Member State	According to requesting by Member State
Belgium	604	37.5	1552	1471
Czech Republic	347	54.3	371	409
Denmark	511	61.4	642	679
France	1308	55.0	2296	2138
Germany	3195	46.1	8295	6255
Greece	138	43.4	238	213
Italy	1924	64.9	1284	2802
Luxembourg	306	53.1	468	456
Netherlands	1597	61.7	2089	2143
Poland	308	39.9	557	588
Portugal	404	78.6	481	506
Spain	2028	62.9	2652	2837
United Kingdom	643	36.1	2241	2242
EU Member States	14 565	49.6	26 292	25 749

Source: [Special Report No 8/2007..., p. 10-12].

In spite of the fact that for many years a number of instruments have been introduced to counteract value added tax evasion – the efficiency of these methods is still unsatisfactory. This is confirmed by the results of the control conducted by the European Court of Auditors. The results of this control are available in a special report of 2007 [Special Report No 8/2007..., p. 1-26]. The report indicates the basic problems in the administrative cooperation between administrative bodies from particular EU Member States. Especially the exchange of tax information leaves much to be desired. The communication concerning tax information between Member States is hindered by significant delays; moreover, the communicated information is often insufficiently detailed. Statistical data from 2006 show that delays took place in the case of as many as 50% of all the requests for information, and in some cases the delay could be as long

as a year or even longer. This was the case with more than 50% of requests in such countries as the Czech Republic, Denmark, France, Spain, the Netherlands, Luxemburg, Portugal and Italy (table 3). Problems with monitoring requests and the complexity of information exchange procedures lead to significant discrepancies in the data concerning the number of received requests declared by particular Member States. They are especially significant in such countries as Germany and Italy. Other instruments than information exchange are rarely used to counteract tax evasion. In 2006 there were only three cases in which officials from one Member State participated in tax proceedings conducted by administration in another Member State. Moreover, also in 2006 there were only 11 simultaneous controls.

4. Preventing VAT evasion at national level

One of the commonly used and recommended instruments in the European Union to counteract value added tax evasion is the reverse charge mechanism. It involves shifting the obligation to pay the value added tax from suppliers and service providers to buyers of goods and services. Goods and services providers are exempt from this tax and from the obligation to settle it. They document the supply of goods or the performance of services with invoices which do not include the value added tax. Buyers of goods and services, basing on such invoices, issue internal invoices in which they include the VAT due for the purchased goods and services, with the base of the tax being the amount which a buyer is obliged to pay. It is also them who are responsible for paying the tax. However, they have the right to deduct the input tax which equals the tax due on the purchased goods and services under the reverse charge mechanism. They receive this right in the same accounting period in which their tax obligation arises.

The discussed system is applicable in a situation when transactions are conducted between registered VAT payers. The system is obligatory in relation to some transactions (e.g. supplies of electrical energy); in other cases the application of the system depends on the decision of a Member State (e.g. for the supply of construction works, used materials, the supplies of goods which take place after the transfer of ownership to an assignee executing this right). Moreover, pursuant to Article 395(1) of Council Directive 2006/112/EC, Member States can request for permission to introduce the reverse charge mechanism as a special means aimed at preventing some forms of tax evasion or avoidance. This possibility was used by Great Britain which has applied the discussed system since June 1, 2007 in relation to the supply of the following goods [Council Decision 2007/250/EC...]:

- mobile telephones, being devices made or adapted for use in connection with a licensed network and operated on specified frequencies, whether or not they have any other use,
- integrated circuit devices such as microprocessors and central processing units in a state prior to integration into end user products.

The reverse charge mechanism applies in respect of supplies of these goods if the taxable amount is equal to or higher than 5000 pounds.

Yet another solution used in order to counteract VAT fraud is the principle of joint and several liability for VAT obligations. Pursuant to this principle, an entrepreneur is liable for the tax accrued in the previous stages of the turnover in the amount indicated on a VAT invoice, if the tax has not been remitted to the tax office by the entity which issued the invoice. In most countries applying this principle, the liability applies only if the failure to pay the tax was purposeful and when an entrepreneur purchasing goods and services was able, with due diligence, to find out about the supplier's intention not to pay the tax. This principle has been introduced by such countries as Spain, Germany, Portugal, Italy and Great Britain.

The remaining methods of preventing and detecting VAT evasion include: financial sanctions, tightening registration requirements (e.g. financial guarantees from registering taxpayers), increasing the frequency of filing tax returns, pre-registration controls, new tax inspection procedures, risk analysis methods. They are applied to a smaller or larger extent by all EU Member States.

5. Conclusion

Value added tax evasion is one of the most serious problems the European Union has to face in the near future. Its instances are widespread in all EU Member States and are mostly the result of VAT design features which are aimed at ensuring the neutrality of the tax, especially such as the invoice-credit method and the destination principle.

The greatest losses to the public revenue are generated by missing trader fraud. The most efficient measure of counteracting this type of fraud is the reverse charge mechanism. A disadvantage of this measure is, however, the lack of a taxpayers' self-control system. Due to this system the scale of another type of fraud is being reduced, because buyers of goods and services who have the right to deduct the input VAT invoiced by the supplier are themselves interested in preventing the underestimation of this tax. In the case of internal invoices, on the other hand, the entity issuing the invoice and deducting the input tax is the same taxpayer.

In 2012 the European Commission has proposed a new solution – quick reaction mechanism (QRM). It is a vehicle authorizing a Member State experiencing a serious case of sudden and massive VAT fraud to adopt certain emergency measures without waiting for the official procedure to be completed. Such a country would be able for instance to apply a reverse charge mechanism within one month.

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UCHYLANIE SIĘ OD PŁACENIA PODATKU OD WARTOŚCI DODANEJ W UNII EUROPEJSKIEJ – SPOSOBY DZIAŁANIA I ŚRODKI ZARADCZE

Streszczenie: Artykuł porusza kwestię uchylania się od płacenia podatku od wartości dodanej. Zjawisko to stanowi duży problem dla europejskich organów podatkowych. Każdego roku strata spowodowana uchylaniem się od płacenia VAT na terytorium Unii wynosi blisko 100 miliardów euro. Podstawowym celem artykułu jest przedstawienie i dokonanie oceny metod walki z oszustwami podatkowymi stosowanymi zarówno w pojedynczych krajach jak i w całej Unii. Ponadto w pracy została zawarta typologia oszustwa VAT oraz skali, w jakiej występuje ono w państwach członkowskich Unii Europejskiej.

Słowa kluczowe: oszustwa VAT, Unia Europejska, współpraca administracyjna.