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**REPORT FROM THE COMMISSION TO THE COUNCIL  
AND THE EUROPEAN PARLIAMENT**

**THIRD ARTICLE 14 REPORT ON THE  
APPLICATION OF COUNCIL REGULATION (EEC) No 218/92 OF 27 JANUARY 1992 ON  
ADMINISTRATIVE COOPERATION IN THE FIELD OF INDIRECT TAXATION (VAT)**

**AND**

**FOURTH REPORT UNDER ARTICLE 12 OF REGULATION (EEC, EURATOM) NO  
1553/89 ON VAT COLLECTION AND CONTROL PROCEDURES**

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## **1. EXECUTIVE SUMMARY**

This report describes the functioning of administrative cooperation and the structure of the underlying control arrangements.

The transitional VAT arrangements have been in place for more than 6 years. During this period, one would have expected that the implementing problems should have been solved and that the system should be running smoothly. However, this does not appear to be the case. The 6 years appear to have given the fraudsters time to appreciate the possibilities offered by the transitional VAT arrangements to make money, while, generally speaking, Member States have not met the challenge posed by fraud.

The transitional VAT system is designed so that intra-community supplies of goods are exempted from tax in the Member State of origin of the goods and instead taxation takes place in the Member State of destination. In addition to this “normal” system, several complex special schemes have been set up in areas where Member States still wanted to maintain additional control over taxation. The exemption mechanism makes the VAT system prone to fraud as goods can circulate tax-free and therefore it is necessary that the Community instruments for administrative cooperation together with national control systems are used to their fullest extent.

The examination by the Commission of Member States’ control efficiency in respect of the transitional system has revealed certain lacunae. VAT control is today hampered by a range of organisational and administration problems in some Member States. VAT control is still based on purely national objectives and there is a lack of an intra-Community perspective. The creation of the internal market has apparently not resulted in a change in national VAT control methodology nor in the allocation of sufficient resources to the control task. The only significant change was the setting up of the VAT Information Exchange System (VIES), but this information system is not optimally used and therefore it does not provide the efficiency foreseen when it was initially conceived.

There are indications that the level of serious fraud in intra-Community trade is growing. The number of carousel frauds being discovered by national tax administrations is increasing. The Community has implemented a VAT system that has made it possible to implement the single market, but VAT is still controlled on a purely national basis and with resources that have not taken the new control challenges into account. The result is that fraudsters can operate in a single market while control is still limited by national borders.

Furthermore, the imperfect functioning of VAT control within the community is a result of the overall function and structure of national control systems. Even though Member States have strong control powers, the lack in many cases of control strategies with clear objectives and control plans gives a confused picture of Member States’ VAT control. The low priority given to the control of intra-Community trade is significant and it seems that purely national priorities take precedence.

Nevertheless, it is significant to note the small amount of resources that are devoted to tax control by Member States in general, and especially to VAT control. On average, only about 8% of tax administrations’ staff are engaged in on-the-spot controls, and for VAT there is an indication that it will take about 40 years to control the 24 million taxable persons in the Community by visiting them. These traders also provide around 100 million

VAT declarations per year, which is a significant administrative burden for both traders and administrations. However, it seems that less and less resources are devoted to the control of declarations and that they only fulfil the role as a document for the settlement of the tax.

The control task is enormous and it is quite clear that Member States have allocated far from enough resources to make it possible to control all traders. Therefore the choice of control methodology is important. Limited human resources should have forced tax administrations to use risk analysis to a great extent. However only a few Member States have adopted risk analysis. Due to their organisational structure, internal administrative structure, technical facilities and sometimes legal obstacles, many Member States will not be able to operate risk analysis systems within the short or medium term as it will not be possible to establish the necessary infrastructure. Therefore, many Member States will still have to control the VAT system in a conventional manner, which demands an increase in resources.

The developments in the field of new electronic technology, where traders will use electronic invoicing and self-billing on a daily basis will put specific demands on Member States' tax control systems. The technology is already operational. However, it seems that Member States in general are very badly prepared to meet the new environment, despite the fact that the Commission, in 1996, arranged the first seminar in this field, followed by several others. Currently, only 3% of the auditors are skilled in computer auditing and this may cause great problems for the control in the future. Nevertheless, it is also obvious that auditing by electronic means provides a possibility for administrations to increase control efficiency and to lower control costs.

Whilst all Member States have penalty systems in place which are applied to traders who do not fulfil their VAT obligations, the level, scope and practical application of these penalties varies between Member States, leading to different treatment of traders for the same offences.

Administrative cooperation and mutual assistance is a core part of the control arrangements of intra-Community trade and a prerequisite for its proper functioning. Exchange of information between tax administrations in the Community is a key element for the success of these arrangements. However, such success cannot be achieved if national organisation of control has not been arranged to meet this new situation. There is therefore a close relationship between the function of national control and intra-Community administrative cooperation.

As a general conclusion, the examination of Member States shows a very low activity in the field of administrative cooperation. Apart from the automatic exchange of VIES data the number of exchanges is very low, in both spontaneous information as well as specific requests. The number of multilateral controls, especially those being funded by Member States themselves, is extremely low. This could be justified were it clear that no serious fraud situation existed; however, the opposite is the case. The reason for the relatively low activity seems to depend on the national control priorities in combination with lack of control resources.

As concerns VIES data, many control officials still have no direct access to this data, even if the situation has improved. In too many cases VIES data is still not integrated into the national control system and the control of intra-Community trade is regarded as a side

issue. It has positively been noted that some Member States refine the use of VIES data into new tools used in the fight against serious frauds, such as carousels.

It is significant that administrative cooperation is hampered by extreme slowness of response to requests for information. There are several reasons for this, but cumbersome internal procedures to process exchanges of information, often due to inappropriate internal structures, appear to be the main ones. Another is the availability of control resources to undertake rapid control, but also the procedures involved to undertake it. As it is clear that VIES data is useful for the control of the transitional system, it is at the same time clear that some fraud types, specifically the most serious like carousel and phoenix frauds, demand administrative cooperation in a rapid way. The special anti-fraud units that some Member States have set up are intended to overcome this shortcoming, but it will not be efficient within the Community as long as all Member States do not have similar arrangements.

## **2. BACKGROUND**

To date, the Commission has produced two reports in accordance with Article 14 of Regulation (EEC) No 218/92. The first report<sup>1</sup> dealt with the setting up of the VAT Information Exchange System (VIES), the second<sup>2</sup> examined the use Member States were making of the possibility to exchange information under the Regulation, and this report, the third, will further develop the theme of the second report, but looks in more detail at VAT control and the interaction between control and administrative cooperation and mutual assistance between Member States.

The Commission is also obliged to produce a report every three years on VAT collection and control procedures in accordance with Article 12(3) of Regulation (EEC, Euratom) No 1553/89<sup>3</sup>. Because of the close relationship between administrative cooperation and VAT control, the Commission has decided to cover both in this report. Accordingly, this is a joint report under Regulation (EEC) No 218/92 and Regulation (EEC, Euratom) No 1553/89.

So that the Commission could base this report soundly on up-to-date information, a series of bilateral visits was arranged with Member States. These visits, which took place between October 1998 and February 1999, were centred on a questionnaire sent to Member States during the summer of 1998. During these visits, Member States were given the opportunity to explain how they had implemented the recommendations contained in the second report; how their tax administrations were organised and how they organised and conducted VAT control. The Commission received full cooperation during these visits from all Member States and the discussions were open and constructive. However, in several aspects of the examined areas Member States had difficulties in providing complete information or were not able to provide any information at all.

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<sup>1</sup> COM(94) 262 final of 23.6.1994.

<sup>2</sup> COM(96) 681 final of 8.1.1997.

<sup>3</sup> OJ L 155, 7.6.1989, p. 9.

This report takes a close look at the relationship between administrative cooperation as conceived in Regulation (EEC) No 218/92, and mutual assistance in Directive 77/799/EEC in the context of the fight against VAT fraud.

### **3. THE PREREQUISITES FOR THE FUNCTIONING OF THE TRANSITIONAL VAT SYSTEM**

#### **3.1. The transitional VAT arrangements**

In order to achieve the removal of border controls for tax purposes inside the Community from 1.1.1993, the Council decided in 1991 to establish the transitional VAT arrangements<sup>4</sup>. These arrangements provide that intra-Community operations between taxable persons continue to be taxed at the rate and conditions of the Member State of destination. An exemption for supplies of goods destined for another Member State was introduced to replace the exemption for exports and the taxable event of “importation” was replaced by “acquisition” in the Member State of arrival of the goods.

#### **3.2. The control implications of the transitional VAT arrangements**

Abolishing border controls resulted in the integration of the control of taxation of intra-Community trade into domestic VAT control.

The demands of VAT control and the challenge presented by the abolition of border controls required cooperation between Member States on a new scale. In particular, Member States needed information from other Member States in order to be able to control the tax. These needs were:

- To be able to obtain information on all intra-Community transactions made between traders on their own VAT identification register and those identified in other Member States.
- To be able to confirm the validity of a VAT identification number of the purchaser.

These data, which form an input into Member States' methodology to control VAT on intra-Community transactions, are provided by the VAT Information Exchange System (VIES) which is a common computer network.

However, the VIES data transmitted between Member States is dependent on declarations from traders making exempt intra-Community supplies. Where these declarations are missing, incomplete or incorrect, the data cannot be depended upon by the Member State controlling the trader. Furthermore, the VIES data only relates to intra-Community supplies of goods, and therefore do not cover the supplies of services, particularly those services provided in accordance with Article 9(2)(e) of the 6<sup>th</sup> VAT Directive.

By its nature, VIES data is historical, being transmitted to the Member State of the taxable person making intra-Community acquisitions at least three months after the date of the transaction, during which time the trader making the acquisition may already have disappeared, with the consequent loss of VAT revenue. This potential risk of fraud was

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<sup>4</sup> Council Directive 91/680/EEC supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers (OJ L 376, 31. 12. 1991, p. 1).



pointed out in the proposals<sup>5</sup> for the legal framework on administrative cooperation and mutual assistance before 1993, but Member States did not evaluate this risk as being high, and therefore the Council “watered down” the initial Commission proposal.

As an addition to the VIES, the Commission set up in 1993 a secure method of exchange of information between Member States, known as Fiscal SCENT. However, the use of this tool is disappointing. For instance, from 1997 to mid 1998 as many as 13 of the 30 terminals had not been used for sending any message.

One of the difficulties identified by Member States in their explanation for the low use of the Fiscal SCENT tool is the lack of a clear legal basis for providing information spontaneously in respect of cases of **suspected** fraud.

### **3.3. Special schemes**

In addition to the changes introduced by the transitional VAT arrangements described above, special arrangements in respect of the taxation of new means of transport, distance sales and sales to non-taxable legal entities were introduced. The purpose of these special schemes was to maintain the Member States’ tax revenue. However, these special schemes also need special control. Generally speaking, to ensure correct taxation, it is necessary for there to be a flow of information between Member States. During its visits to Member States, the Commission noted that many control administrations had no systems in place to provide such information spontaneously to other Member States, or had not taken the revenue risk into account when forming control plans. One major reason seems to be that the special schemes arrangements are too complicated and therefore require control resources that cannot be mobilised. Member States therefore did not follow through with the control commitment for these special schemes, which they considered to be essential.

The control of the special scheme for sales of new means of transport is sporadic in some Member States while most do not have any control, which is worrying as increased fraud using this scheme is reported. The Commission concedes that control of new means of transport is difficult, particularly as VAT rules can depart from normal commercial practice, whereby a second-hand car can still be classified as new for VAT purposes.

### **3.4. The Central Liaison Offices (CLOs)**

The role and functions of the CLOs were examined in detail in the 2<sup>nd</sup> Article 14 report. The Commission does not intend to repeat those criticisms in this report, but rather re-iterate that there is a continuing and growing problem regarding the number of requests for assistance to which replies have not been given within the 3 month deadline permitted by Regulation (EEC) No 218/92 (See Chapter 6 for more details). Furthermore, Member States also appear to be generally unwilling, with the exception of certain Member States, to use the possibilities offered by Article 12 of Regulation (EEC) No 218/92 to delegate power to operational level. While it is clear that a balance must be maintained between the needs of local offices and central administrations, CLOs must be used as a conduit, rather than act as a bottleneck. Furthermore, in some Member States there was some uncertainty about the operational role of CLOs and about the relationship between CLOs and special control and anti-fraud units, which might cause confusion. The CLOs also have a greater

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<sup>5</sup> COM(90)183 final - SYN 275.

role to play in informing control officials of the possibility of exchange of information, particularly as regards the control of special schemes, refunds under the 8<sup>th</sup> Directive and services provided in accordance with Article 9(2)(e) of the 6<sup>th</sup> Directive. However, several CLOs said that they were not powerful enough and were not equipped with enough resources to fulfil that role. On a positive note, some Member States have, however, appointed CLO correspondents as contact points at regional and local level.

### **3.5. The challenge of fraud**

The transitional VAT arrangements themselves present fraud possibilities, because of the fact that there are goods in circulation upon which tax has not been charged. There is therefore a high incentive to divert such untaxed goods into the black market.

In this context it must also be recalled that the Commission already, when this transitional regime was to be introduced, warned of the potential for an increase in certain types of fraud, especially carousel fraud, and that it was likely that there would be a greater volume of fraud-related requests for co-operation<sup>6</sup>. In this context the Commission therefore proposed the necessity of a comprehensive system for administrative cooperation and mutual assistance. However, this proposal was not adopted by the Member States, as they believed it was sufficient to meet this risk by implementing VIES and the other more limited cooperation arrangements that are set out in Regulation No 218/1992.

## **4. DEVELOPMENTS SINCE THE SECOND ARTICLE 14 AND THIRD ARTICLE 12 REPORTS**

### **4.1. Reaction from the European Parliament and the Council**

The Second Article 14 report was communicated to both the Council and the European Parliament. That report concluded that administrative co-operation is an increasingly vital link in the VAT control chain and that failure to make the fullest possible use of it would pose an unacceptable threat to the integrity of the VAT system itself. Therefore the report made eight recommendations with the aim of improving administrative co-operation and reinforcing the fight against fraud. These recommendations concerned both actions to be taken at Community level as well as in Member States.

The Commission's Third Article 12 Report<sup>7</sup> on the VAT control procedures applied in the Member States and on any improvements contemplated also made several recommendations on the best way to tackle fraud based on the best practices hitherto identified by Member States and communicated to the Commission.

However, neither report was discussed by the European Parliament or the Council. The Commission is surprised at this lack of reaction from the other Institutions, and their apparent indifference to the lacunae identified in the reports and to the damage being caused to the financial, economic and employment interests of the Member States and the Community.

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<sup>6</sup> COM(90)183 final – SYN 275.

<sup>7</sup> Report from the Commission to the Council and the European Parliament - VAT collection and control procedures applied in the Member States - Third Commission report [Article 12 of Regulation (EEC, Euratom) No 1553/89] /\* COM(98)0490 final \*/.

## 4.2. Actions at Member State level

The recommendations contained in the Article 14 report concerning Member States' work in the field of administrative cooperation and fraud prevention were discussed by Directors General of Customs and Indirect Taxation<sup>8</sup>. Directors General reaffirmed their commitment to the principle of administrative cooperation, and agreed with the Commission's analysis of the necessity for Member States to improve its performance and use. They also agreed that it would be necessary to set measurable targets to ensure this improvement and expressed their willingness to give it the priority it deserved in terms of organisational and human resources.

Therefore, at the 28<sup>th</sup> SCAC meeting<sup>9</sup>, the Commission asked Member States to agree on certain standards in order to achieve the recommendations. However, Member States were unable to agree on any of the action points proposed by the Commission and delegations were unwilling to commit themselves to the principle of targets.

The matter was therefore brought to the ECOFIN Council<sup>10</sup> where the Commission reminded Ministers that Directors General of national fiscal administrations had agreed on the need to set clear targets for the improvement in their use of administrative cooperation arrangements, but regrettably it had not yet been possible to agree on what those targets should be.

It was only at the 29<sup>th</sup> SCAC meeting<sup>11</sup> that some standards were agreed. Although the standards proposed were set as minimum targets, some Member States asked for derogations, either permanent or temporary, due either to lack of human or technical resources or both.

## 4.3. Actions at Community level

At Community level, the 2<sup>nd</sup> Article 14 report identified a need for Community action to provide Member States with the necessary tools for cooperation and to stimulate their use by officials on the ground. The Commission in 1997 accordingly proposed the Fiscalis programme. This programme was applied from 1998<sup>12</sup> and will run for five years.

The Fiscalis programme, and its predecessor, the Matthaeus-Tax programme, has acted as a focal point for administrative cooperation through exchanges of officials between the administrations of Member States, the organisation of seminars which tackle clearly defined subject areas, and the organisation of multilateral controls in the field of indirect tax. During 1998, seven seminars were held of which one was specifically dedicated to VAT fraud investigation and one specifically to deal with risk analysis. In 1998 13 multilateral controls, each of them involving in average 6 countries, were also initiated.

In the 2<sup>nd</sup> Article 14 report, the Commission also indicated that it was necessary to improve at Community level the functioning of mutual assistance on recovery. The

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<sup>8</sup> 5<sup>th</sup> meeting of Directors General of customs and indirect taxation 26 March 1997.

<sup>9</sup> Meeting of Standing Committee on Administrative Cooperation, SCAC, 8-9 April 1997.

<sup>10</sup> ECOFIN meeting in 12 May 1997.

<sup>11</sup> Meeting of Standing Committee on Administrative Cooperation, SCAC, 25 June 1997.

<sup>12</sup> The Fiscalis programme was adopted by the decision of the European Parliament and of the Council of 30 March 1998 (Decision No 888/98/EC) and was followed by the Fiscalis implementing decision by the Commission on 2 July 1998 (Decision No 98/467/EC).

Commission therefore in 1998 presented a comprehensive revision of the present recovery directive<sup>13</sup>. The Commission proposed that the scope of the Directive be extended to cover direct taxes, fines and penalties. Discussion of this proposal is continuing in the appropriate Council working group.

The Commission has also, in conjunction with Member States, started to look at the taxation problems involved in electronic commerce. The first report<sup>14</sup>, which was agreed in the Council, set out the general principles. The Commission together with Member States and in international fora is seeking to find solutions to the control, tax avoidance and tax fraud problems inherent in this area. While it is currently too early to pre-judge the results of these deliberations, it is clear that to control transactions over the world-wide-web, Member States will have to depend heavily on administrative cooperation, both with one another and with third countries.

The Commission, on a number of occasions in meetings of the SCAC, has proposed to Member States that they should generalise availability for verifying VAT identification numbers by providing access to this facility of the VIES via the World Wide Web. In addition to being a trade facilitation measure, it would enable suppliers to determine whether or not their customers were registered for VAT so that the “reverse charge” provisions of Article 9 of the 6<sup>th</sup> Directive, which displaces the place of supply of certain services to the Member State where the recipient of the service is located, could be correctly applied. In the SCAC, Member States refused to allow the Commission to construct such a “Community” gateway, notwithstanding that at least one Member State already provides such a possibility via its own website. It is regrettable that Member States could not agree to this proposal.

#### **4.4. Actions within the Anti-Fraud sub-Committee (SCAF) of the Standing Committee on Administrative Co-operation in the field of Indirect Taxation (SCAC)**

Within the SCAF, the work to identify frauds and mechanisms behind fraud as well as the general VAT fraud pattern in the Community continued. The Committee undertook this work by carrying out two major studies based upon around 1000 VAT fraud cases, provided by Member States. The second study focused especially on frauds abusing intra-Community trade. The SCAF concluded that the VAT fraud situation is serious and urgently needs to be remedied. The findings are to be used as a platform for an Action plan for dealing with VAT frauds.

The two studies encompassed around 1000 cases and represented together €1300 million of real VAT losses. However, even if the detected amounts were huge, it was estimated that they only represented the tip of the iceberg. In this context the Court of Auditors estimated in a Special Report<sup>15</sup> that a “gap” exists between actual collected VAT receipts

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<sup>13</sup> COM(98)0364 final, Proposal for a European Parliament and Council Directive amending Council Directive 76/308/EEC on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties and in respect of value added tax and certain excise duties.

<sup>14</sup> COM(98)0374 final, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee - Electronic commerce and indirect taxation.

<sup>15</sup> Court of Auditors Special Report 9/98.

and the theoretical amount, calculated on macroeconomic figures. This gap was as high as €70,000 million, and corresponds to 21% of Member States revenue. Even if this calculation has been questioned it indicates a serious discrepancy, which might be caused, at least partly, by fraud.

The analysis of cases made it possible to identify the main techniques used by the fraudsters. Besides the conventional types of fraud like suppression of output tax and abuse of deduction rules, which were very frequently used in domestic trade, the main mechanism behind the construction of intra-Community and international fraud is the abuse of the exemption rules.

The SCAF has at several meetings discussed the strengthening of cooperation to combat this VAT fraud. Discussions have centred on the information that it would be useful to exchange at an operational level. Although the exchange of nominative information is probably the most helpful in detecting and preventing fraud, this is the category which raises the most problems. Because of data protection or fiscal secrecy rules several Member States are unable or unwilling to exchange such data, except with a Member State that is clearly affected by the fraud.

SCAF has further discussed these legal obstacles to co-operation in the fight against fraud. The purpose has been to identify and to define what is not possible because of restrictions in national legislation or because of the lack of a legal base, at a Community level. In this context some Member States raised the need for a single and firm legal instrument, merging the existing Directive 77/799/EEC and the Regulation (EEC) No 218/92. Member States shared the view that legal obstacles need to be abolished and that this should be achieved through Community legislation rather than by means of bilateral agreements.

A further conclusion from the VAT fraud case studies is that Member States retain insufficient records of information from fraud cases, and also have insufficient filing systems. The Commission therefore raised in SCAF proposals for a systematic and coherent system for recording fraud case information to be implemented at national level. However, Member States could not reach any agreement on minimum requirements in this context.

The main reason why Member States are unwilling or unable to commit themselves in SCAF appears to be the level of representation. Often delegates claim that their power is limited to decisions which have no impact on their authorities' resources and since most of the actions required will have some impact on Member States' resources dedicated to control and administrative cooperation, this means that the Committee is unable to achieve meaningful progress and can not take necessary decisions to improve the fight against fraud, even when delegates in principle agree that proposed actions are necessary.

#### **4.5. Court of Auditors reports**

The report by the European Court of Auditors in 1998<sup>16</sup> pointed out that the fight against fraud is characterised by the absence of an integrated strategy. For intra-community transactions it stressed that there is a contradiction, as there exists in practice a single

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<sup>16</sup> Special Report No 9/98 concerning the Protection of the financial interests of the European Union in the field of VAT on intra-Community trade, OJ C 349 of 17.11.1998.

market for fraud but not for law enforcement. The Court of Auditors' work has revealed that the overall losses of VAT tax revenue, both internal and intra-Community, were considerable. The Court of Auditors also observed that the instruments for cooperation between Member states are not fully used. Slow procedures and even an ignorance of existing instruments, in particular on the part of the local authorities, was said often to explain this under-use. It also called upon Member States to set up systems to evaluate the extent of fraud and to be capable of periodically evaluating the effectiveness and results of their anti-fraud activities.

The European Parliament Committee on Budgetary Control has during its discharge procedure for the financial year 1997 examined the Court of Auditors' Special report 9/98 concerning the financial year 1997 on own resources. Based upon the observations of the Court of Auditors, the Committee calls upon the Commission to initiate actions of any nature aimed at encouraging Member States, on the one hand, to set up credible systems of evaluation of the impact of fraud as well as of the evaluation of the effectiveness and the results of control actions, and on the other hand, to develop risk analysis techniques for VAT control. The Commission was also invited to provide an evaluation of the effectiveness of penalty systems. The Committee also asks the Commission to propose a control and cooperation strategy for a genuine fight against fraud.

#### **4.6. Investigations in the Member States**

Having taken all these symptoms of an unacceptable situation into consideration, especially the evidence of a serious fraud situation in combination with indications of unsatisfactory control and administrative co-operation systems, the Commission decided to undertake visits in each Member State in order to examine the functioning and efficiency of administrative co-operation and mutual assistance in the field of VAT. Most of the visits, preceded by a comprehensive questionnaire, were undertaken during the last quarter of 1998. This report is mainly based on an evaluation of the results of those visits.

### **5. THE FUNCTION OF VAT CONTROL IN MEMBER STATES**

#### **5.1. Primary function of VAT control**

The primary function of VAT control is to assure that VAT revenue flows into national treasuries. As VAT is a self-assessment tax, adequate control is required to ensure that taxable persons are paying the correct amount at the correct time. From a Community budget perspective, one element of a Member State's contribution is based on a percentage of VAT actually collected – the VAT resource. Thus the uneven existence of a black economy as between Member States creates a certain inequity as regards each Member State's contribution to the Community budget. Moreover, from a single market perspective, the existence of a black economy creates unacceptable distortions of competition between legitimate traders and those operating illegally.

A key element of VAT control is the so-called self-policing control system. Not all Member States allow the tax administrations to make copies of invoices or collect information from invoices to be used in the control of the counterpart traders. Therefore, these Member States can not efficiently undertake the necessary cross-checking, which the VAT system requires.

## **5.2. The organisational structure of VAT control in Member States and its impact on VAT control**

Generally speaking, Member States have organised their tax administration in two different ways: either based on the type of tax concerned (i.e. with separate administrations for different taxes), or based on the concept of a taxable person as a customer. In the latter case a single tax administration and local office deals with all the taxable person's taxable obligations.

It is clear that the integrated approach has two important benefits: an integrated administration can take an overall approach for all fiscal controls and can accordingly allocate control resources in an optimal and cost efficient way, thus providing improved control and fraud prevention possibilities.

Member States having integrated administrations have also integrated their tax control and computer systems and audit files, which gives a better overview of a taxable person's activities, while non integrated administrations have, generally speaking, very burdensome internal administrative problems to overcome to achieve a similar efficiency.

## **5.3. Control objectives, strategies and targets defined by central or local control programmes**

Looking at Member States' control objectives and on their strategies to achieve them, it is quite clear that the control of the intra-Community trade still is a secondary issue. Very few Member States have a clear control strategy aiming to give intra-Community trade the same level of control as national trade. The control is mainly limited to checks of VIES data, but this is almost at a random level. No Member State had a control strategy for the special schemes.

National control plans are worked out by using different methodologies. Some Member States make a clear link between the overall objective and the strategies to achieve it, and some also convert global objectives into individual targets for each control official or local control office.

However, too many Member States have very vague systems and it is unclear what objectives, strategies and targets actually drive VAT control. Several Member States draw up their control plans at regional or local level and in several cases there seems to be no connection to any overall objective and there is no real feed-back to the central level, which means that the central level has very little knowledge about the ongoing control activity and the results. The strategies to achieve the objective of ensuring that taxable persons actually fulfil their obligations vary between Member States. Most control plans are based upon a philosophy that a sufficient tax control will be achieved by setting a target based on the number of audits or audit days that should be performed within a certain time. Several Member States formulated the overall objective as a revenue target in monetary terms. The aim was in the first place to raise tax revenue for the treasury and to justify their control budgets.

## **5.4. The role of multilateral controls in Member States control systems**

The community VAT system has created the need to establish cross-border control functions. VIES is a part of this control function, but nevertheless it is also necessary to undertake simultaneous controls on a bilateral or multilateral basis.

To facilitate multilateral controls the Community provided funding to undertake simultaneous control exercises. The 1998 Fiscalis programme reinforced this possibility and offers to financially assist Member States in organising multilateral controls as an activity of the programme.

The need for audits under the transitional VAT system is greater than before 1993, when cross-border transactions were scrutinised by border controls. The examination of Member States' activity in this area shows that bilateral or multilateral cross-border control activity was extremely low. Outside the Community funded controls, Member States had on their own expenditure only carried out a handful of simultaneous controls, despite such controls being necessary to ensure compliance with the transitional system as it is constructed. During 1998, 13 multilateral controls were initiated with on average 6 Member States participating in each one. Some Member States have legal restrictions on permitting auditors from other Member States to participate in controls in their country, or have secrecy rules making it impossible to participate in the sharing of information and therefore are not able to participate even if the taxable persons have no objection. Some Member States have said that their priorities are in other fields. To extend these controls demands further resources, which Member States today cannot mobilise.

#### **5.5. Member States allocation of control resources and the correlation between control resources and control activity**

Control resources should normally be a function of the control required to fulfil the overall objective, broken down into measurable targets to be achieved by the different administrations involved in tax control. Control resources are needed both as human resources as well as technical. The amount of resources required to meet the targets depends upon the size and nature of the tax system to be controlled, the organisation of the tax administration, and the structure of taxable persons and their activities. In the absence of clear control objectives and strategies Member States do not allocate control resources according to the actual need. It is apparent that most Member States instead allocate their control activity to the resources available. No Member State could confirm that their allotment of resources, especially human resources, actually fulfilled what they believed would be enough for a sufficient control. Moreover, the levels of control resources diverge, not only between Member States, but also between different regions and offices within a Member State. There is no common principle for the allocation of control resources in the Member States.

Member States have to supervise intra-Community VAT exempted transactions to a value of around €930,000,000,000 - a category of transactions which was subject to formal border controls before 1993, but now has to be controlled by tax authorities. Member States have to control around 24 million VAT traders, who deliver annually around 100 million declarations.

To carry out this giant task, Member States have a limited number of controllers available. Member States today have around 400.000 officials for all types of tax administration. Due to the different level of integration of tax administrations, however, it has been difficult to trace a figure of how many tax controllers are available exclusively or partially for the control of VAT and also the number of VAT controls that have actually been undertaken. One reason is that, in some Member States, central and local tax administrations are different authorities and the central level often has no information about the real resources available.



Despite these uncertainties, it can be estimated that around 20% of the total number of tax officials (or roughly 80.000) are involved in tax audits. Based upon the assumption that integrated administrations use around 30% of their tax audit staff on auditing VAT, (which some of these Member States have indicated), the total number of VAT auditors in the Community could be calculated at about 30.000. This is around 8% of the total staff of tax administrations. (See figure 1 for the proportion of officials engaged in on the spot VAT control per Member State.)

Even if a couple of Member States have not been able to present any figures on the number of VAT controls they undertake during a calendar year, it could be assumed, based on figures from 11 Member States, that the number of on the spot VAT controls will not exceed 600.000 per year in the Community. Comparing these two figures it seems that the average VAT audits per VAT auditor is 20 per year. (See figure 2 for the number of taxable persons per control official.)

The question is what resources are actually needed to control the transitional VAT system in a proper way? There has been no consideration of the control methodology that should be adopted to manage it in an efficient way. There seems to have been no significant increase in control resources in 1993 and no sizeable transfer of controllers from customs administrations to tax administrations.

The second question is whether Member States actually use the resources available in the most efficient way. When resources are limited the control methodology will play an important role. The basic instrument for controls is normally a control plan, whose targets flow from the overall objective set at a higher level. First it can be concluded that several Member States do not have real control plans with clearly defined objectives, targets and a follow-up system. However most Member States have at least some guidelines for control. It is not unusual to find detailed control plans worked out at local level, which then have been agreed at a higher level. Such control plans are sometimes created to fit the available resources, but they are not reflecting the real control needs. The targets are almost always quantified either as a number of audits/controls or audit days to be achieved, or extra revenue to be collected. Several plans set out selection targets, i.e. a number or percentage of taxable persons within certain characteristics that should be subject to controls. Most of the control resources are spent in accordance with the control plan, but there are often some rather limited resources allocated to ad hoc controls.

## **5.6. Traditional and new control methodologies**

### *5.6.1. The role of the VAT declaration for control purposes*

The design of the VAT declaration differs from one Member State to another, as does its role. Some Member States have comprehensive declarations collecting a lot of information for control purposes (and which is cumbersome for the traders to deliver), while on the contrary there are several administrations which have a very simple VAT declaration only taking into account a few boxes. In some Member States it is combined with the collection of other taxes.

It seems that no Member State makes real operational use of all the information collected in the VAT declaration. Most Member States feed the information into computer systems, either automatically or by other means. Some Member States have pointed out that they use it to match data against income tax; however as income declarations are normally delivered much later, such tests will be rather historical and control will not be up-to date.

No Member State claimed that the VAT declaration actually fulfils any strong control purpose.

All together it seems that Member States spend a great deal of human resources on the examination and administration of VAT declarations and that these resources could be better used in more targeted controls, while at the same time a considerable simplification could be achieved without losing any benefits.

This is particularly the case in those Member States where a large amount of the information is collected from taxable persons by non-electronic means, and therefore cannot be further used within the tax administration.

#### *5.6.2. Risk analysis*

Taking into consideration the huge number of controls that the transitional system requires, several Member States regard risk analysis to be the only solution to manage the necessary control level when resources are limited. The problem for many Member States is that they do not have the structure available for introducing risk analysis. Some Member States have problems, practical, formal or both, to make use of information from other tax administrations, or even other national administrations. Some Member States do not have the technical infrastructure to link together different control sources in order to bring together data to be matched in an efficient way. Some Member States do not even have a sufficient technical infrastructure between central, regional and local level to use central risk analysis, and are therefore limited to building risk models based on a local information. Control selection models could be improved on the basis of the experience gained from controls that have previously been undertaken. Unfortunately however, Member States have, in general, low standards of records both about their taxable persons, but also about their controls. Many Member states do not have proper filing systems and often files are kept at local level. No Member State has a real follow-up of controls in respect of analysis of the fraud and the mechanisms behind fraud. Some have follow-ups at local and regional level, but few have a system giving them a total overview of the fraud situation in their Member State. These therefore have great difficulties in describing the nature of fraud and the extent of it and in identifying risks.

In the absence of using risk based selection systems, Member States are not using their resources at an optimum level. Only two Member States are working with risk analysis as the main control selection tool. Several Member States are working with hybrids of risk selection. In these circumstances present control resources and methods will not make it possible to meet the growing fraud challenge unless Member States can adapt their legal, organisational and technical infrastructures to establish real risk analysis systems within the near future.

#### *5.6.3. Computer auditing*

Member States' capacity to adopt new technology was also examined. Several Member States offer their officials this tool, either through access to raw data, or to more refined products where VIES data are consolidated with other control data to give the controller a more comprehensive picture of the taxable person's situation. This type of development is still in its infancy in many Member States, but the growing use of computer systems within the business sector will force Member States to adopt the new technology. The developments in the field of new electronic technology, where traders will use electronic invoicing and self-billing on a daily basis will put specific demands on Member States' tax

control systems. The technology is already operational. However, it seems that Member States in general are very badly prepared to meet the new environment, despite the fact that the Commission, in 1996, arranged the first seminar in this field, followed by several others. Currently, only 3% of the auditors are skilled in computer auditing and this may cause great problems for the control in the future. Nevertheless, it is also obvious that auditing by electronic means provides a possibility for administrations to increase control efficiency and to lower control costs.

#### *5.6.4. Investigation and intelligence services*

Besides targeted control and selection by risk some Member States have set up specific investigation and intelligence services to detect tax fraud and criminal activity involving the tax, excise and customs fields. Even though several Member States have special investigators it is unclear whether their competence is different from the competence of a tax auditor. There are only a couple of Member States having such an activity in the tax field. These units seem to have restrained tax criminal activity. Some Member States had also set up specific fiscal attachés at their embassies in some Member States to ameliorate exchange of intelligence information. In most Member States special auditors were authorised to deal with large enterprises or large groups. This was mainly determined for income tax control reasons, but VAT control also gained from this arrangement.

### **5.7. The role of penalties to achieve voluntary compliance**

All Member States have implemented penalty schemes, which cover the following situations: non declaration, non submission or late submission of declarations, non payment or delayed payment and failure to maintain complete records for tax purpose. Irregularities, such as suppression of output tax and unjustifiable claims of input tax are also penalised in all Member States.

Member States were asked to indicate how much tax was paid in time, and how much was paid late. More than half of the Member States were not able to give figures at all in this respect, which shows that Member States have very little follow-up on the payments and lack of evaluation of the efficiency of their penalty systems. The examination showed, from those Member States who were able to answer the question, that normally 92-94% of the tax was paid in time, even if two Member States had clearly lower figures (72-76%). Those, very few Member States, giving any figure on how much VAT that was not paid at all indicated figures between 1-2%.

## **6. THE FUNCTION OF ADMINISTRATIVE COOPERATION AND MUTUAL ASSISTANCE IN THE FIELD OF INDIRECT TAXATION (VAT)**

### **6.1. Background**

The purpose of administrative cooperation is to permit Member States to properly control traders who engage in intra-Community trade. In such business relationships, the information regarding the counterpart of the activities being controlled is located in another Member State. Therefore, to properly control that a trader has made an exempt intra-Community supply, it is necessary to first have information that the goods were supplied to a taxable person in another Member State. The prima facie evidence for this is an entry on the recapitulative statement, but this is not a prerequisite for exempting (see Chapter 2). Without administrative co-operation, the tax administration controlling the

business can only have an incomplete picture of its traders, and can only concentrate on formal details supplied, without proper means of cross-checking the veracity of the transactions.

The Commission, in its role as guardian of the Treaties, is responsible for the control of Community law. Efficiency and good use of administrative co-operation and mutual assistance tools by Member States is a key point for the Commission in the VAT field. This should contribute to the fight against fraud and tax evasion, which also creates distortions of competition in the single market.

## **6.2. The organisation of administrative cooperation and mutual assistance**

When the transitional VAT arrangements were introduced with effect from 1 January 1993, Regulation (EEC) No 218/92 provided for a common system for the exchange of information on intra-Community transactions, supplementing Directive 77/799/EEC<sup>17</sup> concerning mutual assistance by the competent authorities of the Member States in the field of direct and indirect taxation. The scope of this Directive had been extended to VAT in 1979 by Directive 79/1070/EEC<sup>18</sup>. Originally the Directive set up structures for the exchange of information between tax administrations in relation to direct taxation. However, with the introduction of the transitional VAT arrangements, this valuable legal instrument on its own was no longer fully adequate to meet the new and more specific needs for co-operation between national tax administrations for the control of VAT in the single market. This explains the existence of two different legal instruments providing for cooperation between Member States in the field of VAT. There are different provisions regarding the time limits applying to requests under the Directive and the Regulation, and also regarding the use to which information received can be put. In accordance with the requirements of the Regulation, Member States have set up Central Liaison Offices that have primary responsibility for the exchange of information under the Regulation. However, some Member States have a different entity responsible for the exchange of information under the Directive. This means that the synergy between the Regulation and the Directive for VAT control purposes intended by the Council as highlighted in the recitals<sup>19</sup> has not been achieved. Some Member States are, for instance, fairly strict on the type of information VAT authorities may ask according to the Regulation and to the Directive, and thus these Member States reject some assistance procedure on formal grounds. The Commission believes that this has a negative impact on the use of the possibility for cooperation in VAT control between Member States and considers that control officials making requests for assistance should not be put in a position whereby they have to be aware in advance of the legal base that they are obliged to use to get information.

## **6.3. The use of the tools of administrative cooperation by Member States**

The purpose of the Community arrangements for administrative cooperation put in place by Regulation (EEC) No 218/92 is to avoid tax revenue losses for Member States due to fraud and tax evasion. Under Article 4(2) of the Regulation, a Member State can be

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<sup>17</sup> OJ L 336, 27.12.1977, p. 15.

<sup>18</sup> OJ L 331, 27.12.1979, p. 8.

<sup>19</sup> “Whereas this Regulation provides for a common system for the exchange of information on intra-Community transactions, supplementing Directive 77/799/EEC, as last amended by Directive 79/1070/EEC, and intended to serve tax purposes”

provided on request with information about whether one of its traders has made intra-Community purchases during a particular quarter. Article 4(3) of the Regulation can be used to identify the suppliers from whom the purchases have been made. The aggregated form of Article 4(2) data is also exchanged automatically between Member States at the end of each quarter by the VIES. Member States can also, under Article 2 of Directive 77/799/EEC and under Article 5 of the Regulation, make more specific requests for information, for the purpose of control of particular traders, relating for example to the invoice numbers, dates and values of individual transactions. The use of Articles 4(2), 4(3) and 5 of the Regulation by Member States are the key elements in the control of traders engaged in intra-Community trade. Figure 3 in the annex indicates the proportion of taxable persons in Member States that make intra-Community acquisitions the proper control of whom require tax administrations to depend on administrative cooperation.

At the time of the adoption of the transitional VAT arrangements, the Community did not lay down any particular single control methodology or method of exploiting the VIES data and other opportunities to gather information. Each Member State retained the right to control its own traders in the way that it deemed appropriate. Nevertheless, the Community has, in the context of the Fiscalis programme, fostered a debate on the methodology of control of intra-Community trade. The programme has provided opportunities for Member States to compare approaches to VAT control generally and the intra-Community trade and the use of the VIES in particular and to identify best practice.

Notwithstanding the purpose of Regulation (EEC) No 218/92, Member States are still, generally speaking, unwilling (or unable) to provide details of additional tax discovered as a result of the information exchanged over the VIES. Accordingly, the Commission can only evaluate the Member States' exploitation of the administrative cooperation framework by examining their use of its key elements which consist of requests made under Article 5 of the Regulation or Article 2 of the Directive, and enquiries made under Articles 4(2) and 4(3) of the Regulation. Figures 3 and 4 in the annex show the evolution of the use of these possibilities.

Figure 5 is a cause for concern as it indicates that Member States' use of the possibility to request information from other Member States has not increased significantly in recent times. The number of requests that have been made is only a fraction of the tens of thousands of requests per annum that Member States themselves estimated in June 1993. To put this data in context, on the basis of information supplied to the Commission by Member States, there are of the order of 1,500,000 taxable persons making intra-Community acquisitions and approximately 30,000 VAT officials in the Community engaged in VAT control. Therefore, over the 3-year period between 1996 and 1998, requests for administrative cooperation were made in respect of only 2% of traders making intra-Community acquisitions. Per VAT control official, this works out at less than 1 request each in 3 years. This is a clear indication of inadequate control of intra-Community trade generally. The Commission believes that it is absolutely necessary in the context of the fight against fraud that Member States make more use of the possibility to request information from other Member States.

Figures 6 to 9 put the total number of requests made under Article 2 of the Directive and Article 5 of the Regulation over a three-year period into context. The number of requests is analysed per Member State; per control official; per control and as a proportion of the intra-Community trader population.

Although there has not been a significant increase in the number of Article 2 and Article 5 requests, the number of enquiries made under Article 4 of the Regulation, as can be seen from figure 4, continues to increase. As a prerequisite to making a request under Article 5 of the Regulation, Member States must first use the possibilities provided by Article 4. This increase in the number of Article 4 requests is to be welcomed, and indicates that Member States may have taken into account at least some of the recommendations made in the 2<sup>nd</sup> Article 14 report. Many of the requests made under Article 4 of the Regulation are made to confirm that the trader in the requesting Member State did not make any intra-Community acquisitions. This is also a valid method of exploiting the VIES data.

The conclusion that can be drawn from figure 4 is that, while the use of the VIES data is certainly increasing, there is no corresponding increase in the use of requests made under Article 5 of Regulation (EEC) No 218/92. This may be due to the length of time taken to answer requests for information, as evidenced by the number of requests made for which replies are outstanding after expiry of the deadline (see figures 10 and 11). Member States have consistently complained about the quality of the VIES data, so it is difficult for the Commission to understand how VAT control of intra-Community acquisitions can be properly controlled using incomplete data. The low number of requests made per control official as indicated in Figure 7 and the low number of requests made per control as indicated in Figure 8 indicates that Member States still have a lot of work to do to ensure that control officials make the best use of the possibilities made available to them for the purpose of controlling taxable persons making intra-Community acquisitions. Figure 9 demonstrates the low likelihood of intra-Community traders having their transactions verified.

The low use of the possibility to request information in accordance with Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC and the apparent reduction in the number of requests being made could be due to the following:

- (1) Control officials' experience to date which shows that requests made to other Member States do not result in an additional tax yield, and therefore they have reduced the number of requests being made;
- (2) Tax administrations perceptions that traders making intra-Community supplies and acquisitions are fully compliant and therefore transactions need not be verified;
- (3) The perception of controllers that if a request is made to another Member State, a reply will not be received in sufficient time to be of use in solving a case.

In the Commission's view, the first two scenarios are unlikely, because of the challenge of fraud as outlined at 3.5; the third scenario being the most likely reason for this phenomenon.

A high standard of VAT control requires the use of administrative cooperation to be more widespread in the Member States and thoroughly integrated into national control strategy. Administrative cooperation should not be a specialist function. Information about the intra-Community purchases of a trader should be seen as another piece of the national control jigsaw, without which control is incomplete. This approach entails extensive use by ordinary VAT control officials of the specific enquiry and request opportunities provided by the Community. Member States that make little use of the opportunities provided by the tools of administrative cooperation can not have a complete picture of

their traders. It is clear that the control of traders making intra-Community acquisitions is far from sufficient.

Low use of the instruments of cooperation raises serious questions about the overall credibility and effectiveness of several Member States' control of VAT on intra-Community trade. The establishment of the VIES and Regulation (EEC) No 218/92 (adopted by unanimity) were originally seen by all the Member States as essential to the effective control under the transitional VAT arrangements. The setting up and running of the infrastructure has required significant investment from the Community and the Member States in terms of human and financial resources and the obligations on traders to file quarterly recapitulative statements imposes a considerable burden on them.

### *6.3.1. Central Liaison Offices and their role in meeting deadlines*

Regulation N° 218/92 EEC provides for the setting up in each Member State of a Central Liaison Office (CLO). The legislation does not lay down detailed requirements for the constitution of CLOs, but in 1993, the Commission and the Member States agreed a set of guidelines setting out their main functions and objectives. These were principally to act as the normal channel of communication between competent authorities; to manage the flow of cooperation and assistance between Member States; to monitor the quality and pertinence of requests for assistance and of the responses to them and to supervise the respect of deadlines. In short, the CLO should act as a single point of contact, through which other Member States can rely on obtaining effective and timely assistance with any matters relating to VAT control and cooperation. It is important that CLOs should have the resources, powers and the expertise needed to provide that service. The Commission underlines that even if under Directive 77/799/EEC the competent authorities may be different from the CLO in certain Member States, it is obvious that in VAT matters at least some direct link should exist between the two administrative services within a single Member State.

Article 5 of Regulation (EEC) No 218/92 states that "The requested authority shall provide the information [requested by another Member State] as quickly as possible and in any event no more than three months after receipt of the request". No such deadline exists for requests under Directive 77/799/EEC, but in 1994 the SCAC, for practical reasons, agreed informally that requests made under Article 2 of the Directive would be subject to the same time limit of three months which applies to requests made under Article 5 of the Regulation. This decision provided for a streamlining of procedures applying in Member States to the management of requests and replies under the two legal bases. There has been a steady increase in the number of requests made under these legal bases, for which the **maximum** 3 months deadline has expired. This is extremely worrying, particularly as the number of requests outstanding now exceeds the number of requests made each quarter.

In practice, differences between Member States in the organisation and staffing levels of CLOs and the service provided to CLOs by outfield staff have led to a variation in the level of service they are able to provide which can create difficulties for the smooth operation of administrative cooperation. There are strong indications that, rather than acting as a conduit, some CLOs at least appear to be causing bottlenecks in communication as can be seen from figure 11. A further problem is created in certain Member States by the fact that different parts of the administration are competent in respect of requests made under the different legal instruments, and while the CLO may be

competent for dealing with requests under the Regulation, it may not be competent to deal with requests made under Directive 77/799/EEC. In the Commission's view, this division of tasks in so far as VAT is concerned, undermines the synergy that is explicitly intended in the Community legislation. It also undermines the advantages that result from having a single contact point.

CLOs will only be able to provide their colleagues in other Member States with the service which they expect and are entitled to receive, if they can secure an adequate response, in terms of allocation of resources and priorities, from their own control administration at the appropriate level. Member States that do not reply to requests in time must empathise with the control official in the requesting Member State who may be depending on the reply to resolve a problem that he has encountered. Missed deadlines can lead to missed opportunities for effective control and recovery of the tax.

Despite the potential improvements identified at meetings of the heads of CLOs, held under the Matthaeus-Tax programme, these organisational and staffing differences are continuing to hamper the development of administrative cooperation and need to be addressed by the Member States.

In particular, therefore, administrations need to consider the adequacy of resources within CLOs; the degree of priority given at local level to requests for information from other Member States; the level of human resources assigned to such work at local office level; the requirements for training in the use of the system and for an understanding of the needs of other Member States; and language training to overcome communication difficulties.

#### **6.4. The integration of administrative cooperation into controls and the accessibility of the tools available**

While it is clear that Member States have generally made progress since the last Article 14 report, the low number of Article 5 requests is still giving cause for concern. It is not clear that all control officials have, as a first instinct, the inclination to request information from other Member States to help them with a case, or to supply information spontaneously to another Member State, which may be of help to the latter. The ease of access to the VIES data is still poor in some Member States, where officials must first contact the CLO to obtain information about presumed intra-Community acquisitions. The Commission believes that ease of access to information is a determining factor in control officials' use of the administrative cooperation and mutual assistance possibilities.

One Member State has introduced a procedure whereby as an addition to the information obtained over the VIES, bilateral arrangements have been entered into to permit additional questions to be asked regarding a taxable person's general compliance. The Commission considers that this is a welcome initiative, and is currently in the process of re-designing the forms currently in use for the purpose of the exchange of information so that this aspect could become a standard question between Member States.

#### **6.5. The exploitation of information exchanged for the purposes of control and its impact on the detection of fraud**

While the VIES information is transmitted in a timely fashion between Member States, there are still delays in answering requests made under Article 5 of the Regulation or Article 2 of the Directive. Some of the reasons given by Member States for delayed replies



are that the case may be under investigation by the Member State receiving the request or that the requests may be for insignificant amounts. Other reasons include the lack of priority associated with requests received from other Member States, and the disproportionate amount of time that was necessary to answer the requests, without any apparent result or feedback from the requesting Member State. The provisions of Regulation (EEC) No 218/92 were never intended to deal with individual fraud cases, which by their nature are happening in the here and now, but many Member States are reporting the discovery of fraud cases which have happened in the past (see 4.4). Nevertheless, one Member State (the Netherlands) has already entered into bilateral arrangements with certain other Member States to put in place a “fast stream” approach for cases of suspected fraud. This is effective for bilateral actions, but is not a solution at Community level for combating and preventing widespread frauds that potentially affect all Member States.

The natural reaction of control officials when they receive requests for assistance from other Member States is to accord them low priority on the assumption that any additional tax arising as a result of their actions will accrue to another Member State. It is all the more regrettable therefore, that many Member States use the criteria of additional tax discovered to assess the quality of the work done by control officials. The setting of monetary targets, either per official or per local office militates against good administrative cooperation. Even at central level, certain Member States complain about the frequency and low value of requests for assistance that they receive from other Member States. On receiving a request, some Member States always initiate an inspection of the trader’s records. Other Member States initiate a written procedure, whereby the trader himself is asked to reply to the query raised by the other Member State. In the Commission’s view, a “written procedure” is acceptable only in respect of those cases where the trader from whom the information being sought is above reproach, because otherwise, the answer given to the requesting Member State is at best doubtful, and can, in the worst case scenario i.e. collusion between traders for the purpose of perpetrating fraud, be counter-productive, as it warns both traders that their affairs are subject to investigation, and they can then successfully throw both administrations “off the scent”.

#### **6.6. The use of present legal instruments and their effect on the fight against fraud**

While it is clear that, with the exception of the excessive amount of time taken by some Member States to answer requests received from other Member States, the general consensus among Member States, and control officials (reported, inter alia in Fiscalis seminar evaluation forms) is that the VIES and administrative cooperation are good tools for control. The main problem is that control *a posteriori* happens too late in many cases, which means that while information received is useful, it would have been more useful if received earlier. Requests under Article 5 of Regulation (EEC) No 218/92 can only be made after the quarterly delivery of the VIES data, which could already provide a fraudster 6 months of breathing space. Experience has shown that fraudsters move quickly, and the Commission is therefore convinced that the Regulation should be amended to provide for the quicker exchange of information between Member States. However, the evidence points to the slow response time to requests, rather than the legal instruments themselves as obstacles in the fight against fraud. While a fraud case in a requesting Member State may be top priority for the investigating official there, he is at the mercy of his counterpart in another Member State, over whom he has no control. In an effort to create a fast-track approach to fraud cases, the SCAC decided to have a

shorter time limit of one month for replies to requests where the requesting Member State could justify using this procedure. However, certain Member States consider that most of their cases are fraud cases, and the problem becomes circular. The Commission believes that amendment of the Community legislation is necessary to provide for better possibilities for Member States to tackle fraud quickly.

### **6.7. Obstacles to the efficient use of the existing legal bases.**

There is consensus among Member States that Regulation (EEC) No 218/92 is not a suitable instrument either to deal with specific fraud cases which are known to exist, or to exchange information to detect fraud, since the information covered by the Regulation is not available early enough and cannot be exchanged as quickly as needed. In addition, its scope does not cover all transactions that could be affected by fraud. The Regulation only relates to intra-community supplies and acquisitions, and not, for instance, to domestic supplies or to supplies of services. Since most VAT-fraud mechanisms combine intra-Community with domestic transactions, tax-administrations are obliged to exploit other legal instruments.

For these reasons, Member States mainly use Directive 77/799/EEC as a legal basis for co-operation in fraud matters. However, as Directive 77/799/EEC was originally designed for the exchange of information in relation to direct taxation, it has not been adapted for coping with the specific need for strengthened co-operation between national tax administrations for the control of VAT after the introduction of the transitional VAT arrangements from 1.1.1993.

#### *6.7.1. One single legal framework in VAT matters*

Since administrative co-operation in the Community is based on these two legal instruments, the use of the instrument will depend either on the transactions covered or on the nature of the information requested. Therefore some Member States claim that these instruments should be merged for VAT control purposes, thus providing clear and efficient rules for mutual assistance for all VAT transactions. The Commission welcomes this idea and is, in the light of the experience under the current legal framework, in favour of amending Regulation No 218/92, which is specific to VAT transactions, and reinforcing its functioning. The aim is to create a suitable unique legal framework to deal with the need for strengthened co-operation to tackle VAT fraud and evasion in the Single Market.

#### *6.7.2. Obstacles to spontaneous exchange of information*

An effective fight against fraud requires a very significant increase in the spontaneous exchange of relevant and targeted information in order to facilitate the prevention, detection, investigation and punishment of fraud and tax evasion. Fraudsters move easily between Member States, and ruthlessly exploit the weaknesses in controls and systems. If one Member State tightens its grip on fraud, experience has shown that the fraudsters simply move their operations to other Member States. This means that if the exchange of information is to be effective in combating fraud it is not enough simply to exchange information between Member States that are known to be directly affected by a specific fraud. Other Member States need to be alerted to the danger so that preventative measures can be taken or investigations begun. Such exchanges will allow trends to be discerned. However, a few Member States claim that the current legal instruments do not provide a legal base for exchanging information with Member States not directly affected

by the fraud, since it is stated that the information shall be made available only to the persons directly involved in the assessment or the control.

The Commission sees no legal evidence for such a restrictive interpretation of the possible use of mutual assistance tools. On the contrary, article 4 of the Directive shows firstly that in certain cases, broadly when fraud or tax evasion is suspected, Member states **have to** communicate all relevant information (paragraph 1), and secondly, in other occurrence, it is clear that Member state **may** give information to any Member State if such may enable the competent authority to effect a correct assessment (see Article 4 (3)) according to the objective of Article 1 of the Directive. Nevertheless, the Commission takes the view that Regulation No 218/92 may profitably be amended.

#### *6.7.3. Obstacles hampering co-ordination and technical assistance from the Commission services*

VAT fraud is indeed a problem at Community level. Co-ordination and technical assistance from the Commission services could reinforce the effectiveness of the fight against international fraud. It is impossible for individual Member States to see the whole picture of fraud in the Community. The Commission, if it received relevant information from the Member States, could provide an overview and could, depending on the resources available, eventually identify fraud trends and threats in association with the Member States' own intelligence activities. To achieve this requires case-related and other fraud information to be made available to the Commission by the Member States. The Commission would also circulate information and help to co-ordinate subsequent action in appropriate circumstances. Since the current legal framework has not been conceived to take account of anti-fraud developments that have been included in other more recent legislation, the Regulation No 218/92 should be amended to put beyond doubt that information can be received and disseminated by the Commission to other CLOs of Member States.

#### *6.7.4. Bilateral arrangements providing for automatic or intensified spontaneous exchange of information*

Most Member States support the idea that in order to increase the possibilities of detecting and preventing fraud in intra-Community trade, Member States should also exchange at a Community level other information than the VIES data. Since the Regulation does not provide a suitable legal base, a few Member States make use of the possibilities offered by Directive 77/799/EEC. Under Directive 77/799/EEC, Member States can make bilateral arrangements in order to exchange information automatically or to intensify the spontaneous exchange of information. Although Directive 77/799/EEC does not provide a clear definition, these types of exchange can be described as follows. Firstly, spontaneous exchange is the non-systematic transmission of information by a Member State that it supposes to be of interest to another Member State. The information will be only exchanged if and when it becomes available. Secondly, automatic exchange is the systematic transmission of information to another Member State. It is characterised by regularity and does not require an individual evaluation of the interest of that information for the other Member State. The exchange does not demand a case-related decision of the transmitting Member State.

Recently a few Member States, under Directive 77/799/EEC, concluded bilateral arrangements to exchange information automatically or to intensify the spontaneous

exchange of information. The categories of information which are covered by these arrangements can be summarised as follows:

a) cases where taxation is deemed to take place in the Member State of destination and where any efficient control-system has to rely on the information provided by the Member State of origin;

b) specific cases where there is suspicion of fraud in the other Member State;

c) categories of information relating to operations which generally represent a higher risk for fraud or avoidance in the other Member State.

The Commission became aware that, although most Member States support the idea of an intensified exchange of relevant information, this information is still rarely exchanged. Even for those Member States having bilateral arrangements, the Commission is only aware of one Member State having implemented administrative instructions to ensure that in practice spontaneous exchanges take place.

In order to increase the possibilities of detecting and preventing fraud in intra-Community trade, Member States should agree to start exchanging at least the above-mentioned information at a Community level. But much more could be exchanged. The Commission takes the view that all relevant information available within the administration could be exchanged automatically or spontaneously. In addition, relevant information that is only available from the taxable person should be exchanged if and when it becomes available. Bilateral arrangements are only partial solutions and are not the most effective way of ensuring that all relevant information is available to those who need it. It is a waste of resources for each Member State to make bilateral arrangements with each of the other Member States, and it is more likely that there will be differences between the arrangements, which add to the administrative burden. Indeed, most Member States indicate that they would prefer to see better legislative solutions at Community level. The Commission agrees that such solutions would be beneficial and that Regulation No 218/92 should be amended in order to provide for suitable legal obligations ensuring that all relevant information is exchanged at a Community level.

#### *6.7.5. Level of possibilities for direct contact between anti-fraud units and between controllers*

In principle, all exchange of information should go through the competent authority in the sense of Article 2 of Regulation (EEC) No 218/92 or Article 1 of Directive 77/799/EEC. If this procedure is not respected the information exchanged will not be considered as valid, and can not be used against the fraudster.

On the other hand, Member States may, pursuant to Article 12(1) of the Regulation and to Article 9(2) of the Directive, authorise competent authorities of the Member States to permit, by mutual agreement, the authorities designated by them to communicate directly with each other in specific or in certain categories of cases.

Some Member States have, already within the existing legal framework, established some direct contact. These initiatives can be summarised as follows:

- a) Some Member States have made their anti-fraud unit a competent authority. Others have situated their anti-fraud unit in their internal organisation directly beside the CLO (under the same Directorate and in the same location).
- b) Some Member States have fiscal representatives in their embassies in other Member States also being a competent authority. The fiscal representative operates as a local interface in the requesting Member State.
- c) For multilateral controls some Member States have appointed controllers to exchange information directly, based on the general concept of (unilateral) delegation of powers of the competent authority to individual officials.
- d) Most Member States have by mutual agreement permitted, to authorities designated by them, direct communication with each other. This may cover several categories of cases such as: direct communication of basic data requested in cases of suspicion of fraud, direct communication between border areas as well as direct communication in joint investigations in the context of bilateral or multilateral control. However, several of these agreements are of an informal nature. Only a few Member States have formal arrangements providing for clear procedures to respect in cases of direct exchange of information.

The Commission takes the view that there are advantages arising from direct communication between controllers or between antifraud units: quicker exchange of information, better mutual understanding of the request for information, better motivation of the controllers involved and prioritisation of the action requested, no waste of scarce resources due to useless requests, etc. However, although the existing legal framework provides for the possibility to establish direct contact between controllers, Member States have made poor use of this, and the initiatives in this area are often of a very disparate nature creating different and vague procedures to be followed. Again, an amended Regulation should create a clear legal framework for direct communication, hereby simultaneously ensuring that the CLOs are made aware of all direct contacts between operational officials so that the role of the central office is not undermined.

#### 6.7.6. *Obstacles to the presence of officials of the tax administration of the other Member States.*

In practice, the vast majority of Member States only permit the presence of foreign officials during controls with the permission of the taxable person. However, it is obvious that granting of such permission by the taxable person is unlikely where the purpose of the control is to investigate suspected fraud. On the other hand a few Member States do not allow an official of another Member State to be present at an investigation on the territory of the other State and claim legal problems. In an internal market eliminating all frontiers for fraudsters, the question arises whether and to which extent these frontiers still should be kept for controllers.

Although FISCALIS-programme<sup>20</sup> provides for Community funding for Multilateral controls, Regulation (EEC) No 218/92 does not provide for a legal base for the presence

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<sup>20</sup> Decision No 888/98/EC of the European Parliament and of the Council of 30 March 1998 establishing a programme of Community action to ameliorate the indirect taxation systems of the internal market (Fiscalis programme) OJ L 126, 28.4.1998 p. 1-5.

of officials of the tax administration of the other Member States. Again Member States have to exploit the possibilities offered by Article 6 of Directive 77/799/EEC. Pursuant to this article, Member States may, under the consultation procedure laid down in Article 9, authorise the presence of officials of the tax administration of the other Member State. However, this possibility has not been implemented in national legislation by most Member States. Only a few Member States have made bilateral arrangements, in order to cover the possibility for an official of another Member State to be present at an investigation on the territory of the other State. These arrangements create a legal base making the tax administration no longer dependant on the agreement of the taxable person. At the same time they create a legal structure specifying the rights and obligations and the procedures to follow for each of the parties concerned.

#### *6.7.7. Obstacles hampering exchange of personal data*

Most Member States have difficulties in exchanging personal data because of the restrictions contained in their national law. They claim that the rules on data protection seriously restrict the information which can be exchanged and with whom it can be exchanged. In particular, they claim that the implementation of Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data<sup>21</sup> hampers the exchange of personal data even in cases where fraud is known to exist, and even more so in respect of information revealing a high risk that fraud is being committed. In fact, the data protection rules have the effect of protecting fraudsters and thus damaging the financial and other interests of the Member States and the Community. In relation to data protection, Member States should make use of Article 13 of the Directive, which provides exemptions from the normal rules in order to safeguard the financial interest of a Member State, (including taxation matters). In addition, there needs to be a clear legal provision that relevant information will be made available to ensure an effective fight against fraud.

#### *6.7.8. Notification to the taxable person of the exchange of information*

The national legislation in force in some Member State provides for notification of the person concerned of the exchange of information. It is clear that in cases of fraud such notification hampers control efficiency. The fact that some Member States systematically notify any request for information to the taxable person, brings about that other Member States are reluctant to make use of the mutual assistance arrangements in cases of suspicion of fraud.

The Commission takes the view that since the exchange of information between national tax-authorities does not give rise to a notification to the taxable person, this should also not be the case in exchange of information between competent authorities. Article 8 of the Regulation states that such notification may continue to apply except where their application would prejudice the investigation of tax evasion in another Member State. However, for the reasons set out above, Member States mainly use Directive 77/799/EEC as a legal basis in cases of fraud. Since the Directive does not have the same provision, in practice some Member States will systematically, even in cases of fraud which are known to exist, notify the exchange of information to the taxable person.

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<sup>21</sup> OJ L 281, 23.11.1995 p. 31.

### *6.7.9. Interference with criminal procedures*

When the requested information relates to cases in which representatives of the Member States' national administrations conduct enquiries with a mandate from, or under the authority of, the legal authorities; the exchange of any information is often refused or substantially delayed. As a consequence, the administrative authority in the applicant Member State is often not capable of launching civil or criminal procedures in due time against fraud taking place on its territory.

### *6.7.10. Lack of legal base to exchange of information with or from third countries.*

The current legal framework does not provide a legal base for exchanging information with third countries. When VAT-fraud is linked to import/export transactions, the customs cooperation instruments can be used. However there are several loopholes, for instance for fraud relating to services or for fraud committed in the Community but where the evidence is located in third countries.

## **7. CONCLUSIONS AND RECOMMENDATIONS**

### **7.1. Conclusions**

- (1) The Commission should ensure that Member States can properly control intra-Community trade thanks to a performing and adequate system of exchanges of information. Incomplete control can only lead to an increase in fraud, a drop in revenue receipts and distortions of competition in the single market. Currently, there are no specific exchanges of information taking place regarding distance sales. Because the special scheme for distance sales is clearly not being controlled as it should be, the Commission may make a proposal to modify these arrangements.
- (2) The Commission is still not convinced that, despite certain improvements, national administrations have done all they could to improve the efficiency with which CLOs deal with requests received from other Member States. The role of the CLO should be further reinforced, and Member States should consider associating the work of the CLOs and that of specialised anti-fraud units more closely. While it is clear that at the time of the adoption of the transitional VAT arrangements, the creation of the CLOs was essential, the Commission considers that the time has now come to review their effectiveness, and to see whether or not the exchange of certain information could be made more efficient by creating or supporting other structures.
- (3) The Commission is concerned about the high levels of VAT fraud evidenced by the work of the Anti-Fraud Sub-Committee (SCAF) of the Standing Committee on Administrative Cooperation in the field of Indirect Taxation (SCAC), and is not convinced that Member States are taking all steps necessary to combat this fraud. Intelligence and investigation units, and also specialised anti-fraud units, have significantly contributed to the fight against fraud. However, their role in the control system is not clearly defined nor are their links with the objectives of the control. At a Community level, the apparent reluctance of Member States to contribute actively to the work of the SCAF, being either directly as a result of the

tacit acceptance of the black economy, or by not ensuring that delegates to the Committee are given sufficient power to commit national administrations to courses of action leaves the Commission sceptical regarding their commitment to fight VAT fraud. The low use of the Fiscal SCENT also leads the Commission to wonder whether Member States are only paying lip service to the principle of the exchange of information to help detect fraud.

- (4) With the exception of the interest shown by the Court of Auditors, the apparent reluctance of the other Community institutions to discuss the matters raised in the Second Article 14 and Third Article 12 reports, and the apparent indifference of the Member States towards the recommendations contained in these reports causes the Commission concern.
- (5) The different level of integration between fiscal administrations plays an important role in the efficiency of tax control and thus in the ability to fulfil community requirements concerning administrative cooperation. Where internal barriers exist, and it is mainly in poorly-integrated Member States, they hamper the proper control of the VAT system of which administrative cooperation between Member States is an essential part. As there is a strong correlation between control and administrative cooperation the community control system has less possibilities to work well in those Member States where such barriers still exist.
- (6) While Member States have, generally speaking, very strong control powers, the overall objective on how to use this control power is absent and no real control plans with clear strategies are apparent. It is unclear what actually drives tax control and especially VAT control. Member States do not seem to have considered the scale of resources they need to control the VAT system properly. Member States have allocated their control to the resources available instead of having it based on the real need. Controls are mainly based on traditional control work and selection by using risk criteria is rare. The VAT declaration plays a negligible role in control work, even though it consumes substantial administrative resources, both for administrations and traders. Use of modern technology such as computer auditing was at a very low level and Member States will have great problems to meet new challenges, particularly because of the absence of the necessary legal and technical infrastructure. Member States still depend on traditional control means and, due to significant understaffing, controls serving administrative cooperation will not achieve sufficient levels if there is not a radical change in control policy.
- (7) Member States' use of the possibilities provided for by administrative cooperation and mutual assistance falls far short of optimal. However, this appears to be due principally to the low level of VAT control generally. There is a direct relationship between VAT control and the need to use the administrative cooperation and mutual assistance arrangements.
- (8) The structures which have been set up to deal with administrative cooperation and mutual assistance deal reasonably well with normal VAT control, where records are checked *a posteriori*, sometimes two or three years after the transactions have taken place. In addition the fact that traders are aware that information about them is exchanged between tax administrations has a dissuasive effect. However, the procedures for administrative cooperation and mutual assistance are totally



inadequate when it comes to dealing with fraudsters – those people who deliberately set out, whether on an organised basis or not, to make money from the VAT system. For such people, the only hope that a tax administration has is rapid and efficient action, based on intelligence and good risk analysis.

- (9) The current Community legislation on administrative co-operation and mutual assistance in the field of VAT is found in two different legal instruments, unlike in the Customs area, where such legislation is found in one single instrument – Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and co-operation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters<sup>22</sup>. The view of the Commission is that, for VAT purposes, the amendment of Regulation (EEC) No 218/92 is essential in order to cope with the necessity for strengthened cooperation. In the light of the experience gained, some supplementary rules should be laid down at Community level with the aim of strengthening cooperation both among the administrative authorities of the Member States and between those authorities and the Commission. Such Regulation should essentially:
- specify the different kinds of information which may be requested and clarify the action which is needed to comply with the request for each category;
  - ensure the availability on a central level within Member States and the quick exchange of basic information;
  - ensure a widespread spontaneous exchange of information to facilitate detection and combating of fraud;
  - create a clear legal base for co-ordination and technical assistance from the Commission services as well as for cooperation with third countries.
  - offer more possibilities for direct contacts between anti-fraud units and between controllers in different Member States and for the presence of officials of the tax administration of one Member State to participate in controls in the other Member States.
- (10) VAT control in the Community has not changed significantly despite the new challenges created by the internal market. Member States operate traditional tax control that has, generally speaking, not changed since the introduction of VAT. There has been no overhaul of the VAT control system to find out the control needs of the transitional system with its tax-exempted supplies and its special schemes. When border controls were abolished 1993 and the control was moved to the control of the accounting, no significant move of customs controllers to VAT administrations took place. Member States therefore operate VAT control with unchanged resources, in spite of the fact that the number of potential controls has increased substantially.
- (11) VAT administrations in the Community have to control in the order of 24 million traders delivering 100 million VAT declarations annually.

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<sup>22</sup> OJ L 82, 22. 3. 1997, p. 1.

- Of these, approximately 3.000.000 are taxable persons making intra-Community supplies and/or acquisitions.
  - Exempt intra-community supplies amount to approximately €930,000,000,000, the tax on which is put at risk.
  - Approximately 1,000,000 or 4% of all traders pay 80% of the VAT collected by Member States.
  - About 15,000,000 taxable persons could be classified as small or medium sized Enterprises.
  - Member States, taken together, have about 30.000 VAT control officials (about 8% of their total staff compliment), who carry out around 600.000 on-the-spot controls annually. This means that there is a theoretical likelihood of a taxable person receiving an on-the-spot control once every 40 years.
- (12) Control is mainly based on targets for revenue to be collected; the number of controls to be carried out or the number of hours to be spent on control. These targets are mainly based on plans emanating from the resources available, and therefore are not based on a consideration of the real control need. Member States use very traditional selection methods, and few Member States have established real risk assessment systems for VAT control. Some Member States use some hybrid methodology using certain risk parameters. Most Member States do not have the possibility of changing over to a risk assessment system, as they do not have the necessary infrastructure.
- (13) Member States follow up of controls is insufficient and mainly concentrated on figures. Real analysis of the reasons for irregularities and frauds has not been undertaken. Member States will have to have better records from their audits and cases and to store them in a way that makes it possible for the central part of the administration to continuously evaluate the fraud situation. Many Member States have bad internal communication systems to communicate information that is useful for other officials, for instance to be exchanged rapidly with other Member States. Such systems could also be used for the dissemination of information to tax officials on a daily basis.
- (14) While penalty schemes are implemented in all Member states, there seems to be no follow up or evaluation of them. Only a few Member States can give clear figures of the result of their schemes. It appears that the main objectives of penalties is the raising of additional revenue, rather than acting as an incentive for voluntary compliance with their obligations by taxable persons.
- (15) Despite administrative cooperation being a reality since 1993, and mutual assistance being possible since 1979, co-ordination between national tax administrations is still in its infancy. The Fiscalis Decision<sup>23</sup> provided Community funding for Member States to engage in the multilateral control of traders, but this

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<sup>23</sup> Decision No 888/98/EC of the European parliament and of the Council of 30 March 1998 establishing a programme of Community action to ameliorate the indirect taxation systems of the internal market (OJ L 126, 28. 4. 1998, p. 1.)

activity is still at an early state of development, this methodology having been applied so far to less than 100 of the potential 3,000,000 traders in the Community engaged in intra-Community trade. Accordingly, Member States still have quite a long road to travel in this respect.

- (16) As far as VAT is concerned, the single market does not exist in practice, as there are still 15 separate tax areas where national administrations are responsible for the control of traders to whom they have issued VAT identification numbers. So while businesses look at the opportunities provided by the single market as a whole in terms of free movement of goods, a single business trading in all Member States has to deal with 15 different tax administrations and live with the differences of interpretation of and application of the 6<sup>th</sup> VAT Directive. The Council has been very reluctant to adopt any measures proposed by the Commission to modernise and harmonise the current VAT arrangements, not wishing to cede any aspect of fiscal sovereignty. The result is that businesses optimise the possibility for tax planning available as a result.
- (17) Member States are not in a position to meet the new technical development with electronic invoicing, selfbilling and electronic commerce. Few auditors are experienced, and Member States urgently have to change over to be able to meet the challenges of new technology.

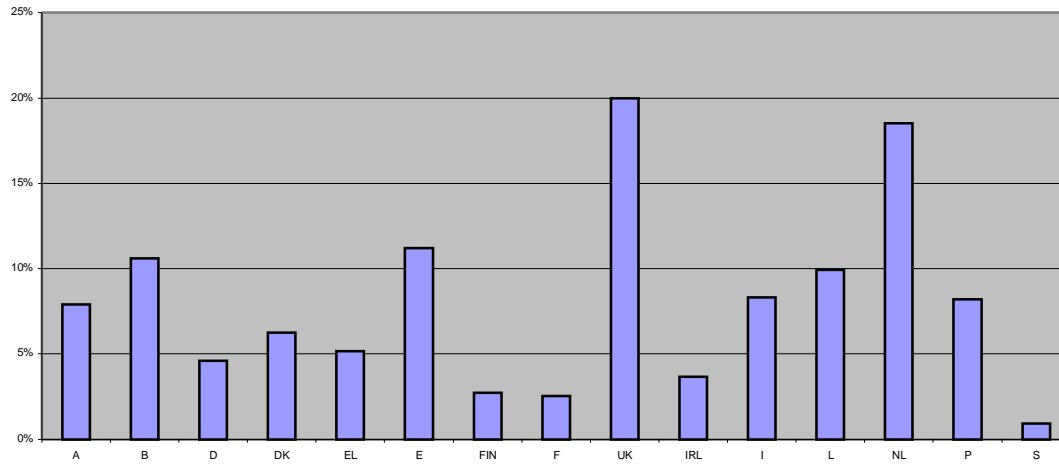
## 7.2. RECOMMENDATIONS

- (1) The Member States, together with the Commission, should urgently consider the adoption of a common anti-fraud policy to combat the frauds in the current VAT system, which puts the proper functioning of legitimate trade in the single market at risk.
- (2) Member States should urgently consider a **total reappraisal of their VAT control policy**. Such a reappraisal should include an examination of overall control policy; the developing and implementing of a control strategy with clear control objectives and an appropriate organisational structure without any internal barriers. Member States should also develop a control methodology based on risk assessment and pave the way for such selection methodology. The Commission and the Member States together will have to consider whether a total overhaul of the declaration and payment system will be necessary in order to make it possible for Member States to release resources for the most urgent on the spot controls. Member States should review the effectiveness of their VAT control effort to ensure that the lack of control does not create distortions of competition between traders who comply voluntarily with their obligations and non-compliant traders.
- (3) The Commission, together with the Member States, should *inter alia* consider **community criteria for risk assessment** systems.
- (4) Member States must reflect on more efficient **follow-up and analysis of the frauds** they detect. For its part, the Commission will have to consider how best use could be made of such information at community level. Member States must consider how such information could be collected rapidly and how it should be distributed internally. The Commission will have to consider if this distribution of information should be extended to intra-Community level.

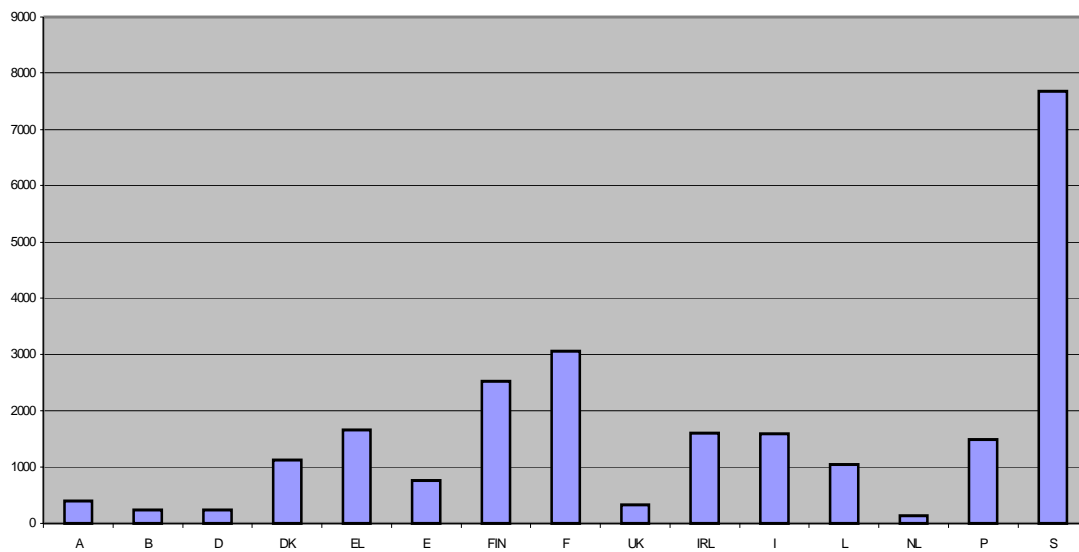
- (5) Member States are urged to consider a comprehensive overhaul of their **systems and procedures for administrative cooperation** and mutual assistance in the field of VAT in the light of its current shortcomings and to consider how to achieve its optimal functioning, including the organisation of their CLOs; the allocation of resources and the removal of all internal barriers, legal as well as administrative which have any impact on a proper functioning of exchange of information. The Member States must make better and more intensive use of these instruments in order to have the same level of cooperation with other Member States as between two different local departments in their own country. The Commission therefore recommends that each local office should have at least one official whose priority work is the servicing of requests received from other Member States. This official should not have the normal target criteria of additional tax discovered applied to him, but should rather be evaluated on the basis of the proportion of requests he has serviced within the shortest possible time.
- (6) The Commission will soon make a **proposal to amend the current Regulation** in order to improve the operation of administrative co-operation and mutual assistance in the VAT field and to tackle other barriers to the exchange of information.
- (7) Member States should recognise the challenge of **new technology** and devote resources for this purpose, including the training of computer auditors; the allocation of the necessary technical and legal infrastructure, and training of officials to raise the general awareness in this field. The Commission will have to consider the legal framework in this area.

## 8. ANNEX - GRAPHICS

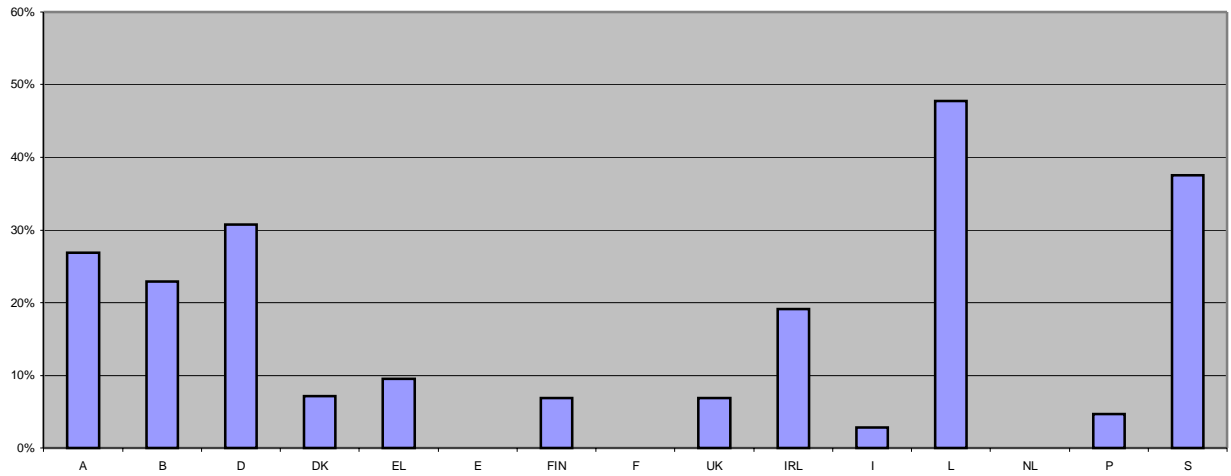
**Figure 1: Proportion of Tax officials engaged in on-the-spot VAT control per Member State**



**Figure 2: Number of taxable persons per VAT control official**

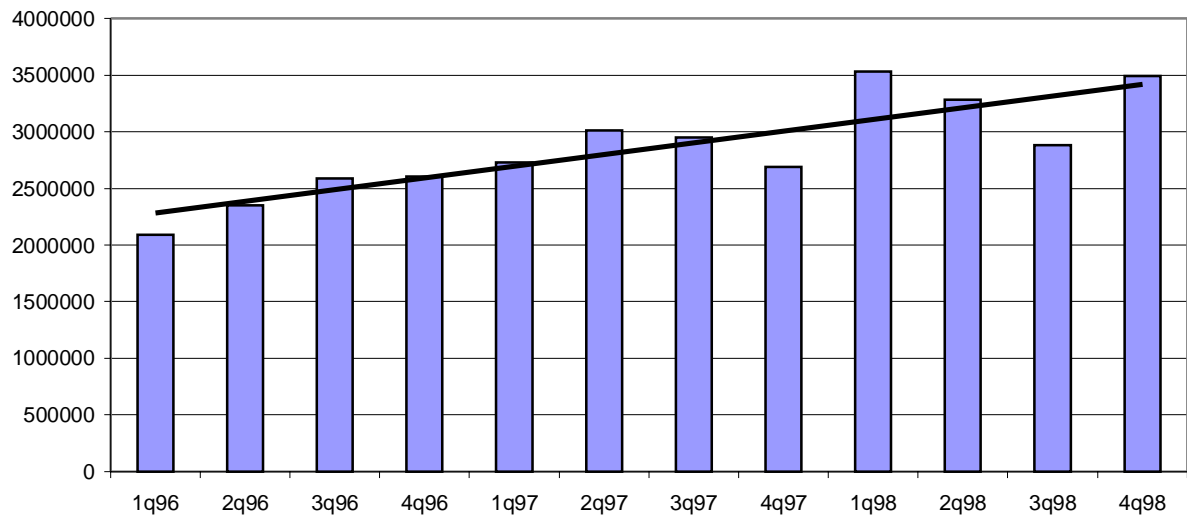


**Figure 3: Proportion of taxable persons making intra-Community acquisitions per Member State**

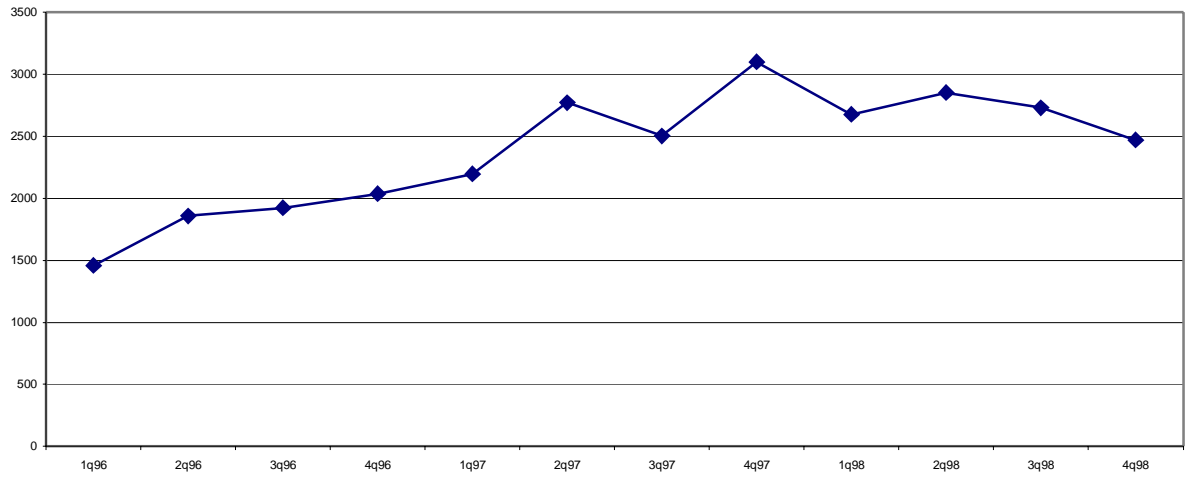


*Note: Spain, France or the Netherlands has provided No figures for the number of taxable persons making intra-Community acquisitions*

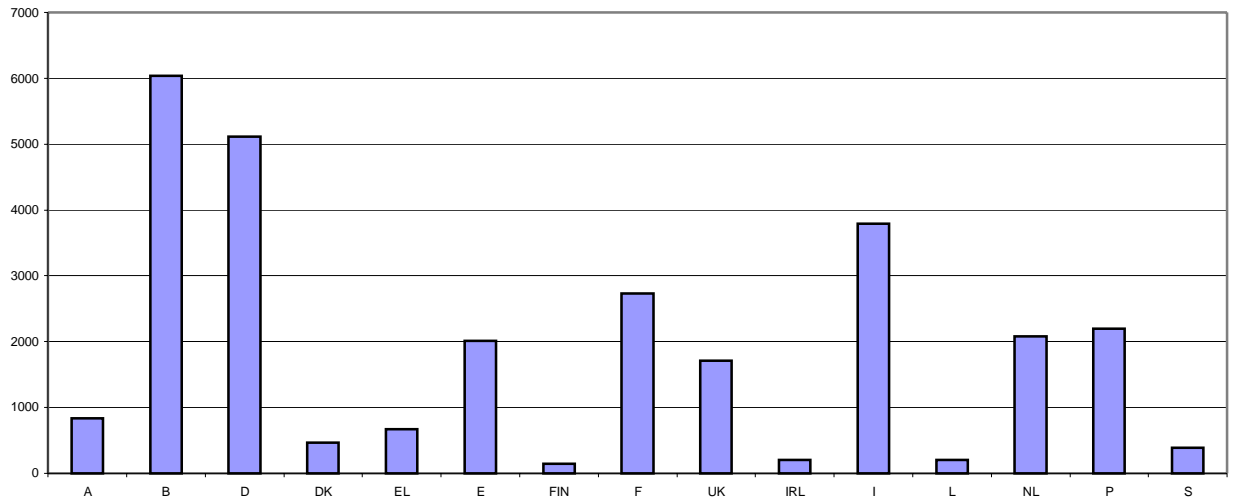
**Figure 4: Overall growth between 1996 and 1998 in the number of enquiries made under Articles 4(2) and 4(3) of Regulation (EEC) No 218/92**



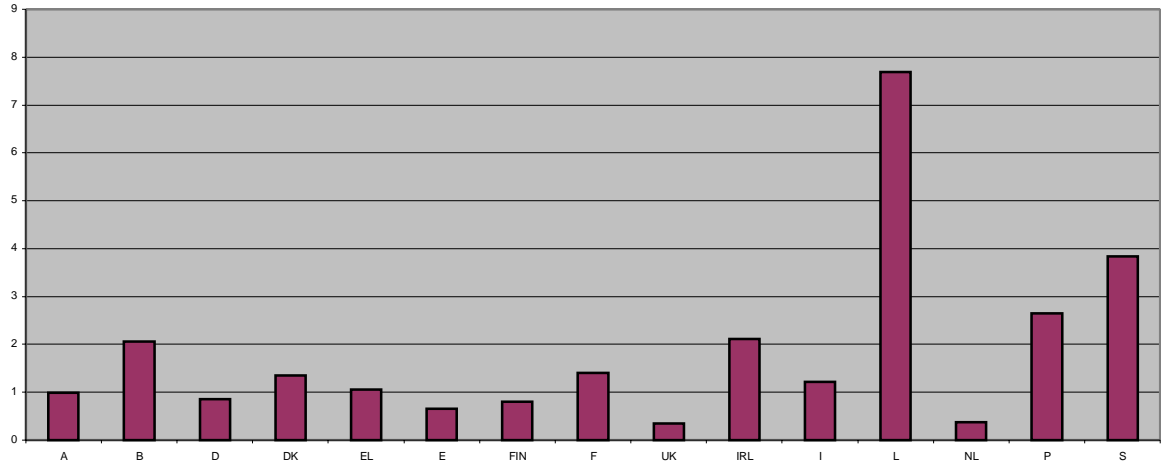
**Figure 5: Number of requests made per quarter between 1996 and 1998 under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC**



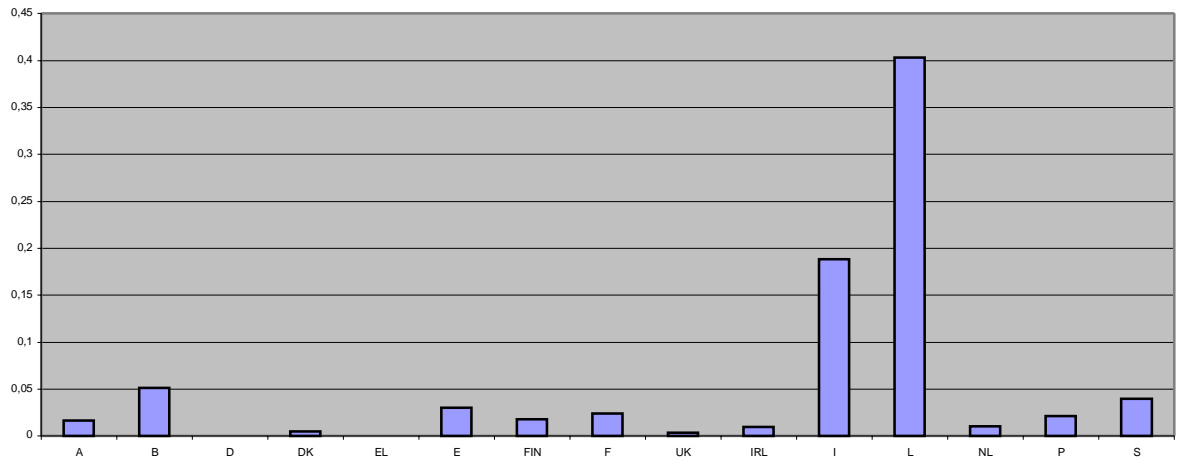
**Figure 6: Number of requests per Member State made between 1996 and 1998 under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC**



**Figure 7: Number of requests made between 1996 and 1998 per Member State under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC per control official**



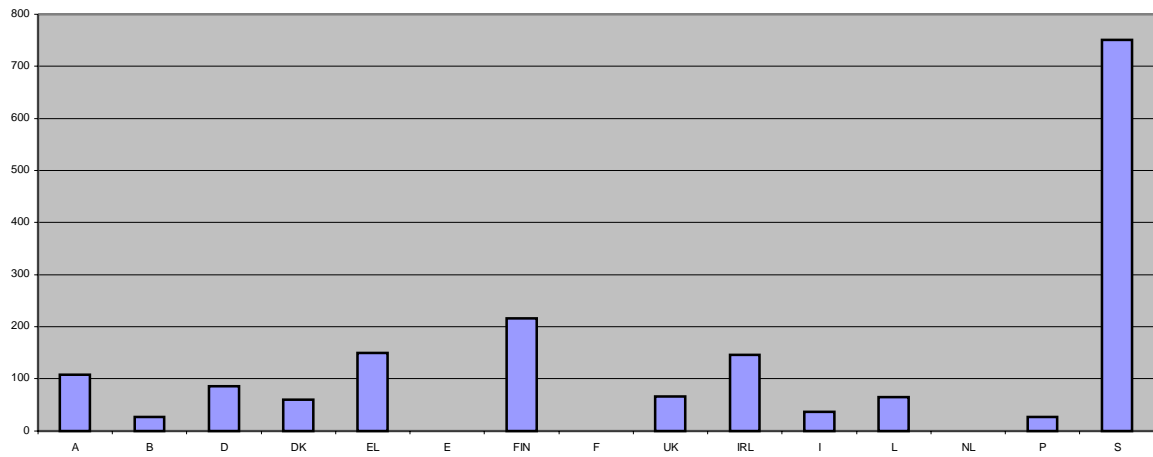
**Figure 8: Number of requests made between 1996 and 1998 per Member State under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC per VAT control**



*Note: No figures for the number of VAT controls undertaken are available in respect of Germany and Greece.*

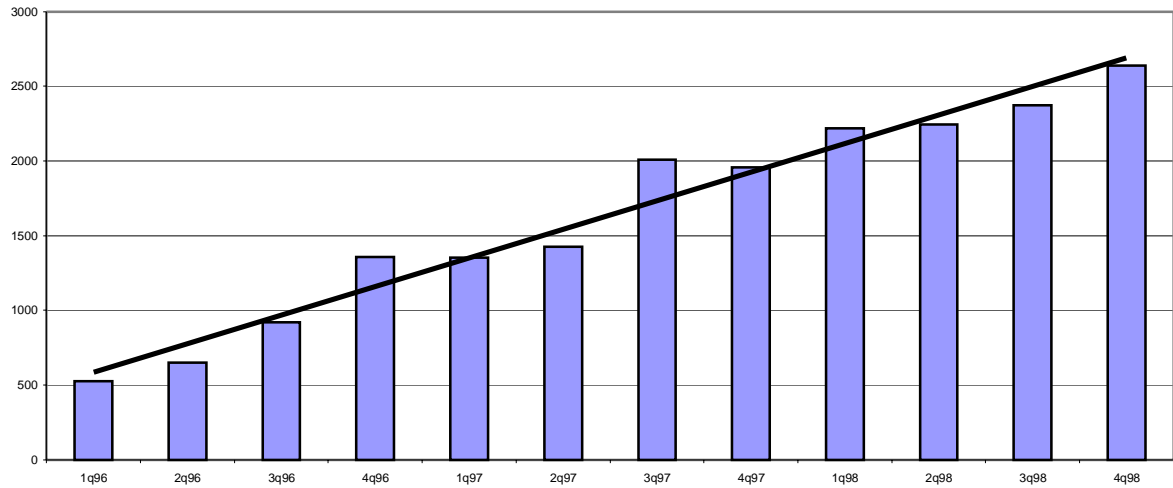


**Figure 9: Number of taxable persons making intra-Community acquisitions per requests made between 1996 and 1998 per Member State under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC**



*Note: No figures for the number of taxable persons making intra-Community acquisitions available for Spain, France or the Netherlands*

**Figure 10: Trend in overdue replies to requests under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC outstanding as at 31 December 1998 per requested Member State**



**Figure 11: Proportion of overdue replies to requests under Article 5 of Regulation (EEC) No 218/92 and Article 2 of Directive 77/799/EEC outstanding as at 31 December 1998 per requested Member State**

