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From:	Presidency
To:	Delegations
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Subject:	Proposal for a Directive on the fight against fraud to the Union's financial interests by means of criminal law - <i>Examination of the Presidency document</i>

1. Introduction

This paper is intended as a base for the meeting of DROIPEN experts with the participation VAT fraud experts which is aimed at reaching a common understanding on how VAT works in the Member States, how fraud with VAT occurs, how it is fought (e.g. through administrative and criminal proceedings) and the effects of such fraud for the Union.

The document contains:

1. Background on the legal framework
2. Items/questions to be discussed
3. Annex: Information paper on VAT

2. Background of the proposal

a) Legal frame

The proposal for a draft Directive on the fight against fraud to the Union's financial interests by means of criminal law (the "PIF Directive"), in the text as agreed as General Approach on 6 June 2013, is based on Article 83 (2) TFEU. Article 83 (2) TFEU provides a legal basis enabling the EU legislature to approximate national criminal law through "[establishing] *minimum rules with regards to the definition of criminal offences and sanctions*" in a given area of Union policy where such approximation "*proves essential to ensure the effective implementation of a Union policy in an area which has been subject to harmonization measures*".¹

To this effect, according to Article 1, the draft Directive "[defines] *criminal offences and sanctions*" which are necessary in order to fight fraud and other illegal activities affecting the EU's financial interests. It defines the constituent elements of different criminal offences (Articles 3 and 4) and contains provisions on the type and level of criminal sanctions to be applied to natural persons (Article 7) and on the sanctions types applicable to legal persons (Article 9), as well as provisions on jurisdiction (Article 11) and prescription periods (Article 12).

It should be noted that on the basis of the draft Directive Member States are obliged to provide in their national law that the criminal conducts regarding the EU's financial interests as described in the draft Directive be punishable as criminal offences. In other words, the obligation that stems from the draft Directive is to provide for criminal sanctions in national legislation; there is no obligation regarding the application of such penalties or another available regime of law enforcement in individual cases. The draft Directive does not impose on Member States to put aside existing systems of liability (e.g. administrative) for conducts falling under its scope, but only to

¹ Article 83 (2) TFEU reads: "*if the approximation of criminal laws and regulations of the Member States proves essential to ensure the effective implementation of a Union policy in an area which has been subject to harmonisation measures, directives may establish minimum rules with regard to the definition of criminal offences and sanctions in the area concerned. Such directives shall be adopted by the same ordinary or special legislative procedure as was followed for the adoption of the harmonisation measures in question (...)*".

provide in their national law for criminal sanctions in respect of those conducts. As a consequence, under the draft Directive Member States will still be able to provide for both criminal sanctions and for sanctions of another nature (e.g. administrative sanctions).²

In individual cases, the *ne bis in idem* principle has the effect that it is legally impossible to impose on the same person and for the same conduct, both criminal sanctions and sanctions of another nature if those other sanctions can be considered as equivalent to criminal sanctions. This requires an assessment of the circumstances of the case in practice. In order to assess whether sanctions of another nature are criminal in nature, the case law of the Court of Justice has defined three alternative criteria, i.e. the legal classification of the offence under national law, the very nature of the offence, and the nature and degree of severity of the penalty that the person concerned is liable to incur.³

The inclusion of (certain cases of) VAT fraud in the scope of the draft Directive would therefore merely entail the obligation for Member States to provide in their national law for criminal sanctions in respect of that conduct. It would seem that all Member States already provide for such criminal sanctions.

b) The PIF proposal

The proposal was submitted by the Commission in July 2012. The main purposes of the proposal were to 'Lisbonise' the 1995 PIF Convention, and to introduce some new rules to strengthen the protection, in particular as regards minimum criminal sanctions, prescription periods and definitions of criminal offences. In relation to VAT, the Commission included the following recitals in the draft directive:

² In Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), for example, this has been explicitly stipulated in recital: “*This Directive should oblige Member States to provide in their national legislation for criminal penalties in respect of the acts of insider dealing and market abuse to which this Directive applies. This Directive should not create obligations regarding the application of such penalties or any other available system of law enforcement, to individual cases.*”

³ See e.g. *Bonda*, case C-489/10, para. 37.

“(4) Fraud affecting Value Added Tax (VAT) diminishes tax receipts of Member States and subsequently the application of a uniform rate to Member States' VAT assessment base. As confirmed by the Court of Justice jurisprudence⁴, there is a direct link between the collection of VAT revenue in compliance with the Union law applicable and the availability to the Union budget of the corresponding resources, since any lacuna in the collection of the first potentially causes a reduction in the second. The Directive therefore covers revenue resulting from VAT receipts in the Member States.

(5) The consideration of the substantial impact on the EU's financial interests resulting from the illegal diminution of the VAT-based own resource and application of thresholds contained in this Directive shall be read in line with the principle of proportionality, given the specific nature and methodology used for calculating that own resource, including differentiated treatment of Member States.”

After negotiations in Council under the Cypriot and Irish Presidencies, the Council (JHA) reached a general approach on a draft text on 6 June 2013⁵. Article 2 on the definition of the Union's financial interests and scope of the Directive provides amongst other: “Revenues arising from VAT shall be excluded from the scope of this directive”.

The European Parliament adopted its report on the proposal on 16 April 2014, in which it endorsed the Commission proposal as regards the inclusion of VAT fraud.

A number of trilogues between Council and the European Parliament have been held under the Italian and Latvian Presidencies. The latest trilogue was held on 2 June 2015. The Parliament and the Council were thereby very close to reaching an agreement on the text. Compromise solutions on almost all the questions that had previously been open were close to being agreed upon. However, the legislators finally also concluded that they remained in substantial disagreement on one key issue, namely the one concerning the inclusion or not of VAT fraud in the scope of the Directive. The negotiations were therefore postponed.

⁴ Case C-539/09.

⁵ Doc 10729/13 DROIPEN 75 JAI 478 GAF 30 FIN 328 CADREFIN 137 CODEC 1394.

On 8 September 2015 the Court of Justice issued its judgement in Case C-105/14 Taricco (the Taricco case) which revived the discussion on the VAT issue. With reference to this judgment, the Luxembourg Presidency of the Council organised a series of discussions, in particular in Council (JHA) in October. In their contributions to the debate, Ministers expressed different views on the consequences to give following the Taricco case. Some Ministers expressed that the judgement would not change their opinion that VAT should be excluded from the PIF directive. However, a large number of Ministers stressed that the decision of the Court clearly shows that VAT should at least for major offences be included in the scope of the PIF directive. Some Ministers also suggested foreseeing some competence for the European Public Prosecutor's Office for VAT offences without necessarily including VAT in the PIF directive.

In conclusion to this debate, the Luxemburg Presidency obtained an informal go-ahead to have the experts examine the possible inclusion of major VAT fraud in the Directive, with a view to re-opening the negotiations with the European Parliament on this file. The DROIPEN experts convened as well as CATS. As reported by the Luxemburg Presidency in its state of play to Coreper⁶ the positions of delegations in DROIPEN and CATS can be summarized as follows:

- Although admitting that the Taricco case would have consequences regarding the PIF directive, a number of delegations expressed a preference to stick to the general approach of 2013.
- However, most of the delegations that oppose the inclusion of VAT fraud expressed openness to discuss, if necessary, possible compromise solutions. One such solution could be the inclusion of particularly serious offences and/or offences with a cross-border or organised crime dimension in the Directive. Possible thresholds of 100 000 euros or more to decide on the seriousness of a VAT fraud offence were thereby mentioned by delegations.
- Delegations underlined that further discussions are needed on whether to use as a parameter the 'value of transaction' or the 'damage'/'advantage', i.e. the lost amount of VAT.

⁶ Doc 14281/15 DROIPEN 149 JAI 877 GAF 51 FIN 784 CADREFIN 76 CODEC 1546.

- The potential effects on national legal systems and on existing systems of administrative sanctions were highlighted. Delegations underlined that any inclusion of VAT fraud in the Directive must be carefully prepared at expert level, in close cooperation also with experts on VAT and general fiscal issues.
- The future competence of the EPPO for VAT issues as an important factor in the search for a global compromise with the Parliament was mentioned by many.

In December 2015, the Council (JHA) took note of the state of play, whereby the Luxembourg Presidency concluded that the Council must at some point take a step towards the Parliament if a PIF-Directive is ever to be adopted⁷. The VAT issue should be explored further. In particular and before negotiations with the European Parliament can resume there appears to be a need to:

- Clarify the exact scope and impact of VAT fraud in general, in particular in close liaison with tax experts (e.g. nature of VAT, VAT calculation methods, interaction between administrative and criminal proceedings and sanctions)
- Define the scope that could be covered in the Directive, and find a corresponding draft (e.g. by which criteria – the cross-border nature of the offence or a threshold ; in case of a threshold, on which basis should the threshold be calculated: the damage done to the budget/the advantage gained or the amount of the transaction in question including or excluding VAT)
- Explore the link between the possible VAT provision in the Directive with the Regulation on the establishment of a European Public Prosecutor's Office (e.g. the cross-border nature of the offence)

Commissioner Jourova thereby asked Member states for their cooperation in obtaining more information on the exact scope and damage of VAT fraud. A letter was sent to all Ministries of Justice on 21 December 2015.

It is in this context that the Netherlands Presidency has convened the meeting of DROIPEN with the participation of VAT fraud experts of WPTQ on 10 February 2016.

⁷ See doc 14281/15.

3. Items/questions to be discussed

On behalf of the DROIPEN experts an information paper about the working of VAT is annexed to this document. The information paper will be presented in the meeting and there will be ample room for questions about the content of the paper.

In order to reach a common understanding on VAT fraud, the delegates and in particular the VAT fraud experts are asked to express their views on the following questions:

- 1. What do you understand under fraud in the context of VAT? Can you define VAT fraud?**
- 2. If yes, does this definition fit the description of fraud in respect of revenue in article 3, heading and point c, in the draft PIF directive?**

“Article 3

Member States shall take the necessary measures to ensure that fraud affecting the Union's financial interests constitutes a criminal offence, when committed intentionally. For the purposes of this Directive, *fraud affecting the Union's financial interests* shall consist of:

- (c) in respect of revenue, any act or omission relating to:
- (i) the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the Union budget or budgets managed by the Union, or on its behalf,
 - (ii) non-disclosure of information in violation of a specific obligation, with the same effect,
 - (iii) misapplication of a legally obtained benefit, with the same effect.”

- 3. How do you determine the amount of VAT fraud before the (criminal) investigation starts?**
- 4. Which type of proceedings do you follow in your Member State in order to tackle VAT fraud?**
 - a. administrative proceedings**
 - b. criminal proceedings**
 - c. (choice or combination of) a and b?**
- 5. If both types of proceedings exist in your Member State, what are the conditions determining which proceedings should be followed? What are the pros and cons of each type of proceedings?**

6. Which obstacles do you encounter in the proceedings in your Member States in the fight against cross border VAT fraud (i.e. coordination, international legal assistance/cooperation)?
7. The budget of the European Union is financed by own resources (Article 311 TFEU)⁸, one of which is based on VAT. Member States pay a national contribution to the EU budget based on a uniform rate of 0.3% or, for some Member States, of 0.15%⁹ of the national harmonised VAT base¹⁰. This base is determined from taxable transactions and is established after complex calculations, taking as a starting point the net VAT revenue collected.

Keeping the impact of VAT fraud on the EU budget as well as the diversity of VAT rates in mind, could major VAT fraud be defined by a uniform threshold? If so which one?

- a. The same as the one applied for criminal sanctions for the other PIF offences, i.e. offences involving damages of at least € 10.000 (damages being understood as VAT lost)?
- b. A threshold based on the value of the transaction; and, if so, which one?
- c. Another threshold?

⁸ Council Decision 2007/436/EC of 7 June 2007 on the system of own resources of the European Union, OJ L 163/17 and Council Decision on the system of own resources of the European Union, 12 February 2014, 5602/14. The 2014 Council Decision will apply retroactively as of 1 January 2014 once it has been ratified by every Member State.

⁹ Over the period 2007-13, a reduced rate of 0.225 % for Austria, 0.15 % for Germany and 0.10 % applies to the Netherlands and Sweden. Once the 2014 Council Decision mentioned in footnote 3 has been ratified by every Member State, 0.15 % applies to the Netherlands, Germany and Sweden retroactively from 1 January 2014.

¹⁰ The VAT base is capped at 50% of Gross National Income (GNI) for each Member State. For those, currently five, Member States half of the GNI is used instead.

Information-Paper on VAT

1. What is VAT

VAT a tax that is levied over the consumption of goods and service. VAT stands for Value Added Tax and is actually the method of how the tax is collected. The VAT is collected in every chain of the business to the final customer and ultimately borne by the final consumer. In the first chart this will be explained. The VAT is levied in all Member States of the EU and is governed by the VAT Directive¹¹.

a) Main features

For a better understanding of the working of VAT as well as VAT fraud it is good to distinguish the following features of VAT:

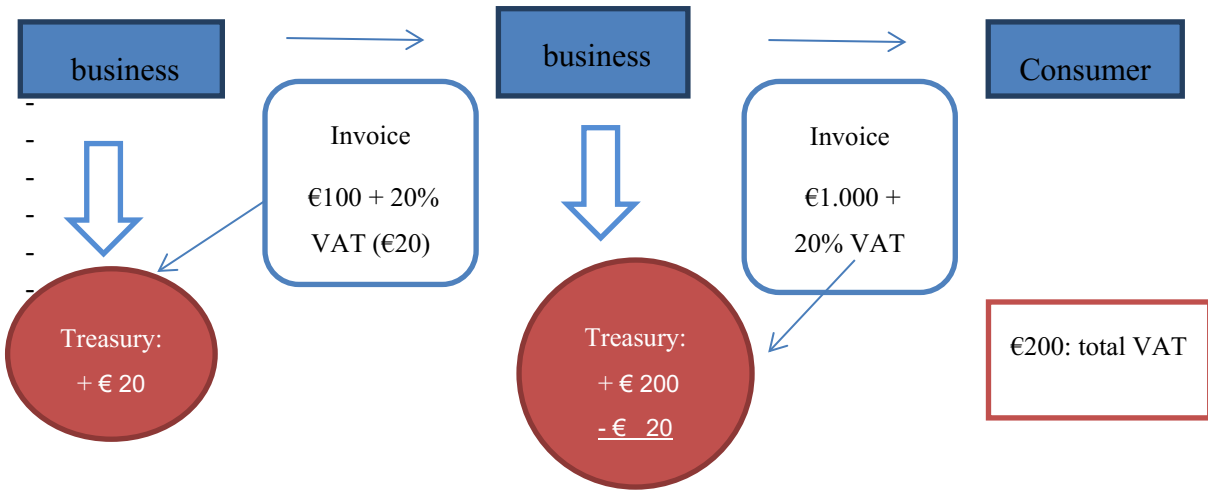
- It is a general tax, since it applies to all supplies of goods and services in the European Union at the rate applicable to them.
- It is a consumption tax because it is borne ultimately by the final consumer, not by businesses involved in the production or distribution of the goods or the deliverance of services. The consumption tax flows into the treasury of the member state of final consumption.
- It is a transparent tax, since it is charged as a percentage of the price. It is therefore possible to identify the actual tax burden at each stage of the production and distribution chain.
- VAT is collected fractionally, via a system of partial payments corresponding with the value added by VAT-registered businesses ("taxable persons") to the tax authorities. Taxable persons are entitled to deduct from the VAT they pay to the tax authority the amount of VAT that they paid at the preceding stage (see example below). As a consequence, VAT is neutral in impact irrespective of the number of transactions. Chart 1 shows the working of this way of collection.
- Finally, It is also an indirect tax as it is imposed on specific transactions and not on an individual person.

It is good to know that VAT rates are not harmonised at EU level. EU law only requires that, as a general rule, the standard VAT rate must at least be 15% and the reduced rate at least 5%.

¹¹ Council Directive 2006/112/EC of 28 November 2006 – as amended (<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02006L0112-20150101&from=EN>).

Chart 1: working fractioned way of collecting VAT

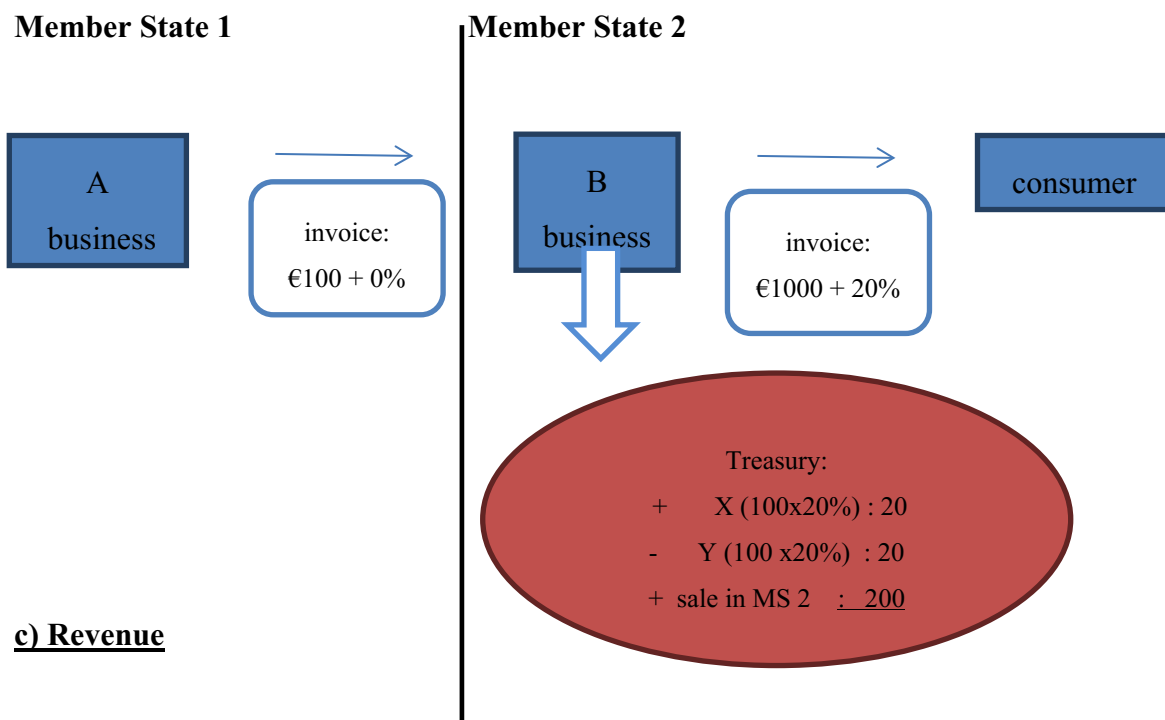
A sells goods to B and B sells goods to the final (private) consumer. It shows the fractioned way of collection € 200 VAT via businesses in the chain that finally is borne by the final consumer.



b) Intra-community supplies of goods/services between taxable businesses

Within the EU, special rules apply to the taxation of intra-community (cross internal EU border) supplies of goods and services between business. Because of that no VAT (0% or reversed charge) is invoiced by the supplier in MS 1 to the buyer in MS 2. It is the buying business that is obliged to “pay” the VAT (X) to the treasury in MS 2 on his purchases (acquisition) and at the same time deduct this VAT (Y) in MS 2. There are special obligations for the supplier to proof/report the intra-community supply.

Chart 2: Intra-community supply



c) Revenue

VAT is a major and growing source of tax revenue in the EU, yielding about EUR **976 billion** in 2014 which represents 7% of the EU's GDP and 17.5% of national tax revenues (including social contributions)¹².

2. VAT fraud - examples

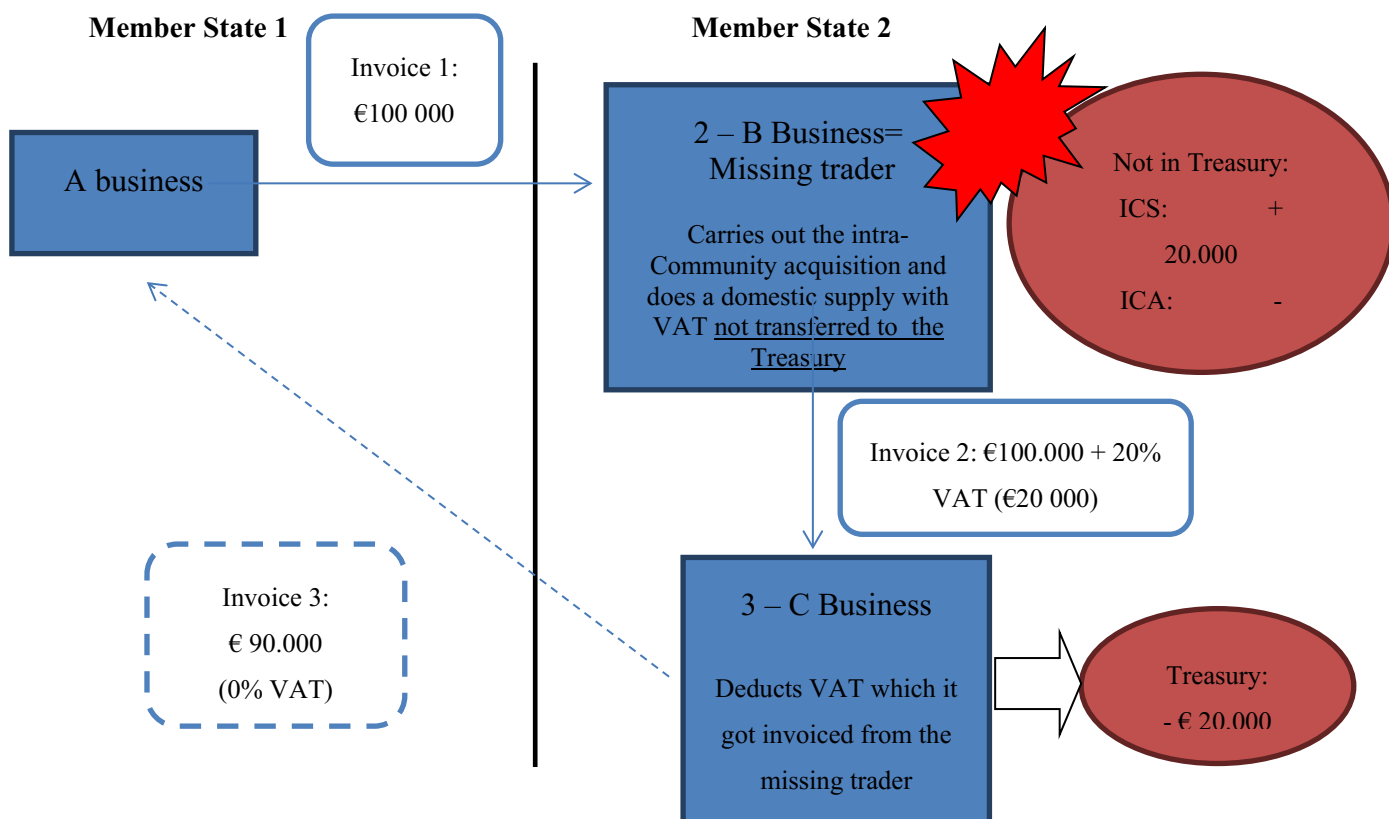
a) VAT fraud in a single Member State

Common examples of VAT fraud at national level are (i) the non-declaration of sales and (ii) the missing trader fraud (where the supplier charges and collects VAT but does not transfer it to the Treasury and disappears).

b) Intra-community fraud

Serious VAT-fraud however often affects more than one Member State because the perpetrators abuse the intra-community VAT system or the rules applying to imports, with different degrees of sophistication.

Chart 3: Missing Trader Intra-Community Fraud (MTIC) and Carrousel fraud (simplified)



¹² http://ec.europa.eu/eurostat/statistics-explained/index.php?title=Tax_revenue_statistics&oldid=200742

The simplified chart above shows the main elements constitutive of MTIC and carousel fraud: (i) the involvement of several companies in different Member States in order to be able to abuse the exemption on the intra-community supply of goods and (ii) the creation of artificial deduction rights, via the missing trader mechanism.

Missing traders means: a trader that sells goods or service for a short period and disappears before he pays the VAT (he received from his buyers) that he is obliged to pay to the treasury.

At the end of the circuit, the goods might come back in the Member State of origin at a lower price (hence the name "carousel", where the same goods are repeatedly supplied in a circular pattern).

In practice it is however not even necessary for goods to be physically transported and the operation can be entirely artificial. It can also become very sophisticated (more Member States or third countries involved, more intermediaries, including companies which are not participating in the fraud). The fraud can also occur with supply of services, like we had with the transfer of allowances to emit greenhouse gases.

3. VAT fraud – figures

It is difficult to establish with certainty the size of VAT-fraud in the EU, for a number of reasons, e.g. the data available in the Member States is often insufficient and incomplete, many cases of VAT-fraud go undetected and available estimates are often made in terms of "VAT gap", which apart from fraud also takes account of legal tax avoidance, legitimate bankruptcies and errors.

Concerning more specifically intra-community VAT fraud, there is a clear lack of comparable data and indicators. Only two Member States, Belgium and the UK are indeed publishing estimates on VAT losses due to intra-community fraud. Several studies commissioned by the Commission, the results of which are summarised in the table below, however provide an estimate of the annual losses to the national treasuries resulting from VAT fraud/VAT gap.

Damage to Member States combined		
VAT fraud	Study by Ecorys ^[1]	18 billion EUR
	Study by Banca d'Italia ^[2]	20 - 35 billion EUR
VAT gap	TAXUD study (2011 data) ^[3]	193 billion EUR
	TAXUD study (2012 data) ^[4]	177 billion EUR
	TAXUD study (2013 data) ^[5]	168 billion EUR

4. Impact of VAT fraud

a) How does VAT contributes to the EU budget

The budget of the European Union is financed by own resources (Article 311 TFEU)¹³, one of which is based on VAT. Member States pay a national contribution to the EU budget based on a uniform rate of 0.3% or, for some Member States, of 0.15%¹⁴ of the national harmonised VAT base¹⁵. Such base is determined from taxable transactions and is established after complex calculations taking as the starting point net VAT revenue collected.

^[1] Study on the impact of the different policy options to protect the financial interests of the Union by means of criminal law, including the possibility of establishing a European Public Prosecutor's Office (EPPO), Ecorys 2013, 143.

^[2] Borselli, Fabrizio, Organised VAT fraud: features, magnitude, policy perspectives, Banca d'Italia Occasional Papers 106, 2011, p 16.

^[3] Report of 2013 with the estimates of the VAT Gap for 2011:
http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf

^[4] Report of 2014 with the estimates of the VAT Gap for 2012:
http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap2012.

^[5] Report of 2015 with estimates of the VAT Gap for 2013:
http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap2013.

¹³ Council Decision 2007/436/EC of 7 June 2007 on the system of own resources of the European Union, OJ L 163/17 and Council Decision on the system of own resources of the European Union, 12 February 2014, 5602/14. The 2014 Council Decision will apply retroactively as of 1 January 2014 once it has been ratified by every Member State.

¹⁴ Over the period 2007-13, a reduced rate of 0.225 % for Austria, 0.15 % for Germany and 0.10 % applies to the Netherlands and Sweden. Once the 2014 Council Decision mentioned in footnote 3 has been ratified by every Member State, 0.15 % applies to the Netherlands, Germany and Sweden retroactively from 1 January 2014.

¹⁵ The VAT base is capped at 50% of Gross National Income (GNI) for each Member State. For those, currently five, Member States half of the GNI is used instead.

In 2014, the overall amount of VAT based own resources contributions to the EU budget was almost **EUR 18 billion a year**, accounting for around 13% of the total revenue of the Union¹⁶.

b) Impact of VAT fraud on the EU budget

The Court of Justice holds in its jurisprudence that VAT fraud has a direct impact on the EU budget, since any lacuna in the collection of VAT revenue potentially causes a reduction in the VAT resources available to the EU budget¹⁷.

Hardly any estimates exist on the precise impact of VAT fraud on the EU budget, as existing estimates on the impact of fraud to the Union's financial interests do not differentiate between fraud related to VAT and other revenue or expenditure.



¹⁶ Multiannual financial framework 2014-2020 and EU budget 2014, European Commission, DG Budget, 2013, p. 24.

¹⁷ Commission vs Germany, C-139/09, paragraph 72 and 76. Åkerberg Fransson, C 617/10, and Taricco, C- 105/14, paragraph 38, paragraph 26.