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(Information)

COURT OF AUDITORS

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 together with the Commission's replies

(Submitted pursuant to Article 188c(4)(2) of the EC Treaty)

(98/C 356/01)

CONTENTS

1. VAT AND THE VAT RESOURCE

A field of national and Community interest

1.1. Almost half of the Union budget (45 % in 1997) is financed by the VAT resource [1]. This resource was established by applying a rate (a maximum of 1,08 % in 1998) to a uniformly established base representing all the taxable operations in each Member State subject to VAT that cannot be deducted by the buyer.

1.2. Payments by the Member States in respect of the VAT resource depend, *inter alia*, on their VAT revenue. They therefore also depend partly on the results that they achieve in the fight against fraud, for which they bear the main responsibility [2]. There has been a worrying rise in tax fraud. Work carried out by the Court in order to assess all losses of VAT revenue (both internal and intra-Community) shows that these losses are considerable [3].

The changes introduced on 1 January 1993

1.3. Since the common VAT system was introduced in the 1970s [4] its declared objective has been to create the conditions necessary for the establishment of an internal market characterised by healthy competition, with the elimination of import taxes and tax refunds on export trade between Member States. This objective was restated in the sixth Council Directive of 1977 [5], which constitutes the basis of the European Union's current legislation on VAT.

1.4. When the single market came into being on 1 January 1993, a new transitional scheme for VAT on intra-Community trade entered into force [6]. This system attempted to fulfil the requirements of an internal market without frontiers whilst allowing room for manoeuvre at national level as regards the establishment of VAT rates and the collection and auditing of the tax.

1.5. The main characteristics of this scheme were as follows:

(a) the terms 'export' and 'import' were abolished with reference to trade between Member States (thus achieving one of the objectives of the first Directive) and, in practice, replaced by an equivalent system: 'intra-Community supplies of goods' (formerly 'exports') were exempted from VAT in the Member State of origin provided that the purchaser was registered for VAT in another Member State and that the goods left the national territory. 'Intra-Community acquisitions of goods' (formerly imports) were taxable in the Member State where they were consumed and had to be declared by the buyer in his periodic VAT statements;

(b) in order to compensate for the elimination of customs formalities and checks and avoid losses of tax revenue, a computerised system for the automatic exchange of information on the value of intra-Community deliveries was set up among the national authorities (VAT information exchange system or VIES) [7];

(c) consumers could henceforth pay VAT at the point of origin on goods purchased in another Member State without any further formalities. Tax-free sales for intra-Community travellers in airports and on board aeroplanes and ships were to come to an end on 30 June 1999;

(d) under three special schemes (distance sales, new means of transport, intra-Community purchases by flat-rate farmers, exempted persons and legal entities that are not liable for VAT), transactions were generally subject to taxation in the country of consumption.

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(1) Council Decision No 94/728/EC, Euratom of 31 October 1994, OJ L 293, 12.11.1994, p. 9. For details of the calculation of the VAT resource, see Council Regulation (EEC) No 1553/89 of 29 May 1989, OJ L 155, 7.6.1989, p. 9.

(2) Doc. SEC(92) 280 final of 24 February 1992, p. 5(a). Tax fraud and underground economic activities, failing appropriate adjustments, may affect not only VAT revenue but also the calculation of the GNP itself (and hence of the GNP resource, another major source of funds for the Community budget). Because of this, not only may the breakdown of the financial burden among the Member States be affected, but so may also the level of budgetary resources, which is established as a percentage of the GNP.

(3) See the Court's Special Report No 6/98 on the 'Assessment of the system of resources based on VAT and GNP', paragraphs 4.16 to 4.19.

(4) Since 1967, the first and second Council Directives (Council Directives 67/227/EEC and 67/228/EEC of 11 April 1967, OJ 71, 14.4.1967, p. 1301/67) concerning the harmonisation of legislation regarding taxes on turnover have provided for the elimination of the cumulative multi-stage tax systems still in force and the setting up, in each Member State, of a general tax on consumption proportional to the price of the goods sold or the services rendered, whatever the number of the intermediaries involved in the production and distribution process.

(5) Council Directive 77/388/EEC of 17 May 1977, OJ L 145, 13.6.1977, p. 1 and subsequent amendments.

(6) Council Directive 91/680/EEC of 16 December 1991, OJ L 376, 31.12.1991, p. 1.

(7) Council Regulation (EEC) No 218/92 of 27 January 1992 concerning administrative cooperation in the field of indirect taxation, OJ L 24, 1.2.1992, p. 1.

A greater risk of irregularities

1.6. The creation of the single market involved the disappearance of routine inspections at internal borders. A system involving the *ex-post* exchange of information (VIES) was therefore set up. Given that, rather than being collected at the moment of importation, VAT is now recovered at a later stage, on the basis of the taxpayers' periodic declarations, the possibility of fraud has been proportionately increased.

1.7. There were two main types of fraud:

(a) the declaration of fictitious intra-Community deliveries: the exempted goods are in fact sold on the internal market and VAT due on final consumption is thus evaded;

(b) failure to declare VAT due on intra-Community purchases: this may then result in VAT fraud on final consumption if the goods are resold through underground trade channels; the right to deduct the tax upstream may also be misused in cases where buyers' VAT declarations request the refund of VAT on purchases for which no VAT was paid.

1.8. Certain Member States are worried by the fact that their VAT revenue has recently fallen below estimated amounts. Two of them have identified an erosion of the tax base, which they feel is linked to the development of an underground economy ([8]) caused by the transitional VAT scheme.

1.9. According to the Commission, intra-Community trade involving the circulation of goods currently covered by the VAT exemption scheme itself accounts for more than ECU 700 000 million, or ECU 100 000 million in taxes. There are therefore significant amounts of money at stake in the field of intra-Community trade.

Prospects for changes in the transitional scheme

1.10. When the Directive introducing the transitional VAT scheme was adopted, it was intended to last until 31 December 1996. In the absence of a Council decision on a definitive system, this 'transitional' scheme has remained in force. For the years to come, there seems to be no possibility other than the continuation of the above arrangement.

1.11. The fact is that the Commission's proposal for the adoption of a definitive scheme ([9]) requires at least two prior conditions to be satisfied. In particular, it envisages the elimination of any distinction between internal and intra-Community transactions (goods to be taxed at origin) and a single place of registration and taxation for Community traders. This therefore presupposes an identity of goods and services and of the VAT rates applied in all the Member States. Failing this, a trader could sell his goods in other Member States, where necessary via a branch company, at the rate applicable in the Member State where he is registered (which could be 2 or 3 % lower). The result at the final consumption stage would be similar goods with different VAT rates according to the seller's place of residence.

1.12. Secondly, given that VAT revenue would be paid in by the traders in their country of registration rather than in the country of consumption of the goods, the proposal would make it necessary to reallocate VAT revenue to the Member States in accordance with national consumption. In order to guarantee that each Member State none the less retains the same level of revenue as under the current system, the Commission has proposed setting up a macroeconomic mechanism designed to reconstitute taxable consumption by subtracting transactions relating to the underground economy, for which no VAT was collected ([10]). Failing this, the varying levels of fraud in the Member States would create distortions in the revenue allocated to them.

1.13. The choice of a macroeconomic method implies the availability of uniform or equivalent sources, methods, funds and statistical procedures. This choice is likely to bring about disagreements between Member States in their individual calculations of statistical taxable consumption, in particular as regards the reduction in each Member State's assessment base via the subtraction of the underground economy. In actual fact, this subject has been the subject of study for many years, *inter alia*, in connection with the drawing up of national accounts. The estimates put forward vary considerably, as a result, in particular, of the methods and sources used ([11]).

1.14. It is true that the Member States already have to comply, by the end of 1998, with certain exhaustiveness

([8]) The Commission gives the following definition of the underground economy: 'the black economy covers undeclared but licit activities, i.e.
— those which are the activities of production units which are properly registered but which in returns understate either their production or their income,
— those which are the activities of clandestine production units, relying on hidden labour'.
See Doc. SEC(92) 588 final of 24 April 1992, p. 30.

([9]) Doc. COM(96) 328 final of 22 July 1996.

([10]) For a definition of the underground economy, see note 8.

([11]) On this point, see paragraphs 4.8 to 4.26 of the Court's Special Report No 6/98 on the 'Assessment of the system of resources based on VAT and GNP'.

obligations in respect of their national accounts [12]. Nevertheless, in the current situation, it should be stressed that exhaustive national accounts will involve a conflict of interests for the Member States, in so far as they would lead to an increase in the gross national product at market prices (GNP) [13]. This is because any increase in the GNP requires the States to provide additional resources for the Community budget via the GNP resource. The Commission proposal can only accentuate this conflict of interests since, under the proposed VAT system, Member States would have an objective interest in limiting the size of the underground economy in their national accounts, or even underestimating taxable consumption, so as to maximise their share of the redistribution of overall VAT income. Auditing the way in which the national accounts are drawn up would thus take on even greater importance in the context of the establishment of the GNP.

1.15. The Commission, however, has acknowledged that 'Eurostat itself is not engaged in directly measuring the size of the underground economy in the Member States' and, in respect of the current work on the exhaustiveness of the GNP, 'it is not expected that reliability or variability indicators will be attached to the results' [14]. This therefore seems to imply that an objective evaluation of the underground economy is not possible at the present time.

Audits carried out by the Court together with certain National Audit Institutions

1.16. Since 1994, a Working Party made up of the National Audit Institutions and the European Court of Auditors has been examining various aspects relating to VAT on intra-Community trade. This group has found that the VIES automatic information exchange system is still suffering from shortcomings despite the improvements made since its creation. Moreover, it has become evident that the Member States' audit methods need to take account specifically of the tax evasion risk linked directly to the abolition of tax frontiers. Lastly, the Member States and the Commission were recommended to monitor the development of revenue from VAT on intra-Community trade more closely [15].

1.17. In 1996 and 1997, the Working Party examined the Community's fraud prevention arrangements and certain national systems. Certain cases of intra-Community fraud that the competent national authorities considered to be representative were analysed and, more particularly, the way the machinery for administrative cooperation works was examined.

1.18. The following observations are taken from inquiries carried out by the Working Party in five Member States and at the Commission. The results of these inquiries have been communicated to the authorities concerned. Taking into account the various reports drawn up by the Commission [16] and information obtained from its departments, the majority of the shortcomings noted and recommendations put forward might concern other Member States, or even all of them.

2. VAT FRAUD IN INTRA-COMMUNITY TRADE

No single definition of fraud

2.1. In the Member States audited, the legal definitions of fraud require the presence of an element of intentionality on the part of an individual [17]. Fraud is not always defined specifically for VAT purposes, but may have a more general scope. As a rule, cases involving failure to make a VAT statement, the submission of declarations with false or incomplete information, the falsification of documents or the use of false documents' constitute criminal offences. In some Member States, however, the existence of an offence is linked to obtaining a profit, whereas in others it is enough for the act to have been committed (for example, failing to submit a statement).

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[12] Commission Decision 97/19/EC, Euratom of 3 September 1997, OJ L 252, 16.9.1997, p. 33. For Austria, Finland and Sweden, the deadline is 1999.

[13] GNP at market prices is defined in Council Directive 89/130/EEC, Euratom of 13 February 1989 (OJ L 49, 21.2.1989, p. 26).

[14] See reply to written question P-1784/97, OJ C 45, 10.2.1998, p. 103.

[15] See the Annual Report of the Court of Auditors concerning the 1994 financial year, paragraphs 1.90 to 1.111 and the Annual Report concerning the 1995 financial year, paragraphs 1.72 to 1.103.

[16] These are the reports:
- second and third reports under Article 12 of Regulation (EEC, Euratom) No 1553/89, Doc. COM(95) 354 final and Doc. COM (98),
- study on the systems of administrative and criminal sanctions of the Member States and the general principles of the Community's system of sanctions, Doc SEC(93) 1172 of 16 July 1993,
- comparative analysis by the Commission of the Member States' reports concerning measures taken at a national level in the fight against the waste and misappropriation of Community funds, Doc. COM(5) 556 final of 14 November 1995,
- 1995 Annual Report: 'the fight against fraud', Doc. COM(96) 173 final of 8 May 1996,
- second report under Article 14 of Regulation (EEC) No 218/92, Doc. COM(96) 681 final,
- report submitted by the Commission in accordance with Article 28(l) of Directive 77/388/EEC, Doc. COM (94) 515 final.

[17] The Court of Justice of the European Communities has stressed the distinction between the notion of evasion, which is a purely objective phenomenon, and that of fraud, which contains an element of intentionality. See the Judgment of 12 July 1998, Joined Cases 138 and 139/86, Direct Cosmetics, ECR p. 3937, paragraphs 20-23.

2.2. On 26 July 1995, because of various shortcomings and incompatibilities that were detrimental to the repression of fraud and to legal cooperation in criminal matters, the Member States subscribed to a Convention on the protection of the financial interests of the European Communities [18]. The intention of this Convention was to create minimum criminal standards, starting with a single definition of fraud for both Community expenditure and revenue. In respect of revenue, it defined fraud as 'any intentional act or omission relating to:

— the use or presentation of false, inaccurate or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of the European Communities,

— non-disclosure of information in violation of a specific obligation, with the same effect,

— misapplication of a legally obtained benefit, with the same effect'.

2.3. However, according to the explanatory report on the Convention adopted by the Council, VAT was excluded from its scope because it was not 'an own resource collected directly for the account of the Communities' [19]. Accordingly, unlike other Community fields, provision was not made for ensuring an identical level of protection in all the Member States, despite the fact that it accounts for almost half the Communities' budgetary resources [20].

No uniform sanctions

2.4. The exclusion of VAT from this agreement implies the maintenance of different definitions of fraud. This has repercussions in terms of legal action taken as the result of fraudulent behaviour in connection with VAT. Thus, the same behaviour could be sanctioned in substantially different ways according to the Member States. Here are some examples.

2.5. In one Member State, falsification of accounting records by a company manager constitutes a serious fraud which is liable to a criminal penalty (a prison sentence). In another, it is regarded as a preparatory act and is punished as a breach of administrative law (a fine).

2.6. Moreover, in certain Member States administrative penalties may be combined with criminal ones for the same act. However, only in some could multiple penalties really be imposed for the same offence.

2.7. Accomplices may often benefit from a commutation of penalty if they have played a marginal role, but the legal systems of the Member States differ with regard to the degree of involvement in the fraud (instigator, main perpetrator, accessory, principal in the second degree, etc.). Moreover, in two Member States, accomplices are not punishable if the fraud did not entail financial consequences. The fact that fraud of this kind may cause losses for other Member States was not sufficient to justify legal proceedings.

2.8. Other differences concerned, for example:

— the criminal liability of the company or legal entity to which a fraudulent manager belonged, a liability that is recognised in certain Member States but not in others,

— the application of the penalty as from the 'beginning of the (attempted) implementation' of the fraud or only when it has been carried out to the full,

— the determination of the penalties in relation to the 'seriousness of the crime. For example, some Member States envisage a fine ranging between a minimum and a maximum, others a penalty that is proportional to the amount defrauded.

No evaluation of the system of penalties

2.9. Most of the Member States audited do not evaluate the application of the system of penalties, in particular with regard to whether they are effective and proportionate to the offence. An analysis of this kind would, however, give a better idea of the degree of dissuasion offered by the penalties in the field of tax evasion. This would seem to be all the more necessary as the penalties are not yet defined and applied in a uniform fashion throughout the Member States(see the previous section).

3. THE PROTECTION OF THE COMMUNITY'S FINANCIAL INTERESTS AS REGARDS VAT ON INTRA-COMMUNITY TRADE

A responsibility shared between the Member States and the Commission

3.1. Responsibility for the detection and the correction of VAT irregularities and fraud is in the first place the responsibility of the Member States, which are required to take effective action to prevent and repress the phenomenon in question and recover the resources lost. However, the Regulation defining the arrangements for

[18] See OJ C 316, 27.11.1995, p. 48. It should be noted that this agreement was not yet in force because it had not been ratified by the Member States.

[19] See OJ C 191, 23.6.1997, pp. 1 and 4.

[20] It should be noted that VAT fraud may also affect the GNP resource, which constitutes the other main source of funds for the Community. See note 2.

the collection of Community VAT own resources ([21]), assigned to the Commission a role in monitoring the effectiveness of the collection procedures and the prevention of irregularities. According to the Commission, the provisions of this Regulation, in particular the procedures for the on-the-spot audit of the VAT resource, constitute a legal basis for the fight against fraud ([22]).

Administrative cooperation

3.2. Regulation (EEC) No 218/92 ([23]) on administrative cooperation in the field of indirect taxes was adopted in connection with the establishment of the internal market and subsequent amendments to the legislation on VAT. It enabled the creation of a common system of electronic exchanges of information on VAT in respect of transfers of goods between Member States so that the transitional VAT scheme could 'be effectively established without the risk of fraud which might cause distortions of competition' ([24]). Each Member State had set up electronic databases from which information was exchanged via a network controlled by the Commission, which provided quarterly summary statistics (the monitoring of management, figures for the exchanges of data on turnover, etc.).

3.3. Article 11 of Regulation No 218/92 stated that 'the Member States and the Commission shall examine and evaluate the operation of the arrangements for administrative cooperation provided for in this Regulation and the Commission shall pool the Member States' experience, in particular that concerning new means of tax avoidance and evasion, with the aim of improving the operation of those arrangements'. The Standing Committee on Administrative Cooperation (SCAC), composed of the representatives of the Member States under the chairmanship of the Commission, is responsible for evaluating the working of administrative cooperation. Two subcommittees deal respectively with the fight against fraud and IT issues. The same Regulation also provides for a two-year assessment report by the Commission.

Mutual assistance

3.4. In addition to the VIES system, Council Directive 77/799/EEC of 19 December 1977 also provides for exchanges of information between Member States ([25]). This piece of legislation, which originally applied to the field of direct taxation, was extended to VAT because 'as a matter of particular urgency, mutual assistance must be extended to cover value added tax, both because it is a general tax on consumption and because it plays an important part in the Community's own resources system.' ([26]). The Directive laid down procedures for exchanging information between Member States and provided for procedures for consultation and the sharing of experiences ([27]) among the Member States and the Commission. The SCAC committee was also competent for questions concerning the application of this Directive.

3.5. The field covered by Council Directive 76/308/EEC of 15 March 1976 concerning mutual assistance as regards the recovery of debts ([28]) was extended to VAT by Directive 79/1071/EEC ([29]). A Recovery Committee was also set up to organise close and effective cooperation between the Member States and the Commission in this field.

The action taken by the Member States

Audit strategies

3.6. All the Member States audited use risk analysis to improve their targeting of checks on taxpayers and high risk sectors. This enables them to rank their checks in order of priority so as to make more efficient use of their resources ([30]). However, they do not normally keep detailed data on their anti-fraud activities or on the

([21]) Council Regulation (EEC) No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989, p. 13).
([22]) See the Commission's reply to written question 2630/94 (OJ C 75, 27.3.1995, p. 62 and unpublished annex).
([23]) OJ L 24, 1.2.1992.
([24]) See the third recital of Regulation (EEC) No 218/92. In its first proposal for the Regulation (Doc. COM(90) 183 final), the Commission had envisaged other provisions concerning the exchange of information between the Member States and the Commission in order to strengthen the fight against VAT and excise fraud on a similar model to that used in the customs field (Regulation (EEC) No 1468/81). At the time, the Member States did not accept them.
([25]) OJ L 336, 27.12.1977, p. 15.
([26]) Council Directive 79/1070/EEC of 6 December 1979, OJ L 331, 27.12.1979, p. 8.
([27]) Council Directive 77/799/EEC of 19 December 1977, Articles 9 and 10.
([28]) OJ L 73, 19.3.1976, p. 18.
([29]) OJ L 331, 27.12.1979, p. 10.
([30]) In the draft version of its third report, drawn up in accordance with the requirements of Regulation (EEC, Euratom) No 1553/89, the Commission gives a detailed description of the audit methods introduced in the Member States.

results of such activities. This impairs the effectiveness of risk analyses, in so far as it makes it impossible to assess the relevance of the criteria used.

3.7. In order to avoid the need to carry out the often problematic task of recovering undue tax credits, most of the Member States audited take great care over checking the VAT statements involving the reimbursement of tax credits. Nevertheless, their verification strategy does not involve the systematic checking of the payment of the VAT invoiced by suppliers. One Member State has taken specific measures, in the event of any signs of fraud, to freeze taxpayers' VAT credit as long as is necessary to establish the merits of the question and, where necessary, until information requested from the authorities of the other Member States has been obtained.

3.8. Some fraud systems involve fictitious companies which, once registered, can, before disappearing, ask for unwarranted refunds, draw up false invoices or fail to declare their turnover or not pay in the VAT that they owe. For this reason certain Member States provide specifically for the checking of new VAT registrations. The Court's audit in one Member State also revealed that tax evaders increasingly used companies which, in particular because of their limited turnover, are only required to submit their VAT statements once a year. It therefore often becomes impossible to reconcile the data with those from the taxpayer if the latter applies for reimbursement on the basis of a quarterly or even monthly statement.

Differences in powers of prosecution

3.9. In this field, the situation varies from one Member State to another. In some cases, legal action has to be taken whenever fraud is suspected. In others, charges can only be preferred at the request of the public prosecutor or the tax authorities.

The reconciling of data

3.10. In its Annual Report concerning the 1995 financial year [31], the Court had pointed out the usefulness of cross-checks between the VIES and Intrastat data concerning statistics on trade in goods between Member States [32]. An examination of the legal background in the Member States audited showed that only in one of them were the tax authorities allowed to use the individual taxpayers' Intrastat statements in connection with their VAT checks.

3.11. In respect of access to computerised data, there are significant differences between the Member States audited. For example, the anti-fraud service in one Member State has access only to tax declarations. Moreover, access is not available in real time (including access to the VIES database). In contrast, the tax authorities in certain other Member States have direct, unlimited access to other data.

Access to the legislation of other Member States

3.12. One effect of the development of the single market is that each tax authority is also ultimately affected by transactions carried out by taxpayers established in other Member States. In the event of fraud in particular, it may be very important to know about the procedures that are applied in the other countries of the Union in respect of prosecution and time-barring periods. An examination of the situation in the Member States audited showed that there were shortcomings in their documentation on the legal and practical aspects of VAT legislation in the other Member States.

The recovery of evaded VAT

3.13. In the words of the Commission, 'action undertaken with regard to combating evasion would prove fruitless if it cannot lead to the actual recovery of the tax payable: the detection and prosecution of evasion have no real point unless they result in the full collection of the tax payable' [33].

3.14. Most of the Member States audited have overall data on corrections of the tax base following audits carried out on taxpayers by their departments. However, none of these Member States was in a position to provide information on the amounts recovered and on the reasons for the failure to recover other amounts owed. That being the situation, it was not possible to form a judgment on the effectiveness of the fight against fraud and on all the procedures aimed at recovering amounts not paid to the tax authorities.

Exchanges of information between Member States

3.15. Overall, little use has been made of administrative cooperation and mutual assistance, although there has been an increase since 1995 (with considerable differences from one Member State to another). Although all the Member States acknowledge the usefulness of exchanges of information at Community level for the prevention, detection and investigation of fraud, no

[31] OJ C 340, 12.11.1996, paragraphs 1.80 to 1.88, p. 38.
[32] Council Regulation (EEC) No 3330/91 of 7 November 1991 (OJ L 316, 16.11.1991, p. 1).
[33] Doc. COM(94) 471 final of 3 November 1994, paragraph 101.

agreement has yet been reached on the type of information that is to be exchanged ([34]).

3.16. One Member State audited mentioned problems with obtaining information as a result of the legislation of another Member State. The latter had invoked national provisions preventing a request for information leading to an additional request concerning the same taxpayer.

3.17. The possibility of forwarding information received under the mutual assistance Directive and the Regulation on administrative cooperation to other Member States concerned has only been made use of in a few cases. Directive 77/799/EEC provided for consultation between Member States in order to determine the categories of cases in which an automatic exchange of information could be carried out. It was noted that, among the Member States audited, only one such agreement had been concluded.

3.18. Exchanges of information under Article 5 of the Regulation on administrative cooperation are generally preceded by a reconciliation of the VIES data received from other Member States with the intracommunity purchases declared by the taxpayers. However, a significant number of taxpayers do not submit summaries of the intracommunity deliveries that have gone into the VIES system ([35]). In December 1996, one of the Member States audited was not yet in a position to carry out these reconciliations for 1995 because the taxpayers still had time within which to submit their VAT returns. Another Member State audited planned to carry out these reconciliations for the financial year 1994 in March 1997.

3.19. Moreover, these reconciliations may produce significant discrepancies (of up to 85 %), which means that the national authorities have to carry out a considerable amount of research work in order to establish the reasons. Such discrepancies may actually lead to an abandonment of this type of auditing method, which is sometimes considered too expensive, especially in terms of human resources, and unsuitable for revealing which economic sectors involve the greatest risks of fraud.

3.20. The Member States audited do not share information on fictitious companies. In 1995, one of the Member States audited proposed that all Member States should exchange information that could be of use in the fight against fraudulent reimbursements. Only two Member States were in favour.

3.21. In the Member States audited, contacts with officials from other Member States are generally restricted to the central level. Bringing in officials from the tax authorities of other Member States occurs only to a limited extent, although there is a draft agreement on this between two of the Member States audited ([36]).

Action taken by the Commission

Periodic reports

Reports on the national systems

3.22. In accordance with the requirements of Regulation (EEC) No 1553/89, the Commission has drawn up two reports on the procedures applied in the Member States for the recovery and auditing of VAT ([37]). These reports are no more than summaries of information provided by the Member States. The data on VAT irregularities communicated to the Commission were not analysed and the differing structures of the two reports make it impossible to evaluate the development of the phenomenon.

3.23. The absence of regular monitoring of the effectiveness of national management and auditing procedures, by means, for example, of a management chart, along with the lack of information on fraud and irregularities, reduced the impact of these reports. In addition, the Commission does not examine, for each Member State, the auditing methods used and the results achieved by their audit systems. This being so, it is not in a position to put forward any proposals for improvements.

3.24. In the draft version of its third report, the Commission does carry out an analysis of VAT fraud and irregularities. However, it limits itself to making general suggestions regarding audit procedures likely to prevent fraud without providing any indication of the Member States concerned.

3.25. For the future, the Commission intends to examine, together with the authorities responsible, all the control procedures in force in each Member State so as to identify possible improvements. It intends to give an account of these in a fourth report.

3.26. However, if the Commission feels that this examination can be carried out with its current powers, this invites the question why it was not possible before. If, on the other hand, it needs greater powers, it should state what new factors have come into play since 1996,

([34]) Doc. SCAC No 178, 7 November 1997 and Doc. SCAC No 39, 16 February 1998.

([35]) In chapter 2.2.2 of its second report under Article 14 of Regulation (EEC) No 218/92, the Commission gives a 95 % compliance rate for 1994 and 1995 for the summary statements of the Member States as a whole.

([36]) In application of Article 6 of Directive 77/799/EEC.

([37]) SEC(92) 280 of 24 February 1992 and Doc. COM(95) 354 of 20 July 1995.

when, due to opposition from the Council, it withdrew proposed legislation that would have enabled it to carry out on-the-spot checks on the national authorities with the aim of drawing up recommendations where necessary ([38]).

Reports on administrative cooperation

3.27. In 1994 and 1997, the Commission published reports on the operation of Council Regulation (EEC) No 218/92 concerning administrative cooperation in respect of VAT ([39]). The first set out the administrative structures introduced at the Community and national levels and described the operation of the VIES system. It concluded that the system had been implemented successfully, even though, in the Court's view, there were certain shortcomings (discussed in the latter's Annual Report concerning the financial year 1994 ([40])). In particular, it noted that no new types of fraud had been identified since the implementation of the internal market. The Commission also set out the prospects with regard to mutual assistance. The development of the 'SCENT' tax computer network, allowing the targeted exchange of anti-fraud messages between audit authorities, was presented as an effective tool in the future fight against fraud. Furthermore, it envisaged more frequent use of Directive 76/308/EEC on mutual assistance in respect of the recovery of sums owed.

3.28. In its second report, the Commission evaluated the operation of administrative cooperation and mutual assistance in 1994 and 1995. It noted that insufficient use was being made of these systems to enable satisfactory monitoring of intra-Community transactions in all the Member States and put forward recommendations for specific action at both Community and national level. The report also recognised the absence of a Community strategy for the fight against fraud. This was attributed, on the one hand, to the limited character of the mandate originally given to SCAC's anti-fraud subcommittee and, on the other hand, to the unwillingness of certain Member States to cooperate in multilateral inquiries into supposed cases of fraud. The Commission felt that the assistance that it was able to provide in the coordination of the Community's work in this field was limited by the absence of an adequate legal basis, of the sort that exists in the fields of Customs and Agriculture.

([38]) Doc. COM(94) 283 of 14 July 1994.
([39]) COM(94) 262 final of 23 June 1994 and COM(96) 681 final of 8 January 1997.
([40]) OJ C 303, 14.11.1995, paragraphs 1.90 to 1.111.

The Standing Committee on administrative cooperation (SCAC) and its anti-fraud subcommittee (AFS)

The work of the anti-fraud subcommittee

3.29. The AFS, which is chaired by the Commission, is responsible for pooling 'the Member States' experience, in particular that concerning new means of tax avoidance and evasion' ([41]). During its early years, this subcommittee concentrated its activities on setting up an electronic communications network with an anti-fraud content known as 'tax SCENT' (see paragraph 3.27). However, this system has hardly ever been used by the Member States, which are very unwilling to exchange information on fraud.

3.30. The activities of the anti-fraud subcommittee were only relaunched by SCAC in 1996. Its mandate was broadened and a new work programme was adopted. A survey was introduced to try to evaluate the extent of VAT fraud in the European Union. The Member States were asked to provide data on the most important cases of fraud discovered in 1995, with the aim of establishing a typology based on various criteria (such as the turnover, the sector of activity and the number of people employed by the companies concerned) ([42]). Slightly fewer than 500 cases were analysed but, for several reasons, the representativeness of the sample examined is still to be demonstrated. The fact is that the latter depended on the national audit systems, the degree of efficiency of which had not been tested by the Commission (see paragraphs 3.22 to 3.25), in particular in relation to their adaptability to new fraud risks (see paragraphs 1.6 to 1.9). Moreover, the information gathered was often incomplete and heterogeneous.

3.31. Subject to these provisos, the study reached the following conclusions:

(a) a significant proportion of the tax dodgers were isolated traders or traders with fewer than five employees who had been registered for VAT for several years;

(b) the two most widespread types of fraud out of the nine listed in the survey were the failure to declare VAT collected on sales (32 %) and misuse of the right to deduct VAT on purchases (25 %). In the categories of fraud involving transactions between Member States, 14 % of the cases consisted of

([41]) Article 11 of Regulation (EEC) No 218/92.
([42]) Following this study, the AFS Committee decided to launch a second study concerning cases of fraud detected during the first half of 1998. The aim of this exercise was to gain a better knowledge of the systems, frequency and amounts involved in fraud based on fictitious companies, on roundabout devices and on intra-Community transactions.

infringements of the rules of the intra-Community scheme, 9 % of infringements of the rules on imports/exports and, finally, 3 % of the cases involved so-called 'roundabout' fraud ([43]);

(c) almost half the taxpayers involved in roundabout fraud or fictitious companies had been registered for VAT after 1992. The highest amounts evaded seemed to concern fraud of this type ([44]);

(d) similar fraud mechanisms were identified throughout the Community;

(e) routine VAT checks always played an important role in the detection of fraud. These involved the cross-checking of invoices in order to uncover abuses of deduction rights and the exchange of information with other Member States with regard to intra-Community trade.

Other work carried out by SCAC

Administrative cooperation

3.32. In order to evaluate the effectiveness of the administrative cooperation instruments provided for under Community legislation for the control of multinationals, in 1994 and 1995 SCAC used the Directive on mutual assistance between competent authorities to carry out coordinated checks with other Member States ([45]).

3.33. It turned out that these instruments could be used to keep a better check on the activities of multinationals, but a number of practical and legal obstacles were found to lie in the way of the establishment of fully effective cooperation.

3.34. In 1997, in order to implement the recommendations set out in the second report on the operation of administrative cooperation (see paragraph 3.28), the committee discussed a series of specific measures to be implemented by the Member States. These involved, for example, defining minimum levels for the use of the VIES database by the officials responsible for auditing VAT, guaranteeing the participation of the Member States in multilateral audit exercises and shortening the periods allowed for replies to requests for information from other Member States. All of the Member States except three adopted these objectives in their entirety and are to submit a regular report on the progress achieved as of the first quarter of 1998.

Mutual assistance in debt collection

3.35. The question of mutual assistance in debt collection in the field of indirect taxation has been discussed several times at the SCAC. It quickly became clear that this system suffered from several defects. A survey carried out in 1995 by the Commission, identified five categories of problems:

(a) the significant differences between Member States in terms of debt collection powers;

(b) the fact that national laws treated tax debts between one Member State and internal tax debts differently;

(c) the low priority granted to the recovery of debts on behalf of other Member States;

(d) the slowness, complexity and the insufficient understanding of the mutual assistance procedures;

(e) the difficulty involved in merely locating certain debtors.

3.36. It was officially recognised some time ago that mutual assistance in debt collection was working poorly. The Commission is currently preparing draft legislation to reform the existing agreements.

Administrative cooperation programmes

3.37. In April 1997, in order to improve the working of the internal market's systems of indirect taxation, the Commission proposed the 'Fiscalis' ([46]) action plan to the European Parliament and the Council with three aims: the acquisition of a high level of knowledge of Community law on the part of officials in charge of indirect taxation, effective cooperation among Member States and between the Member States and the Commission and, finally, an ongoing improvement of administrative procedures. This programme, announced as a component of the first phase of the new common VAT system (see paragraphs 1.10 to 1.15) was essentially a renewal for five years (from 1 January 1998 to 31 December 2002) of the old Mattheus Tax ([47]) programme and a reorganisation and perpetuation of various pre-existing measures financed under various headings (e.g. the VIES system, 'tax SCENT' and the multilateral

([43]) 'Roundabout fraud' uses a chain of companies (real or fictitious) in order to obtain a series of undue VAT benefits (deductions or refunds). At the same time, it aims to make the authorities lose track of the goods, by declaring them for exportation when they are actually sold on the black market.

([44]) Doc. SCAF 26 rev 1 of 20 October 1997.

([45]) See Article 4(2) and (3) of Directive 77/799/EEC.

([46]) Doc. COM(97) 175 of 23 April 1997.

([47]) Council Decision of 29 October 1993, OJ L 280, 13.11.1993, p. 27.

audit measures). SCAC was to be its management committee, whereas, under Regulation (EEC) No 218/92, it acts as an advisory committee (see paragraphs 3.2. and 3.3). The Commission felt that the various administrative cooperation measures at both Member State and Commission levels would contribute significant added value. This proposal nevertheless met with reservations on the part of certain Member States. After an amended proposal had been drafted ([48]), the programme was finally adopted on 30 March 1998 ([49]).

Unit on Coordination of Fraud Prevention (UCLAF)

3.38. In 1995, following a reorganisation of UCLAF aimed at improving its effectiveness, some officials who had previously been responsible for the fight against fraud in various Commission Directorates-General were brought together. With regard to VAT, this change resulted in no more than the transfer of one official to UCLAF. Currently, two temporary members of staff are assigned full-time to the fight against VAT fraud under the supervision of the Head of the unit responsible for own resources.

3.39. As an explanation for the inadequacy of the resources invested in the coordination of the fight against VAT fraud, UCLAF cites the absence of an appropriate legal basis and the unwillingness of certain Member States to accept a Community operational measure, in contrast with the fields of customs and agriculture, where the Member States are required to notify the Commission of the amounts involved in any irregularities that they uncover. Furthermore, at least one Member State feels that it is unable to cooperate with UCLAF because there is no legal basis for this at a national level.

3.40. Information available from other sources was not exploited. For example, the IRENE database, which records the amounts involved in customs frauds, has not been used for estimating, even approximately, VAT fraud on imports from countries outside the Union. Despite the Member States' responsibility for tax collection, there was also no systematic Commission monitoring to verify the methods and the rate of recovery of the VAT in question.

3.41. In specific cases of transnational fraud, UCLAF does organise coordination meetings between the various departments responsible, such as customs, the police and the tax authorities. Also, seminars are organised to encourage contacts and discussions between anti-VAT fraud specialists on practical methods of identifying and fighting VAT fraud.

3.42. Since the recent revival of the activities of SCAC's anti-fraud subcommittee, co-chaired by UCLAF (which uses it to make its own activities more widely known), the latter feels that its efforts of persuasion have reached their limit. It believes that it is vital for Member States to agree to exchange the information in their possession in respect of VAT fraud and thinks that an amendment of the legal basis is essential to its activities at Community level.

Fraud risks in connection with certain exceptional arrangements

Distance sales

3.43. For distance sales ([50]) to private individuals inside a Member State by companies situated outside the Member State in question, VAT is applied at the point of origin where the seller's turnover does not exceed a certain threshold established by the Member State of destination and where it involves products that are not subject to excise duties. Beyond this threshold (ECU 35 000 or ECU 100 000 according to the Member State concerned), a special system of exemptions applies. Sellers are required to be registered for VAT in the Member State of destination and, where appropriate, have a tax representative there in order to submit the necessary tax returns.

3.44. The monitoring of this threshold and, where applicable, the requirement to submit a VAT return, is a delicate matter. In some of the Member States audited, traders are not required to declare taxable turnover relating to distance sales to other countries of the Union separately. The lack of regular exchanges of information between the Member States and the limited number of checks carried out means that there are real possibilities of non-taxation.

3.45. Furthermore, in cases where a seller exceeds the threshold in question and the VAT of the Member State of origin is lower than that of the Member State of destination, he has no interest in pointing out that he has actually exceeded it. If he were to do so, he would be subject to complicated administrative and declarative requirements that differ from one Member State of destination to another. The revenue authorities under whose jurisdiction the seller falls also have no interest in verifying the threshold, in that exceeding it would entail a loss of revenue for them.

([48]) Doc. COM(97) 621 of 24 November 1997.

([49]) European Parliament and Council Decision No 888/98/EC of 30 March 1998, OJ L 126, 28.4.1998, p. 1.

([50]) Distance sales (for example, mail order) are defined as any supply of goods for which shipment is carried out by, or on behalf of, the seller. The buyers must be private individuals, taxpayers with no right to deduct VAT or legal entities that are not liable for VAT (Article 28(b) of Directive 77/388/EEC).

Intra-Community tax-free sales

3.46. Intra-Community tax-free sales should, in theory, have ceased with the completion of the internal market on 1 January 1993, but in fact the Council of Ministers granted a transition period (until 30 June 1999) so that the sectors of the economy concerned could prepare for the disappearance of intra-Community tax-free sales. In order to ensure that travellers do not exceed the allowances established in terms of quantity and value, Member States agreed on a minimum level of checks ([51]) to be carried out by the sellers, compliance with which had to be ensured by the national tax authorities. Finally, the Commission was instructed to 'review the operation of Member States' controls ... in the light of practical experience [and] ... report ... as soon as possible on the operation of these controls and, if necessary, propose any appropriate measure for adoption at the earliest possible date and in any event not later than 31 December 1993'.

3.47. The Commission submitted its report in July 1996 ([52]). It concluded that none of the Member States had established an effective control system, that this situation could lead to distortions of competition, not only between traders but also between modes of transport, and that it had probably reduced the Community's own resources base. In addition, it observed that the duty-free sector, far from preparing for the abolition of tax-free sales, had further developed them, in particular on board roll-on/roll-off ferries, by increasing the size of their shops and the variety of products offered.

3.48. Contrary to the Council's guidelines, no measures had been proposed to rectify this situation. Indeed, the Commission feels that it would be useless to propose stricter requirements in view of the lack of a clear will on the part of the Member States to apply a minimum level of control and the fact that this special scheme is to end on 30 June 1999.

4. CONCLUSIONS

Increasing the protection of financial interests at the level of the European Union

4.1. Generally speaking, the fight against fraud is characterised by the absence of an integrated strategy, with the risk that priority would be given to a view that is limited to the national context, which may result in a dispersion of efforts and an inefficient use of available funds. This is particularly the case where the fraud has no budgetary effects in a Member State and that State therefore has no reason to take action (see, in particular, paragraphs 2.2 to 2.8, 3.12, 3.15 to 17, 3.20 to 3.21, 3.28, 3.35 to 3.37, 3.39, 3.44 to 3.45, 3.47 to 3.8).

4.2. As for Community transit, the collection of VAT may be affected because 'the European Union is caught in a contradiction of its own making: it has a single market in which persons and goods move freely across internal borders, while the authorities charged with administering and policing that market remain constrained by those same borders. In practice there exists a single market for fraud but not for law enforcement' ([53]). Moreover, work carried out by the Court on the evaluation of overall losses of VAT tax revenue, both internal and intra-Community, has shown that these losses are considerable ([54]).

4.3. A comparable legal definition of cases that are liable for prosecution, procedures for taking legal action and applicable sanctions should result in the same behaviour being punished in an equivalent way in each Member State. Differences in the national definitions of fraud as well as, consequently, in the punishments applied can reduce the dissuasive impact of the prosecution of fraudulent activities. The same is true for national peculiarities in respect of reductions in fines and statutes of limitation (see, in particular, paragraphs 2.1 and 2.4 to 2.8).

4.4. In order to make good shortcomings and incompatibilities that adversely affect the fight against fraud and legal cooperation between Member States in criminal matters, a Convention has been concluded for the protection of the Community's financial interests. This Convention, which was signed in 1995 but has not yet come into force, was meant to ensure greater compatibility between the provisions of the criminal law in the various Member States by setting up minimum penal standards. The fact that the VAT resource was excluded from its scope means that there will not be an identical level of protection for this resource in all the Member States, even though it contributes nearly half of the Community budget (see, in particular, paragraphs 2.2 to 2.3).

4.5. The differences in legal and administrative frameworks constitute a series of risk factors that are likely to be used by tax evaders who know how to exploit the loopholes in the various legal systems. This is also true with regard to the varying capacity of the Member States to fight fraud effectively. In this context,

([51]) 'Guidelines for checks on tax free sales agreed by the Council of Ministers of 14 December 1992.' Doc. COM(06) 245 final of 26 July 1996.

([52]) Report on systems for checks at sales outlets implemented by the Member States. Doc. COM(96) 245 final of 26 July 1996.

([53]) Doc. PE 220.895/def (A4-0053/97) of 20 February 1997, volume I paragraph 10.5.2.

([54]) See Special Report No 6/98 of the European Court of Auditors entitled: 'Assessment of the system of own resources based on VAT and GNP', paragraphs 4.16 to 4.19.

an attempt on the part of the national authorities to align their inspection methods and strategies more closely would make it possible to increase the efficacy of the fight against a phenomenon that is becoming increasingly multinational (see, in particular, paragraphs 3.6 to 3.8).

4.6. The Commission's responsibilities with regard to the application of Community law in the Member States and the effects of VAT fraud on the Community budget require the implementation of more incisive measures. The courses and other training initiatives that it organises make it possible to carry out useful exchanges of experiences among national departments. However, these measures cannot relieve it of its responsibility for identifying malfunctions in the national systems in the field of the fight against fraud and putting forward adequate remedies to the Member States concerned (see, in particular, paragraphs 3.22 to 3.26, 3.38 to 3.42 and 3.48).

4.7. The prospect of the adoption of definitive arrangements implies compliance with a number of preconditions. Some of these would already be necessary for the smooth operation of the current system. Arrangements should therefore be made for them to be implemented without delay. The fact is that differences in the application of VAT legislation have created an extremely complex situation as well as a total absence of legal certainty for the majority of traders (which, moreover, may well benefit the tax-evaders). The harmonisation of the performance of the various national authorities constitutes another field in which urgent action is necessary (see, in particular, paragraphs 1.10 to 1.15).

4.8. The current transitional system included exceptional or individual arrangements which are very difficult to audit, and which give rise to possibilities of fraud and the distortion of competition. The Member States and the Commission should ask themselves whether these arrangements are justified and guarantee the setting-up of truly effective audit systems (see, in particular, paragraphs 3.43 to 3.47).

Improving administrative cooperation and exchanges of information between Member States

4.9. The instruments for cooperation between Member States are not being fully used, despite the fact that a study carried out by the Court and certain national audit institutions has shown that, when used, they generally give added benefits in terms of the prosecution of fraud that is detected. Slow procedures and even an ignorance of existing instruments, in particular on the part of the local authorities, often explain this under-use. These instruments should therefore be made usable on a wide scale and Member States should lift their current reservations, in particular with regard to exchanging information on fraud cases (see, in particular, paragraphs 3.15 to 3.17).

4.10. If it is to be successfully used in the fight against fraud, information on intra-Community transfers of goods, from any useful source, needs to be considerably improved in terms of quality, in particular as regards its exhaustiveness (see, in particular, paragraphs 3.18 to 3.19).

4.11. Given that the time factor often plays an important role in fraud systems, the opportunities available for cooperation between the tax authorities of the Member States should be made easier and faster (see, in particular, paragraphs 3.20 to 3.21).

Assessment tools

4.12. Risk analysis enables the ranking of checks in order of priority. However, in order to fight effectively against VAT fraud, Member States should set up systems capable of appraising the extent of the fraud and, above all, capable of periodically evaluating the effectiveness and results of their audit measures (see, in particular, paragraph 3.6).

4.13. The absence of any evaluation of the system of penalties provided and the application thereof, in particular with regard to whether they are effective, dissuasive and proportionate, constitutes a shortcoming that needs to be overcome as soon as possible (see, in particular, paragraph 2.9).

4.14. With regard to the recovery of evaded taxes, and in order to be able to assess the efficacy of their verification procedures and appreciate the scale of the phenomenon, the Member States should acquire information on any adjustments that have been carried out and the amounts finally recovered (see, in particular, paragraph 3.14).

4.15. The reports that the Commission is asked to submit ought to provide an occasion for the assessment of the efforts and progress that have been made at both Community and Member State level (see, in particular, paragraphs 3.23 to 3.25).

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 2 July 1998.

For the Court of Auditors

Bernhard FRIEDMANN

President

COMMISSION'S REPLIES

1. VAT AND THE VAT RESOURCE

Audits carried out by the Court together with certain national audit institutions

1.16. The Commission would agree with the Court both that the VIES still suffers from shortcomings and that national control methods do not sufficiently take into account the risks of evasion linked to the abolition of fiscal frontiers. In particular administrative cooperation has still not been integrated into day-to-day national control methodology.

Following the remarks of the Court in its annual report concerning the financial year 1995, the Commission has taken steps to monitor more closely the evolution of Member States' VAT revenue. The results of the bilateral discussions that subsequently took place with all Member States were discussed at the meeting of Deputy Directors-General for Indirect Taxation on 24 March 1998. On this occasion, the Member States concurred with the operational procedure proposed by the Commission concerning the automatic transmission to the Commission of information about VAT receipts and about the reasons explaining their evolution.

2. VAT FRAUD IN INTRA-COMMUNITY TRADE

No single definition of fraud

2.3. The Commission regrets that the Council has taken the position that VAT should be excluded from the scope of the convention, contrary to the financial interests of the Community and the Member States.

3. THE PROTECTION OF THE COMMUNITY'S FINANCIAL INTERESTS AS REGARDS VAT ON INTRA-COMMUNITY TRADE

The action taken by the Member States

Audit strategies

3.6. The Commission is deeply concerned about this problem, which affects many Member States. Detailed and accurate figures on the results of anti-fraud efforts are an essential tool, as the Court says, in providing feedback to improve anti-fraud methods.

3.7. The Commission agrees that, even though verification of repayments of tax is very important, there is also a need to check previous payments of VAT invoiced by suppliers. One Member State has pioneered this form of 'chain of transactions' control and the Commission has recommended its wider use in its third Article 12 report.

The reconciling of data

3.11. The Commission shares the Court's view of these divergences. The Commission emphasised in its third Article 12 report the need for rapid access to all relevant sources of information.

Access to the legislation of other Member States

3.12. The Commission agrees that it is important for the Member States to be well informed about each other's tax systems and administration. The Commission itself has a role to play in disseminating this information. The extent of such a massive task (and the consequent burden of translation) should not be underestimated. Nevertheless a start has been made. In the context of the Matthaeus-Tax programme, the Commission has circulated basic guides to all the national tax administrations in three languages. There is provision under the Fiscalis programme for manuals and guides to national systems and administrations to be developed by the Community in the future.

Exchanges of information between Member States

3.15. The Commission shares the concerns of the Court that it is unable to reach any agreement with the Member States on the specific information to be exchanged. The Member States continue to express their commitment to the idea in principle while simultaneously refusing to agree to any specific exchanges of information at Community level.

3.17. This remark of the Court demonstrates the weakness of optional provisions in Community legislation on information exchange. The Member States rarely make use of such provisions, which raises questions about their suitability in this area.

3.18. The Commission has consistently urged the Member States to remedy these weaknesses. Nevertheless the use of the VIES as a control method through such cross-checking should not be over-emphasised.

3.19. The Commission shares this concern that the cost of fulfilling these research requirements will exceed the

benefit in control terms. The Commission also agrees that the VIES is unsuitable for sectoral research. The Commission concludes that the limits of the VIES as a control tool for the future are clear. Community tools which take into account the cost-benefit and which enable Member States to prioritise according to risk are the only long-term solution. Community tools which include a sectoral approach are also essential in future.

3.20. The Commission shares the Court's analysis. Sharing of information on fictitious companies and the individuals behind them is indispensable if the internal market is not to become a haven for fraudsters. The reluctance of the Member States to do this, as noted by the Court, is very revealing of the fundamental attitude of the Member States towards administrative cooperation.

3.21. The Commission shares the Court's analysis. Cooperation between officials on the ground is a precondition of successful cooperation. Provision for the exchange of information between local offices exists under Directive 77/799/EEC. Again this is only an optional provision, little used by these Member States. The reluctance of central administrations in the Member States to delegate the exchange of information to the experts in the field is disappointing and again very revealing of the Member States' fundamental attitude towards administrative cooperation.

Action taken by the Commission

Periodic reports

Reports on the national systems

3.22. to 3.26. The Commission accepts the Court's criticism of the previous Article 12 reports and the questions it raises about the intentions of the Commission in future. Nevertheless the Court's comments fail to recognise that the Commission has had to work within practical limitations. The content of the first two Article 12 reports was limited by the fact that the Commission is entirely dependent on the Member States for the information on their national control systems and the Commission, not being a tax administration, lacked detailed experience and understanding of the control process.

If this is taken into account, the Commission's position can be better understood. For the first two reports, the Commission had to gain an overall understanding of the audit systems in the Member States, which proved to be very complicated. The Commission needed to demonstrate an understanding of audit procedures to be taken seriously. In its third report, the Commission sought to set out its position on auditing, and this is what the report does.

Only after these prior stages can the Commission proceed to the delicate and difficult task of studying in detail each Member States' audit system and coming up with recommendations. As the third report says, the Commission intends to study with the Member States their audit procedures as a whole, using the third report as a starting point or reference. The fourth report will contain the fruits of the study.

In an area where the Commission does not have the power to oblige Member States to change their audit systems, it makes sense for the Commission to develop its own expertise in the matter first. Recommendations for change based on a deeper understanding of the very complicated business of control are far more likely to be implemented by the Member States.

The Standing Committee on administrative cooperation (SCAC) and its anti-fraud subcommittee (AFS)

The work of the anti-fraud subcommittee

3.29. The Commission shares the Court's opinion on the use of the fiscal SCENT system. The Commission has been trying for some time to remedy this situation, but this is ultimately in the hands of the Member States. The extremely low level of use of the system by some Member States is again revealing of their attitude towards administrative cooperation.

Mutual assistance in debt collection

3.36. On 25 June 1998 the Commission adopted a proposal for a Council Decision amending Council Directive 76/308/EEC on mutual assistance for the recovery of claims (COM(98) 364). This proposal widens the scope of the Directive, eliminates certain limits on its use, guarantees automatic recognition of the legal instrument, ensures equality of treatment between domestic and inter-Member State claims and provides greater transparency about each Member State's track record in using and fulfilling its obligations under this Directive.

The Unit on Coordination of Fraud Prevention (UCLAF)

3.39. The Commission agrees that UCLAF has an important part to play in strengthening action to combat VAT fraud. UCLAF's primary role is to coordinate and assist the Member States in the fight against VAT fraud, since they are mainly responsible for such action. The lack of an adequate legal base and the reticence of some Member States to accept the legitimacy of operational

action at Community level to combat VAT fraud show why resources in UCLAF can currently be put to more effective use in other priority areas.

3.40. The use of other available sources of information, and in particular IRENE, to estimate the amount of VAT fraud in relation to imports from third countries would be very difficult, if not impossible, and moreover such an effort would be very resource intensive. In order to calculate the amount of VAT evaded in particular cases it would be necessary to know the product, the country and the rate of VAT for each relevant transaction. In addition, it would be necessary to ascertain what type of irregularity was involved: for example, if goods have been wrongly declared at import in order to benefit from a lower rate of customs duty, the only VAT which will have been evaded will be the VAT due on the additional customs duty (not VAT on the full value of the goods). Moreover, the estimate could not be complete because the data only cover cases where there are customs duties at stake. Since VAT on imports is almost always recoverable by the importer when he is registered for VAT the real amount of tax loss is even more difficult to calculate. Nevertheless, the Commission accepts that efforts should be made to use available data wherever practicable to estimate amounts of VAT defrauded, and is seeing what can be done in this respect.

4. CONCLUSION

Increasing the protection of financial interests at the level of the European Union

4.1. to 4.5., 4.9. to 4.15. The Commission endorses the comments of the Court. It is currently reflecting on what action needs to be taken at Community level to remedy the problems.

4.6. The Commission shares the Court's view that the Commission has a responsibility to identify the shortcomings of national systems in the fight against fraud and to suggest adequate remedies to the Member States. The Commission agrees that more incisive action is required. As the remarks made under 3.22 to 3.26 indicate, the Commission is fully committed to this action. The Commission is clear however that the chances of adoption of its recommendations by the Member States depend entirely on their real added-value. Until recently the Commission did not have enough experience to make the sort of profound evaluation and recommendations proposed by the Court. The experience built up over previous years now enables the Commission to carry out the responsibilities the Court identifies.

4.8. The exceptional or individual arrangements allowing for taxation in the Member State of destination served two main purposes: to ensure, through the tax system, that the tax revenue accrued to the Member State where consumption occurred and to allow the Member States to continue to apply different rates of VAT. It is precisely these arrangements that make the current system more complicated by:

— encouraging traders not to comply with tax obligations deemed to be too onerous and too expensive,

— similarly requiring more resources to be deployed to ensure proper monitoring of tax administrations.

Only a tax system ensuring that all taxes have been paid on goods which move between Member States can eliminate problems of monitoring connected with the tax-free movement of goods in intra-Community trade. The Commission has never made any secret of its criticism of individual arrangements for taxation in the Member State of destination. In its working programme for the Single Market it clearly indicated its preference for a system of taxation in the Member State of origin, which would be compatible with a genuine single market and would do away with individual arrangements for taxation in the Member State of destination.