

Editorial

VAT Fraud with Emission Allowances Trading

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Recently, the Council adopted an amendment of the Value-Added Tax (VAT) Directive, providing a tool against cross-border VAT fraud with greenhouse gas emission allowances: A new step in the fight against growing carousel fraud but probably not the last one.

The European Union Emission Trading System (EU ETS), created in 2003 as a market instrument that should contribute to achieving a reduction of CO₂ emissions in line with the Kyoto Protocol, is a cap-and-trade system for transactions of European Unit Allowances (EUAs) granted by the Member States to its emitting facilities (industries and transport) by means of a National Allocation Plan.¹ More than 2 billion EUAs have been granted to about 12,000 emitting facilities in the twenty-seven Member States. Trading takes place on six trading platforms and various other market platforms.² The EU carbon market for EUAs is estimated to be worth about EUR 90 billion a year. In the course of 2008, several market platforms signalled an accelerated growth in trade volume of EUAs, developing into a peak in May 2009, when several hundred million EUAs were traded in various EU Member States.³ These strong indications of suspicious trading activities in EUAs (that is, services in the sense of the VAT) appeared to be caused by VAT carousel fraud, a fraud scheme already well known in the trade of goods.⁴ The carousel fraud in EUAs is a relatively simple form of 'missing trader fraud': fraudulent traders, making use of stolen VAT identification numbers, buy carbon credits tax-free in one EU Member State, sell them in another Member State at a markup by including VAT (which varies from 15% to 25% among EU Member States) and then (after one or more transactions, including those with bona fide traders) disappear without having paid the VAT to the fisc. With the support of Belgium, Denmark, France, the Netherlands, Spain, and the United Kingdom, the European criminal intelligence agency Europol set up a specific project to collect and analyse information to identify and disrupt the organized criminal structures behind these fraud schemes. It estimated that up to 90% of the volume of the market for tradable emission rights was caused by fraudulent activities, leading to a loss of tax revenues of approximately EUR 5 billion for a number of EU Member States.⁵

Meanwhile, a number of Member States had already taken measures in an attempt to stop this carousel fraud in EUAs. France decided to exempt relevant transactions for VAT purposes, treating them as exempt transactions

involving financial products as a result of which the supplier is unable to recover any VAT incurred on related costs. The United Kingdom decided to zero rate these transactions, which allows the supplier to recover VAT incurred on related costs. The Netherlands introduced the reverse charge mechanism for all transactions relating to emissions allowance trading, including local transactions. The reverse charge mechanism means that no VAT is charged by the supplier to taxable customers who, in turn, become liable for the payment of the VAT. In practice, taxable persons with a full right of deduction input VAT would declare and deduct VAT at the same time without effective payment to the treasury. The reverse charge system, although not in line with the general VAT method of fractionated payments, is not an unknown phenomenon in EU VAT. For instance, until 2010, reverse charge was already applied to a number of specific cross-border services to taxable customers as one of the exceptions to the main rule that cross-border services are subject to VAT where the supplier of the service is established, whereas now reverse charge has become the new main rule for services performed to taxable persons in other Member States.⁶

In 2008, the European Commission, analysing a proposal from Germany and Austria to apply a general reverse charge system as a tool to combat VAT fraud, expressed its willingness to propose a pilot project for

¹ Directive 2003/87/EC of 13 Oct. 2003, OJ L 275, 25 Oct. 2003, 32–46. Each transfer of EUAs (one EUA represents the right to emit one tonne CO₂) is recorded in a national registry before being centrally stored in the Community Independent Transaction Log (CITL) at the EU Commission.

² The six trading platforms (exchanges) are European Climate Exchange (London, UK), Nordic Power Exchange (Oslo, Norway), European Energy Exchange (Leipzig, Germany), Energy Exchange Austria (Graz, Austria), Climex (Amsterdam, The Netherlands), and BlueNext (Paris, France); other market platforms are a.o. SEN-DECO2, Italian Power Exchange GME, and Greenmarket (at the Munich exchange).

³ The market price of one EUA was around EUR 12.5 at that time.

⁴ S. Cnossen, 'German and Austrian VAT Proposals to Combat Carousel Fraud', *EC Tax Review* 4 (2009): 102–197.

⁵ In April 2010, raids by British and German prosecutors led to the arrest of twenty-five people in a case involving the loss of an estimated EUR 180 million tax revenues, see <<http://euobserver.com/22/29996>>.

⁶ For certain domestic high-risk sectors such as construction and waste, the VAT Directive foresees in the application of the reverse charge mechanism.

such a far-reaching anti-fraud instrument.⁷ The ECOFIN did not reach political agreement on this suggestion. However, in a number of market sectors, carousel fraud grew further, and the call for EU-wide measures aimed at particular fraud sensitive sectors or certain goods became stronger. On 16 March 2010, the Council adopted Directive 2010/23/EU. This directive includes a temporary measure in the form of a targeted reverse charge system in relation to the transfer of EUAs.

The scope of Directive 2010/23/EU is smaller than suggested by the European Commission, who proposed to apply reverse charge also to mobile telephones and integrated circuit devices, perfume, and precious metals (such as platinum), which have been signalled by the Member States as goods to which fraud seems to have moved. However, according to this directive the Member States should not only produce an evaluation report on the application of this targeted application of the reverse charge mechanism so as to enable an assessment of its efficiency, they should also report on any consequent shifts in trends of fraudulent activities, including supplies of other goods and services. It is not yet clear whether such a shift of carousel fraud to other goods and services

may lead to other (far-reaching) anti-fraud measures or to extending the reverse charge mechanism to other goods and services.

Depending on the magnitude of VAT fraud and the degree of distortion of competition it may cause, we can expect an ongoing debate on various alternative anti-fraud measures, like comprehensive reverse charging with transaction-based reporting (listing requirements), the introduction of VAT bank accounts into which taxable customers must pay the VAT charged to them by their suppliers (no credit could be taken for VAT not paid to that account), or exchange of information, verification, and – only if indicated – interstate investigation and prosecution. However, irrespective as to whether the measures will be general or targeted, no adequate instrument against VAT fraud can be developed without first making and keeping the database of VAT liable persons and their identification numbers (the VAT Information Exchange System (VIES)) up to date.

⁷ Communication COM (2008) 109 final; see also COM (2006) 254 final and COM (2007) 758 final.