

VAT Carousel Fraud in the EU

The need for Reform in Italy and on a Supranational Level*

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Article

ABSTRACT

The article analyses VAT carousel fraud as a complex and transnational scheme that severely damages Member States' treasuries and the EU budget. Using the Italian context as a case study, it explains the fraud mechanism, the related criminal offences under Italian law (fraudulent declaration and issuance of false invoices), and the inadequacy of existing legislation. The author argues that carousel fraud's peculiar structure—chains of paper and buffer companies operating across borders—requires the creation of an autonomous criminal offence in Italy and a harmonised European legislative response. Effective solutions must combine criminal sanctions with administrative measures to protect both national and EU financial interests.

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What has become known as carousel fraud is a decidedly insidious abuse of the European VAT system and one that is well structured, complex, and that frequently involves many EU Member States. This alarming phenomenon has led to the loss of significant financial resources, has damaged Member States, and, in doing so, indirectly harmed EU institutions.

Carousel fraud influences the financing of the entire EU budget inasmuch as it has an impact on the relationship between gross national income (GNI), based own resources, and other own resources in the budget. The real damage can be seen in the need for the EU to ask Member States for GNI-based own resources to make up for total expenditure that is not covered by other resources, which can also impact on the EU budget redistribution phase.¹

The European Commission's efforts over the years to use EU state-wide international cooperation initiatives to eradicate tax fraud are deserving of great praise. Of particular note is a document published by the Commission on 27 June 2012: *Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries*.²

I. Mechanism

The mechanism by which carousel fraud functions has been clearly laid out by the European Commission in a document published on 16 April 2004: *Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud*.³

The report reads: "A so-called 'conduit company' A, makes an exempt intra-community supply of goods to a 'missing trader' B in another Member State. This company B acquires goods without paying VAT and subsequently makes a domestic supply to a third company C, called the broker. The missing trader collects VAT on its sales to the broker but does not pay the VAT to the Treasury and disappears. The broker C claims a refund of the VAT on its purchases from B. Consequently, the financial loss to the Treasury equals the VAT paid by C to B. Subsequently, company C may declare an exempt intra-community supply to company A and, in turn, A may make an exempt intra-community supply to B, and the fraud pattern resumes, thus explaining the term 'carousel fraud' [...] In order to distort VAT investigations, the goods will often be supplied from B to C via intermediary companies, called 'buffers'."

In order to add to the Commission's definition, we will herein consider a case in which the bogus trader B, also known as the "paper company" – as it only exists on paper –, was established in Italy. In this example, company B is properly VAT-registered and is placed between an EU-based cedent – company A – and an Italian buyer – company C – who is not the end user and thus subject to VAT obligations as the cessionary. Other intermediary buffer companies are often created within EU borders between companies A, B, and C. Company B carries out an intra-community acquisition of goods from A and, in accordance with applicable European VAT legislation, registers the invoice issued by A both as a purchase invoice and as a sales invoice, thus nullifying the tax effect of the operation.⁴ The goods are then sold to C by B, an invoice is issued, and VAT applied. The Italian buyer C pays the VAT to B via the reverse charge mechanism; however, B then fails to make the payment to the Treasury either during its periodic VAT calculations or at the presentation of its annual tax declaration.

Company B – which, being a paper company, leads to nothing or non-existent persons – disappears and the Treasury no longer has the ability to claim the VAT credit it holds from any existing company or person. This lack of a VAT payment implies that every buyer in the subsequent commercial circuit is able to buy goods at

competitive prices, as the buyer is not burdened by the tax on that first internal operation from the paper company B to the buyer C.

In fact, the first internal transaction usually occurs at a price that is lower than what was charged when the “non-internal” transaction between the EU-based cedent A and the paper company B occurred. This is done so that the latter is able to profit from the future non-payment of VAT or to take advantage of the non-payment related to previous, similar illicit operations. The price that arises is therefore anomalous, along the same lines as the reduced VAT calculated on a limited tax base.

The VAT that was not paid is normally split between the parties involved in the fraud, which are placed between B and C, so as to lead the authorities’ investigations astray. The Italian buyer C, in turn, deducts the tax that it had previously paid as a result of the refund exercised by the paper company. When periodic or year-end VAT calculations are carried out by the Italian buyer C, it appears to have a VAT credit when the sum of the tax paid on its purchases, including the part it had previously paid to the paper company B, which was not paid to the Treasury, is superior to the VAT collected on its sales. This credit is then either used to offset the VAT debt in successive tax periods or, if all prerequisites are met, to claim a refund. It may also be used to counteract other taxes and charges from the same period according to the Legislative Decree of 9 July 1997, No. 241 Article 17, using the Italian unified tax return form.

The Italian buyer C, which had previously paid the VAT to the paper company B, declares an exempt intra-community supply to the initial EU-based supplier A or another EU-based operator and, according to applicable legislation, claims a refund for the VAT it had initially paid.⁵ At this point, the EU-based operator A sells the goods to the same paper company B, the illicit mechanism starts again, and the VAT non-payment is repeated. This is the origin of the term carousel that is given to this particular type of tax fraud, indicating that a cyclic tax fraud mechanism is created. The damage to the Treasury therefore clearly derives from the entire illicit mechanism; the VAT is not paid to the Italian state by the paper company B during its tax calculations, while it is detracted from the Italian buyer C.

II. Criminal Offences

Carousel fraud invokes a number of offences that fall under the Legislative Decree of 10 March 2000, No. 74 (that constitutes legislation for applicable income tax and value added tax offenses in Italy).

Of these offence types, two are of particular interest to this report: *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* (Article 2), where, in our example, the offence is considered to have been committed by the Italian buyer C, and *the issuance of invoices or other documentation pertaining to non-existent operations* (Article 8), when the offence is considered to have been committed by the paper company B.⁶

1. Fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations (Article 2 of the Legislative Decree of 10 March 2000, No. 74)

The crime of *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* foresees a term of imprisonment that ranges from one year and six months to six years for a taxpayer who, using invoices or other documentation pertaining to non-existent transactions (by registering said documentation in his compulsory bookkeeping or by attempting to use it as evidence in his dealings with the financial authorities), declares one or more fictitious passive operation in one of his annual tax returns in order to evade income or value added taxation.

In this case, a crime is considered to have been committed without any minimum limit to the suspect's liability to punishment. This type of fraudulent conduct is characterised by the fact that the suspect declares a fictitious passive operation in one of his annual income or value added tax returns (the suspect therefore "falsely increases" a tax deductible in order to decrease taxable income and, subsequently, payable tax). This crime, which is instantaneous in nature, is not considered committed until a successive act, not the mere use of false documentation, has been carried out – in fact, not until the moment in which the declaration is presented. Only in this latter act has the "supposed, attempted tax evasion and the actual offence with respect to taxation" been committed.⁷ The invoices and/or any other pertinent documentation constitute the object of the crime if, and inasmuch as, they refer to non-existent operations. For invoices or other documents pertinent to non-existent operations, we mean any that are "emitted with reference to operations that are wholly or partially non-existent," any "that indicate any payment or VAT amount that is higher than the actual figure," as well as any "that attribute the operation to subjects are not the actual parties."

As for the concept of falsity that may characterise the crime in question, the current prevailing view taken by the courts is that only an *ideological* falsity is compatible with the intention of the offence at hand.⁸ This view is contrasted, however, by the opinion that this type of offence can be considered committed in the case of an invoice or other document's *material* falsity.⁹

As far as the crime of *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* is concerned, carousel fraud was committed by the Italian buyer C as he had detracted the previously paid VAT for a subjectively fictitious operation. In fact, the operation, which was carried out due to the presence of the false subject, paper company B, can be described as subjectively inexistent.

2. The issuance of invoices or other documentation pertaining to non-existent operations (Article 8 of the Legislative Decree of 10 March 2000, No. 74)

The crime of *the issuance of invoices or other documentation pertaining to non-existent operations* foresees a term of imprisonment that ranges from one year and six months to six years for anyone who issues an invoice or other documentation pertaining to a non-existent operation with the aim of allowing a third party to evade income or value added tax. This type of offence is both in contrast to and correlated to the previously described *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* as it is its natural predecessor.

The peculiarity here is the intended exception in the law for any instance of conspiracy in the crime (Article 110 of the criminal code), as indicated by Article 9 of the Legislative Decree of 10 March 2000, No. 74, in which grounds for conspiracy between the issuer and the user of a false invoice or other document are denied. Once again, a crime is considered to have been committed here without any minimum limit to the suspect's liability to punishment being reached. This offence, which is an independent legal entity, excludes the need for any consequential use of the invoice or other falsified documents by third parties and is, furthermore, completely non-dependent on any tax evasion, successful or otherwise, by said third parties. It follows that the offence, not being directly linked to any occurrence of tax evasion, can be considered an offence of mere potential damage, as it functions as a pre-emptive means to protect the Treasury from actions that do not, in themselves, constitute tax evasion but that are carried out in preparation for said offence and which are therefore intrinsically insidious and signify a marked potential damage to the Treasury's interests.¹⁰ More specifically, we are speaking here of an inchoate offence and one which is indirectly committed, as the potential damage depends on the document's use by its recipient and not on the person who committed the offence.¹¹ The crime is of an instantaneous nature and is committed at the moment that a false invoice, or other documentation, is issued for a non-existent operation; the consummation of the offence coincides with the transfer of said documents to other persons.

As far as the concepts of object and falsity that characterise the crime in question are concerned, the same considerations that were applied above for *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* are still to be considered valid here.

In the context of carousel fraud, the crime of *the issuance of invoices or other documentation pertaining to non-existent operations* was committed by the paper company B, whose sole objective was that of issuing a subjectively false invoice with the aim of allowing the buyer C to illegally detract the previously paid VAT.

III. Conclusions: The Need for Italian Legislators to Create an Independent Criminal Offence

The recent flood of carousel fraud offences has led some in the field¹² to make critical observations – and with good reason – as to capability of the Italian legislator's actions to fight the type of offence in question. In fact, although these actions may be frequent, they often prove to be inadequate and disjointed, as they often focus either on punishing the offence at a criminal level or on fighting the phenomenon at an administrative level and recovering the lost tax income. In focusing on one or the other, there is a lack of systematic response, which, starting from a definition of carousel fraud on a European level, fully appreciates the particular nature of this offence with respect to other tax fraud offences and which concerns itself with joint action, both on a judicial level and as regards to lost tax recovery.

In a purely judicial context, one could start with the creation of a legislative solution outlining the offence of carousel fraud in a way that is independent from the pre-existing laws defined in Articles 2 and 8 of the Legislative Decree of 10 March 2000, No. 74.¹³ The particular, unique, and specific nature of carousel fraud, which makes it worthy of a single, unique legislative solution and one separate from *fraudulent declaration via the use of invoices or other documentation pertaining to non-existent operations* and *the issuance of invoices or other documentation pertaining to non-existent operations*, has clearly emerged from the need for action perceived by the EU.

The Italian Court of Cassation was quick to support this need for action and defined the current law, based on the Legislative Decree of 10 March 2000, No. 74, as inadequate. The need for autonomous legislation was highlighted because of the inherent peculiarity of this fraud type, which, due to the way it is structured, can be traced to a chain of companies (paper company, filter, and final recipients). The chain is set up for the specific aim of issuing false invoices and used for large-scale VAT fraud by persons, managers of the companies, with precise roles within that chain based on stable resources and means on an international scale.¹⁴ Taking the wording used by top-level Italian judges as a cue, the supranational nature at the base of carousel fraud requires a legislative solution that must not be restricted to a limited national context; the need for individual state and EU financial interests to be protected now means that criminal sanctions that are “thorough in their action, not only within national confines but also on a European level”¹⁵ must be put in place.

* This reviewed and updated report was published on the occasion of the convention entitled “Tax violations; balance fighting evasion and avoiding excess” held at the Centro di Diritto Penale Tributario – Università degli Studi di Padova, Padova (Italia), 22 June 2012.

1. F. Rapisarda, I nuovi strumenti normativi approntati dall'UE contro le frodi sull'Iva intracomunitaria, in *il fisco*, Vol. 36, 5 October 2009, pp. 5956-5969.↵

2. COM(2012) 351 def.↵

3. COM(2004) 260 def.↵

4. Current legislation on European VAT (in Italy found in the Decree Law of 30 August 1993, no. 331, converted, with modifications, from the Law of 29 October 1993, no. 427) foresees a provisional tax implementation regime, by which the tax is paid to the country that receives the goods

- (Article 38, comma 7, Decree Law of 30 August 1993, No. 331). This regime was described in the Communication of the European Commission of 16 April 2004 [COM(2004)260 def].↵
5. The procedure is in line with the provisional regime for EU VAT, according to which intra-community transfers are not taxable (Article 41, Decree Law of 30 August 1993, No. 331).↵
 6. Other hypotheses for a classifiable crime that falls under the jurisdiction of the Legislative Decree of 10 March 2000, No. 74, which have not been included here for the sake of brevity, are fraudulent compensation (Article 10-quater) by the national buyer (C) and non-payment of VAT (Article. 10-ter) by the paper company (B).↵
 7. Court of Cassation, United Criminal Sections, sentence No. 27 of 7 November 2000.↵
 8. Court of Cassation, Section III criminal, sentence No. 12720 of 26 March 2008; Court of Cassation, Section III criminal, sentence No. 30896 of 8 August 2001; Court of Cassation, Section I criminal, sentence No. 32493 of 26 July 2004.↵
 9. Court of Cassation, Section III criminal, sentence No. 12284 of 23 March 2007.↵
 10. A. Traversi, S. Gennai, *I nuovi delitti tributari*, Milan, 2000, p. 252.↵
 11. V. Napoleoni, *I fondamenti del nuovo diritto penale tributario nel Decreto Legislativo 10 marzo 2000, No. 74*, Milan, 2000, p. 157, in accordance with Court of Cassation, Section III criminal, sentence no. 26395 of 11 June 2004; Court of Cassation, Section III criminal, sentence No. 12719 of 26 March 2008.↵
 12. C. Di Gregorio, G. Mainolfi, G. Rispoli, *Confisca per equivalente e frode fiscale*, Milano, 2011, p. 221.↵
 13. Tra la dottrina che si è occupata della questione, I. Caraccioli, *Contro le frodi carosello una figura autonoma di reato*, in *Il Sole24 Ore*, 17 December 2007, p. 35.↵
 14. Court of Cassation, United Criminal Sections, sentence No. 1235 of 19 January 2011. Similarly, Court of Cassation, Section V criminal, sentence No. 3257 of 30 January 2007.↵
 15. **Court of Cassation, United Criminal Sections, sentence No. 1235 of 19 January 2011. For an in-depth examination of the European integration process described herein, please see G. Grasso, L. Picotti, R. Sicurella (eds.), *L'evoluzione del diritto penale nei settori d'interesse europeo alla luce del Trattato di Lisbona*, Milan, 2011.**↵

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