IPRPD
International Journal of Business & Management Studies
ISSN 2694-1430 (Print), 2694-1449 (Online)
Volume 03; Issue no 05: May, 2022

Fiscal and Economic Competition Implications of Carousel Fraud in the European Union

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Abstract

This investigation sheds light on tax and economic competition implications of community VAT accounting. The regulation of a transitional regime characterized by the destination principle results in the so-called "carousel fraud" in the European Union which causes damage to public funds, distortion of competition between companies in the same sector and deterioration of international trade. European tax harmonization mechanisms are proposed to improve tax justice, fair economic competition in the region and optimal international trade conditions.

Keywords: Fraud, VAT, European Union, Harmonization
JEL Classification: E62, H26, K34

1.0 Introduction

The European tax harmonization is a process of approximation of the laws of the Member States in fiscal matters, initiated in the European Economic Community in 1957, which is of particular interest today for the economic crisis that the region has been suffering for several years and which highlights the need to increase cooperation between the States in fiscal and economic matters (Wesseling, 1998).

The present investigation, whose scope of study will focus on the Value Added Tax, hereinafter referred to as VAT, of the intra-Community transactions in goods, it intends to carry out a study of the loopholes that occur in said Community VAT with the regulations of a transitional regime in Directive 2006/112 CE and which is considered to be the code of conduct of the European VAT system (Jacob, Michaely & Müller, 2019).

However, it should be noted that it has remained outside the scope of this study, the intra-Community services provision having a rather complex taxation system, particularly regarding the services taxation place, and which do not cause this type of fraud since they have another exemption regime (McGowan & Billings, 1997). Therefore, the operation and all those articles of the European Directives which refer to the provision of services will be excluded from this research work.

In particular, this transitional regime for intra-Community taxable transactions establishes; (1) the destination principle, i.e. goods and services (Harry, 2002) shall be taxed at the destination Member State and not where they are produced; (2) the exemption of intra-Community deliveries of goods; and a new taxable fact the (3) intra-Community acquisition of goods. The combination of these three factors causes the birth of a fraud called Carousel because it refers to the fact that the goods turn and turn until they reach an end user.

In this context, the most relevant legislative background in the European tax harmonization regarding the VAT process will be analysed, taking into account Gruson, & Merkx (2021) recent conclusions. Then a concrete study will be made of the carousel fraud functioning through practical exemplification, delimiting its characteristics, as well as study the main consequences for tax administrations, the market, and competitive companies.

We will also delve in the progress that the European Commission has adopted, or attempted to adopt, to address this type of fraud. These include the Council Regulation 904/2010 of 7 October on VAT administrative cooperation to exchange common information between Member States which improves the functioning of the tax and the electronic VIES system which has a key role in determining exemptions of intra-community deliveries (Di Pietro, Lasarte & Martinez, 2010).

Therefore, the purpose of this article is to highlight the need to advance European tax harmonization regarding the VAT by establishing the definitive tax regime established by the European Commission in Directive 1977 and that still today, it has not been possible to carry out, basically due to the diversity of tax rates in each Member State and the reluctance of the Member States to lose their sovereignty in favour of the European Union (Sijbren, 1990).

Our objective for the practical example of the operation of the new definitive VAT tax regime is to prevent fraud on tax administrations, because the source principle will be established in intra-Community operations, which will eliminate the exemption from intra-Community deliveries of goods. Thus, the goods will not leave the country of origin untaxed and this could not be used by companies of another Member State to defraud tax administrations, nor can competition in the sector be altered, since it will not be possible to establish a selling price for a good lower than the competitors because no additional profits will be made as a result of fraud.

The efficient functioning of the European market is damaged by the carousel fraud. Competitive companies can be displaced from the market for the benefit of companies that fraudulently reduce their costs through this fraud. As the Attorney General's Office of the State of Spain pointed out[1], when goods do not pay VAT by fraudulent means, this significant price reduction prevents companies that do pay the tax from competing, causing a 'notorious and undue advantage' in favour of the fraudulent enterprise (Rubio, 1992). In this scenario, economic competition is distorted by allowing, in a snowball effect, companies that use fraud to become empowered and steadily increase their market share to the detriment of companies that fully comply with their fiscal obligations.

2.0 Methodology

The methodological strategy of this article is based on documentary research, since it seeks to study, analyse and interpret information on an object of study, in this case the carousel fraud, from a wealth of documentary sources that can cover both primary and secondary sources. The primary sources provide direct evidence on the basis of the research, while the secondary sources arise from studies and interpretations of primary sources.

The documentary research is characterized by the observation of phenomena to be analysed using written documents as sources. But the only written documents we are going to analyse are the legal texts, specifically the European texts, which are those that have a legal character and are source of the law and regulate the general VAT structure and the destination principle of intra-Community transactions of goods that are the carousel fraud origin.

Moving on to the determination of the regulations under study, this investigation has focused on the analysis of the following sources: First of all, the Primary sources consisting of the Treaty establishing the European Community. Secondly, the derived sources are defined as those regulatory texts approved by the Community institutions and which must be hierarchically subject to the constituent agreements, as provided for in Article 249 of the European Economic Community (old Article 189 of the EEC)[2] in the following order:

Initially, the directives which oblige the achievement of the result by the Member States, leaving each state free to achieve said result with the means and forms they determine. In our research we have studied each of the European Directives on VAT tax harmonization and we will analyse them for their relevance in subsequent paragraphs. We will analyse from the Sixth Directive 77/388/EEC of 1977, which is regarded as the "Code of Conduct for the Common VAT System" which regulated the general VAT structure to be followed by the Member States during a transitional period, the Directive 91/680/EEC which supplemented the common VAT system and amended, with a view to the abolition of borders, the sixth Directive 77/388/EEC and subsequently recast in the existing Directive 2006/112 EC governing the current common VAT system in Europe.

The second link is represented by the Regulations which are mandatory in all their elements and directly applicable to the Member States. Among all the Regulations on the VAT harmonization, we have analysed the council Regulation (EC) No. 904/2010 of 7 October on administrative cooperation and the fight against fraud which replaced the previous one and supplemented the Directive 2010/24/EU of the European Council of March 16 2010 on mutual assistance in the collection of funds relating to certain taxes, duties and other measures. Despite being a very comprehensive and innovative regulation, it has proven to be ineffective over time due of the slow transmission of tax information between the Member States and the lack of agreements between said States, to facilitate the transmission of information from national tax administrations in order to combat the carousel fraud.

It is also important to emphasize that in order to explain in a concrete and clear way the functioning of the carousel fraud, as well as how to abolish this fraud, a practical example has been used describing different intra-Community transactions of goods through a flowchart, as well as various participating companies from different member States using as a reference the general tax rate currently in force in the Spanish state, which is 21 per cent. With said example, we have been able to see the consequences of the carousel fraud on public funds and on commercial competition in the sectors where said fraud operates. Finally, we propose that, by applying the source principle for intra-Community transactions of goods, we could eradicate said problem and achieve a sound tax harmonization in Europe.

[1] Attorney General's Office of the State of Spain. Instruction 3/2007 of March 30, 2007.

[2] According to said Article*: "For the fulfillment of its mission, the European Parliament and the Council shall jointly adopt regulations and directives, take decisions, make recommendations and issue opinions, under the conditions provided for in this Treaty".*

3.0 Background and current status of the subject

The first question raised in this article is about the meaning of the term tax harmonization. While European tax harmonization involves bringing national legislations closer to a common tax legislation; fiscal unification involves the establishment of a single tax legislation in Europe, the result of the elimination of national legislations.
In the case of value-added tax in Europe, tax harmonization was aimed at establishing the same taxes in all States, but with their special characteristics, since the directives adopted gave the Member States many powers to establish their peculiarities, but following a common pattern.

The first time that the term tax harmonization appears in Europe was in the European Economic Community Treaty, hereinafter EEC, which established that the first taxes to harmonize in Europe were the Value Added Tax and excise duties, and specifically in the case of VAT in Article 95 EEC, it was stated that the principle of VAT taxation should be applied in the country of destination as established in Article 3 of the GATT. According to the principle of VAT taxation in the country of destination, the transaction must be taxed at the place of consumption, and if it is not easy to specify said place, criteria such as the domicile or permanent establishment of the consumer will be taken into account (Helm & Smith, 1989).

We can distinguish three phases in the VAT harmonization process in Europe (Sinn, 1990). The first phase covers the period from the 60s to the 80s and it starts with the Neumark Report[3], considered by most of the jurisprudence as a key element in the start of the European tax harmonization process. It also led to the adoption of the first European council Directive of April 11 1967, regarding the harmonization of the Member States laws on Sales Volume Taxes (67/227/EEC)[4] which established a consumption tax proportional to the price of goods and services without taking into account the number of transactions.

In particular, the most important contribution of the study was the establishment of a single turnover tax in the Union, which would tax the added value at each production and distribution stage, and not cascading. However, due to the wide diversity of turnover taxes in national regimes, Neumark chose the easiest solution, to establish the destination principle.

In this first phase, the European Council adopted a large number of Directives. Among them, the most important is the Sixth Directive 77/388/EEC of 1977, considered as the "Code of Conduct for the Common VAT System" and which regulates the general VAT structure to be followed by the Member States during a transitional period not later than January 1 1978 and with a view to establish a definitive regime in the future (Hans, 1990).

In the second stage, covering the period from the 80s to the 90s (Dieter & Stephen,1989), Directive 91/680/EEC was adopted which supplemented the common VAT system and amended, with a view to the abolition of borders, the sixth Directive 77/388/EEC. In particular, a Title called "XVI bis" was introduced in which the transitional taxation regime for the trade between Member States was developed extensively. In general, said regime was characterized by the establishment of the destination principle for intra-Community operations. In addition, a new taxable fact is born of this Directive: The Intra-Community acquisition of goods, which is essential so that, together with the intra-Community delivery of the goods exemption regulaztion also detailed in this directive, the carousel fraud originates, which we will later analyse.

The immediate effect of the intra-Community operations regulation resulted in a modification of the concept of the third taxable fact: imports of goods, since from that moment on the entry of goods in the European community from third countries, that is, non-member countries, shall be considered as import of goods (Fuster, 2019).

Finally, the third phase in VAT harmonization will cover from the 90s decade to the present, (Mintz, 2004) specifically we will take as a reference to mark the beginning of said period, Directive 92/77/EEC which outlined the value added tax common system and amended Directive 77/388/EEC. However, said Directive 92/77/EEC was amended and recast in the existing Directive 2006/112 EC governing the current VAT common system in Europe.
It is essential to emphasize that in this third phase the development of the previous Directives which established a deadline to establish the definitive VAT harmonization regime which has not been adopted at the moment and there is no provision to establish the definitive regime because the European Union has since 2016 paralyzed the economic and political integration process and this was aggravated to a greater extent by the health situation caused by Covid-19. Specifically, on April 7 2016, the commission presented an action plan for the modernization of the VAT system in the Union oriented at the current digital environment and which established the way for the creation of a single VAT area in the EU by applying greater flexibility to the Member States in the implementation of Reduced VAT rates, as well as short-term measures to combat the carousel fraud and proposals to simplify the VAT regulations.

In short, despite the initial commitment of the European Member States to establish a definitive VAT regime with harmonized tax rates, at this time, the transitional regime is still in place and no progress has been made on real VAT harmonization in Europe.

[3] Said report was named after Dr. Fritz Neumark (chairman of the 1960 fiscal and financial committee).

[4] In this Directive, among the general considerations of its adoption, it states that *"considering that, of the studies carried out, it appears that this harmonization must lead to the disappearance of cumulative sales tax systems, and the adoption by all member States of a common value added tax system".*

4.0 Discussion and results of the Carousel Fraud

4.1. Concept and operation

The carousel fraud is directly linked as we will see below to the three VAT fraud types which consist of tax fraud, failure to file tax returns and, finally, abuse of the VAT deduction right. In particular, the term "carousel" is due to the fact that this process involves a complex network of organizations in which goods are exchanged between companies with the same scheme that turn and turn like a carousel without reaching an end user.

We proceed to explain in detail through a case study, how the carousel fraud works represented in Figure 1, using as a VAT indicator the general tax rate of 21% currently charged in the Spanish Country.

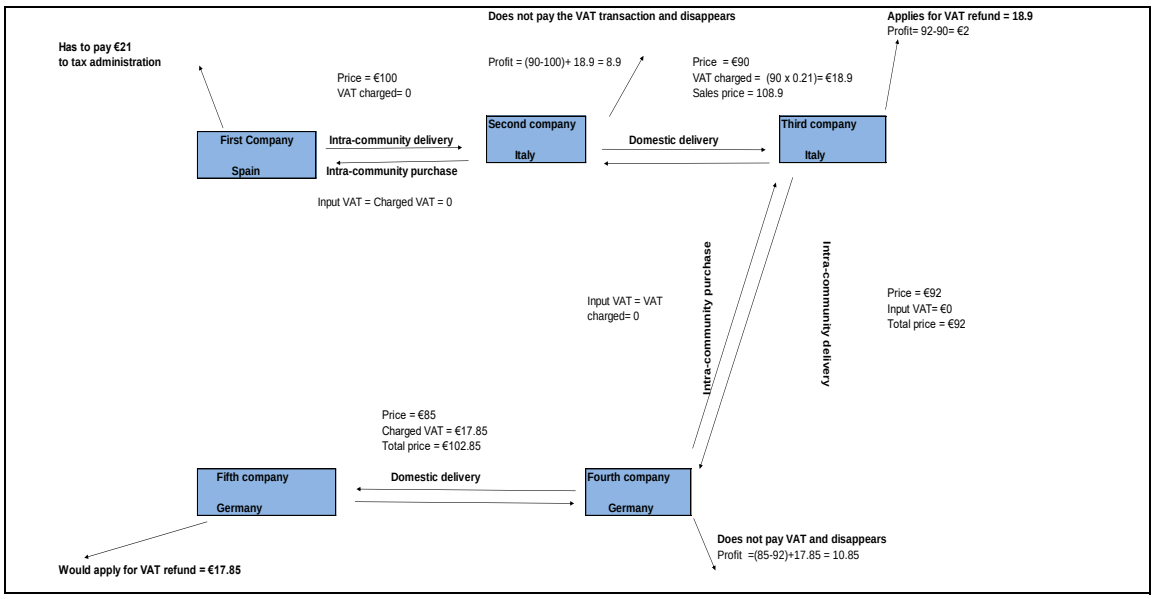

FIGURE 1: How Carousel Fraud works

Source: Author's elaboration

First, there is a first company with a tax address in Spain that sells goods to a second company based in Italy. This is an intra-Community delivery of goods which, in accordance with Article 138.1 of Directive 2006/112/EC[5], is an exempt transaction and therefore the first company should not charge VAT on the transaction or settle it with the tax authorities. In particular, as established in Figure 1, we are going to assume that the selling price of the goods before taxes on intra-Community delivery is 100 euros and since VAT should not be paid, the total selling price of the goods will be the same, that is, €100.

For the second company located in a Member State other than the first company, the purchase of goods is an intra-Community purchase of goods, which, in accordance with the second Article of Directive 2006/112/EC, is a transaction subject to VAT, since, both the person who acquires the goods and the person who delivers them are legal entities. However, since the intra-Community delivery of goods is exempt, the mechanism provided for in the law to counteract the exemption is the self-billed tax through the investment of the taxpayer[6] (The VAT taxpayer in this case is the person who acquires the goods and therefore has the obligation to settle the tax on the transaction) followed by a VAT deduction[7] which voids the tax effect and therefore the VAT paid and deducted on the transaction is voided.

Therefore, if the second company sells the product to a third company in the same Member State (Italy), it must charge VAT, since this is an domestic delivery and is subject to the corresponding VAT at the tax rate of each Member State. However, the third company also based in Italy has the right to deduct the VAT which was paid in this operation, in accordance with the provisions of Article 168 a) Directive 2006.

[5] According to Article 138.1 of the Directive: "*Member States shall exempt deliveries of goods shipped or transported, outside their respective territory, but within the Community, by the seller, by the acquirer when the following conditions are met*: a) the goods are delivered to another taxpayer, or to a legal entity not subject to tax, acting in its capacity as such in a Member State other than that in which the shipping or transport of the goods begins. b) the taxpayer, or the legal entity not subject to tax, to whom the goods are delivered is identified for VAT purposes in a Member State other than that from which the goods are being shipped or transported and has indicated its VAT identification number to the supplier".

[6] Article 200 of the Directive establishes: "The persons who make a taxable intra-Community acquisition shall be liable for VAT".

[7] According to Article 168 c): "*To the extent that the goods and services are used for the needs of their taxable operations, the taxpayer shall have the right, in the Member State in which he conducts operations, to deduct from the amount of the tax from which he is liable the following amounts: c) the VAT incurred from intra-Community purchases of goods in accordance sub-paragraph i) of point b) of paragraph 1 of Article 2*.

In particular in this case, if the second company that charged the VAT of the transaction does not pay it to the tax authorities because it is a shell company constituted to defraud the tax authorities and disappears, the process called carousel fraud is started at this time. Since, in addition, the third company will have the right to apply for a deduction of the VAT paid on the interior delivery. The immediate consequence of this is that the tax administration must return to the third company the VAT amount that the second company has not paid to the tax authorities, with a double tort for treasury, since not only it does not receive the revenue but must also refund an income that it did not receive.

For practical purposes and following the diagram in Figure 1, in the domestic delivery of the goods, the second company sells the goods at a base price of €90 and charges a VAT of €18.90 on the operation; therefore, the total price of the sale is 108.90 euros. However, since the third company will apply for a refund of this VAT from the transaction that the second company has not paid, there is a deficit in treasury of 18.90 euros and this operation will also allow the second company to obtain a sufficiently high profit to be able to establish a lower sales price than the purchase price, since it will get the full charged VAT that is not going to pay to the tax authorities. In particular, the profit amounts to 8.9 euros from the difference between the sales and purchase price, plus the charged VAT.

So far we can describe the basic fraud scheme called "acquisition or fraud". From this comes a more complex plot organized by more companies, which is what we call missing trader fraud or carousel fraud. In fact, to illustrate the full operation of the carousel fraud following from the third point of the basic fraud, it is important to introduce to the analysis the participation of two additional companies. Therefore, the third company based in Italy performs an intra-Community exempted delivery of goods to a fourth company located in Germany in accordance with the procedure described above.

The price required for intra-Community delivery shall be 92 euros and since this is an intra-Community exempt delivery it shall not be subject to VAT. In this case, the profit obtained in the operation by the third company is of 2 euros, the difference between the sales and the purchase price. This fourth German-based company delivers domestically to a fifth German company and follows the pattern of the second company by disappearing without paying the corresponding VAT to the tax authorities. Said company bills the fifth company for a lower base price than that paid by the second company (€100) and the third company (€90) since the benefit of this fourth company from the input VAT fraud will be enough to compensate for this selling price reduction.

In fact, the profit obtained by the fourth company amounts to €10.85 obtained from the sum of the unpaid VAT plus the basic selling price and subtracting the price paid in the previous intra-Community acquisition. This cycle can then be repeated and the goods can be turned and turned like a carousel, through the various Member States, which have to refund the VAT that the disappearing shell companies have not paid until it reaches the end consumer.

Following the example shown in Figure 1, in the European Union the VAT refunded from fraud abuses amounts to 36.75 euros, which corresponds to the sum of the amounts of the input VAT by the companies in their operations and that said operators have not paid to the corresponding tax authority. In fact, the amount of 36.75 euros of defrauded VAT corresponds to the sum of 18.90 euros (the VAT paid by the third company in the domestic delivery) plus 17.85 euros (the VAT paid by the fifth company in the domestic delivery).

It is important to note that regarding the form in which the carousel fraud manifests itself we find that: Firstly, by simulating goods, that is to say, fraudsters may use counterfeit goods, defective goods, goods transported in empty boxes or goods that have no added value. Secondly, through transport simulation, which means that there really is no transport, therefore, the bill of lading[8] or any other determining document, which proves that the goods have been transported and have actually left the Member State country of origin is falsified (Martinez & Martinez, 2008)

And finally, by usurping the Inter-Community Operator Number of another company that has never participated in any fraud, and that is necessary to obtain the exemption, or also to impersonate a third company to obtain an electronic signature that allows to apply for registration to exercise an economic activity.

As a direct consequence derived of this fraud we highlight on the one hand, the tax revenues high losses of treasury since the VAT that is defrauded by the shell companies is not paid to the same. However, not only this amount is not paid, but in addition fraudulent income is also obtained from the tax authorities since the taxpayer of a purchase made within a Member State has the right to apply for a refund of the VAT paid in said operation.

On the other hand, companies involved in fraud, by increasing their profits from tax fraud, can lower the cost of goods, establishing a lower selling price in the following transactions and therefore there is a distortion of competition because unfair competition is being carried out regarding other companies of the sector that do not perform this type of fraud. This leads to the displacement or elimination of law-abiding competitors and the creation of perverse economic incentives in the European common market.

[8]. A contract that accredits that the physical transport of the goods has been carried out from the Member State of origin to another Member State.

4.2 Fraud participants

The number of participants in the carousel fraud will vary depending on the times the goods are passed around before is sold to the end consumer, and the most common thing is that there are many shell companies in order to hide the links between companies in the same scheme.

In our particular case, the number of participants is five. The first participant is the inaugural company which fraudulently fails to comply with the obligations required in the Member States, including Spain[9], to operate the exemption in intra-Community operations and which consists in proving the existence of transport to another Member State, that is to say, that the goods actually leave the country and the obligation to confirm that the buyer has an operator registration number of the intra-Community and that he is in the VIES[10], since in order for the exemption to operate, the buying company must have a VAT identification number. If these requirements are not met, the exemption will not be applied, therefore, the intra-Community delivery will be subject to tax and the public authorities may require the taxpayer to declare and pay the tax.

The second participant is called "missing trader or carousel operator" and is the first company in the fraudulent chain (in the above example the second company). The main characteristics of this type of companies are that they often lack assets and structure, partners and managers are often insolvent, transactions are made in cash, they do not meet tax obligations and the life of the company is usually not longer than one year. Indeed, these are companies that do not have a business structure or do real business.

In third place, we find the figure of the Broker or Shell Company (third company), which is considered the intermediary link of the chain. On the one hand, for this company the VAT input in the purchase of goods becomes a tax credit since it has the right to deduct that VAT. And on the other hand, regarding the delivery of goods as they are exempt, there is no obligation to pay the tax. It should be noted that this company complies perfectly with the tax obligations established in the VAT regulations, however, it will try to hide the link between the shell company and the companies in the same Member State that buy the goods from them.

So far, the fraudulent behaviour of these companies is considered essential for the so-called basic fraud to exist. Fourthly, the fourth company can follow two lines of action; it may be a company that does not participate in the fraud scam, it simply makes an intra-Community acquisition of goods from the shell company, self-bills the tax and sells the goods in the internal market by declaring and paying the tax in accordance with the VAT regulations. Or it may be a company involved in the fraud, that is to say it will be considered fraudulent and therefore it is part of the scam, with the purpose to obtain profits by defrauding tax administrations. And finally, the fifth company that follows the same pattern of behaviour as the third company and is therefore a shell company or Broker.

4.3 European Commission actions to alleviate the damage caused by fraud

In 2000, the European Commission, aware of the growth of the carousel fraud that had taken place and the loss of revenue that it entailed for tax administrations, initiated a series of actions to combat this type of fraud. One of the main actions in this field is the approval of the VIES (Vat Information Exchange System) system. This is a common electronic system between Member States to exchange data and provide detailed information on all exempted intra-Community deliveries by intra-Community operators. Since when a company makes an intra-Community delivery to an operator located in another Member State it has to check in the VIES that the company acquiring the goods has an intra-Community operator number, hereinafter NOI.

However, VIES is more specifically focused on information exchange and there is no closer cooperation in the tax collection area, and since no progress has been made on tax collection cooperation and no progress either has been made in establishing the definitive VAT tax regime, mainly because the Member States do not want to lose their national sovereignty, in the interests of establishing Community rules. And here lies the fundamental problem for which that tax harmonization regarding the VAT is currently considered to be stagnant and it is not possible to root out the carousel fraud.

In fact, in 2008, the European Commission published the communication 12/2008 which sought to end the transitional tax regime by establishing a central VAT rate and a system of tax compensation between Member States in which member States would have to pay or receive from other member States a financial compensation determined on the basis of their trade balance (Moreno, 2008). However, this system was rejected by the Member States (Fuest, 2008).

In addition, another measure that has been put in place in the European Union is the so-called "derivation of responsibility". In particular, in Spain, the "derivation of joint tax liability" has been introduced in Article 87.5 of Law 37/1992 of 28 December of the value added tax. According to said article, it may be required, when it is proved that the acquirer of the goods has participated or knew of the fraud, to pay the VAT debt that the seller has not paid

[9] According to Article 25 of the Spanish VAT Law 37/1992 of 28 December, shall be exempt from tax "the deliveries of goods in Article 8 of this Law, issued or transported by the seller, by the acquirer or by a third party on behalf of any of the above, to the territory of another Member State, provided that the acquirer is: a) an employer or professional identified for value added tax purposes in a Member State other than the Kingdom of Spain. b) a legal personality who does not act as an employer or professional but is identified for tax purposes in a Member State other than the Kingdom of Spain".

[10]. "Vat Information Exchange System".

in said transaction. A measure which has provoked a great deal of controversy as being considered incompatible with Community law.

In 2010 the European Regulation 904/2010/EU was approved, regarding administrative cooperation and the fight against VAT fraud, supplementing Directive 2010/24/EU on mutual assistance for the recovery of claims relating to taxes, duties and other measures[11].

This regulation contains a number of very important measures, such as: to reduce the time for the provision of information regarding intra-Community operations, to establish in the Union countries common requirements for the entry and exit of VIES registers, to obtain confirmation of the validity or invalidity of the identification numbers for VAT purposes and the creation of a "EUROFISC" information system, which consists of a decentralized information network that allows Member States to exchange rapid and selective information to combat VAT fraud and to absorb the cooperation mechanisms from their background (Nicodème, 2007).

Finally, it should be noted that on 7 April 2016 the Commission presented an action plan for the modernization of the VAT system in the European Union, establishing guidelines to harmonize VAT types in the Member States, improve digital tax information systems and strengthen the capacity of public administrations to prevent the emergence of shell companies involved in the carousel fraud, but without taking a firmer step in the establishment of the definitive Community VAT system.

Although the European authorities presented all these measures as great solutions to eliminate the carousel fraud, in general terms, they have largely failed because tax databases and information systems in Europe are not sufficiently developed to transmit information in a fast manner. Thus, the exchange of tax information and mutual assistance between Member States has not been as effective and efficient as expected.

4.4. Carousel fraud solution

It is important to note that, over the years the European Commission has analysed a number of measures to be implemented to combat the carousel fraud, without taking a further step in establishing the definitive VAT regime. In particular, these are measures that we can group into the following categories (Gonzalez, 2008):

The first group refers to measures to improve mutual assistance between the States of the Union in order to prevent fraudsters from acting in the risk sectors. The purpose of the measure was to create a preventive effect that would give the taxpayer the impression that the tax administration controlled all kinds of information about intra-Community transactions and that it could at any time initiate investigations and control against the taxpayer's operations.

Secondly, we find measures for the early detection of fraud, the purpose of which was to have all kinds of tax information to prevent the occurrence of the carousel fraud, by studying the information collected from the European tax administrations databases and other sources of information, in order to detect future frauds of companies that had previously committed an offense against the tax administrations.

Thirdly, the measures to combat and expel fraudsters once the companies that are part of the fraud scheme have been detected. To this end, it was necessary to establish a protocol of repressive actions by the National Fraud Prevention Offices so that measures could be taken to bring the scam to an end quickly, as well as, collaborative actions with the Prosecutor's Office and the judiciary once the fraud has been discovered and not allow said offenders to continue to carry out said activities.

In addition, we find that the measures aimed at recovering the defrauded taxes because, even if the fraud were detected and regularizations were carried out, none of the fraudsters would be able to pay the tax, so the recovery of the same is considered practically impossible. One of these measures was the introduction of an assumption of joint liability for buyers of goods from companies related to organized schemes.

Fifthly, it was considered essential to establish a national and intra-Community communication of the strategy to be followed in the European Union regarding the type of fraud to be combated and the anti-fraud policy to be carried out by the tax administrations.

Although all these measures could combat the carousel fraud, they have been clearly unproductive because all the databases and information systems between the European Member States are not sufficiently developed to transmit information in a fast manner. In this respect, the tax administrations of the Member States have serious difficulties in detecting false intra-Community transactions with false NOIs, and in most cases it cannot prevent a network of companies from acting more than once in different sectors. Additionally, other measures such as the derivation of joint liability have been ruled out because they could lead to an alteration in the normal functioning of the market.

In view of the efforts made by the European union to combat the carousel fraud that have proved unsuccessful, it is clear that the only reliable solution to eliminate the carousel fraud, is the solid establishment of the

[11] Article 1 of this Directive provides that '*This Directive lays down the rules under which the Member States are to provide assistance for the recovery in a Member State of any claims referred to in Article 2 which arise in another Member State*". Article 4 provides that "*The competent authority shall designate a central liaison office which shall have principal responsibility for contacts with other Member States in the field of mutual assistance covered by this Directive'.*

definitive tax regime once put forward by the European Commission in Directive 1977 and which has not yet been implemented today. This is a system that has as its primary element the destination principle in intra-Community operations, which would eliminate this fraud because the goods would not leave the country of origin without declaring to the tax administration the corresponding tax.

It has not been possible to establish this definitive VAT regime so far, because the Member States have not been able to agree on common rules allowing the basic actions to be taken for the adoption of this system, mainly due to the reluctance of the States to increase collaboration and cooperation between them so that the European Union is not given more power in meddling in the sovereignty of their national policies.

We currently have a mixed VAT system. On the one hand, the domestic operations which are taxed in the country from which the goods are shipped (origin) and not where they are consumed, and on the other hand the intra-Community operations which do so at destination: the intra-community deliveries of goods that are exempt and intra-community purchases of goods, in which, in reality, the investment of the taxpayer takes place.

In this sense, the delivery of goods made domestically are subject to tax in the Member State of origin, while intra-Community deliveries have the obligation to declare and pay the tax outside the Member State of origin. Thus, in intra-Community deliveries of goods, these leave the country of origin without having paid the VAT.

The deficiencies of the transitional regime which are, among other things, the complexity of the rules for locating taxable facts and the obsolescence of the adopted Directives, highlight the need to change to the definitive regime which was originally proposed and which has not yet been adopted. The definitive regime intends to introduce the country-of-origin principle, which harmonizes VAT rates (De la fiera, 2015) to avoid harming the European economic competition allocating revenues to the Member State of consumption.

With this definitive regime, intra-Community operations shall be taxed in the Member State of origin and shall therefore have the same tax regime as domestic operations carried out within the same Member State. However, it is essential to harmonize the VAT rates in the Member States, since in the event that there are different VAT rates in each Member state, trade will be diverted to the countries where the tax rate is lower.

In Figure 2, we will explicitly analyse the functioning of the definitive VAT regime by applying the country-of-origin principle, using the same harmonized VAT rate of 21%. We will use the same sales operations and companies in Figure 1, with the fundamental objective of demonstrating how such a system would eradicate the carousel fraud.

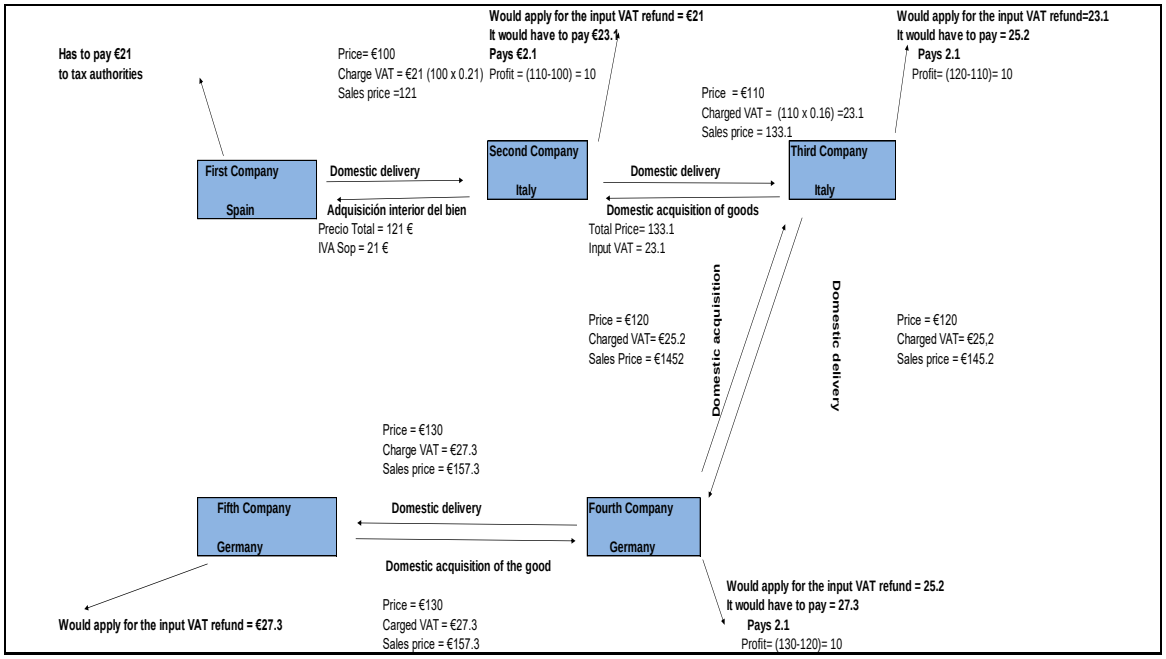

FIGURE 2. Definitive tax regime operation

Source: Author's elaboration

Under this definitive regime, intra-Community operations between the Member States would function as domestic deliveries between a single Member State, with the same harmonized VAT rate.

As we see in Figure 2, with the country-of-origin principle, the first company based in Spain will sell goods to the second Italian company for a sales price that includes the VAT output, thus bringing the total selling price to 121 euros. This operation will no longer be an intra-Community delivery, but it will be a domestic delivery. Therefore, this is not an exempt transaction and the first company will have to charge and pay to the tax administration the VAT output of the transaction (21 euros), the second company being able to deduct the input VAT. The difference between figure 1 and 2 is that the goods have left Spain with the tax paid and the second

company that has paid the input VAT in the transaction cannot disappear with the VAT of the transaction and therefore the carousel fraud cannot occur.

Then, the second company will make a sale within the same Member State, in this case Italy, to a third company with a base price of 110 euros plus the corresponding VAT. This is a base price slightly higher than the previous transaction, because of the added value that the second company has introduced into the goods. Adding to this price the VAT paid on the transaction (€23.1), the total price paid by the third company will be €133.1.

In this case, the second company will have to pay the tax administration 23.1 euros paid in the operation and will also have to request the refund of the input VAT from the previous operation (€21). In short, the final result to be paid to the tax administration will be €2.1 (the difference between what it has to pay and the refund right), being its business profit on such a transaction €10 (base price paid on the domestic purchase minus the base selling price on the delivery of the good). In fact, since fraud is not possible, and since if the second company does not pay the output VAT, it will not be able to obtain the refund of the input VAT of the previous operation, said company cannot reduce the sales price, because if it does, it will not obtain positive benefits, thus, not damaging the competition within the sector.

Continuing with the third operation in Figure 2, the Italian company which will make a sale to a fourth company based in Germany for a sales price of 145.2 euros will have to ask for the refund of the input VAT (€23.1) from the previous transaction and on the other hand, it must pay the output VAT of this transaction (€25.2). In compensating said amounts, the third company will have to pay the tax administration an amount of 2.1 euros.

Therefore, the third company will obtain a net profit of €10 from the operations of purchase and sale of goods. Regarding the fourth transaction, the fourth company makes a sale to a fifth company located in the same Member State (Germany) for a base amount of €130 plus the VAT output (27.3), i.e. a sales price of €157.3. Said company must also apply for the refund of the input VAT from the previous transaction (€25.2) and pay the VAT output on the sale which will be €27.3. Thus, when these amounts are offset, the result will be the fourth company paying the tax authorities €2.1. The profit obtained by the fourth company in this operation will be €10.

Finally, the fifth company will deliver internally between Member States, which we are not going to see in this example, but it will have to apply for the VAT input from the previous operation amounting to €27,3. It is important to point out that it has been intended to demonstrate, by analysing this practical scenario, that the establishment of the definitive VAT regime with the country-of-origin principle is considered key to eradicate the carousel fraud and its consequences, basically for two reasons.

Firstly, the tax administration will receive the VAT from the previous transactions without any fraud because companies will have to declare said tax to the tax authorities if they want to be entitled to its deduction later. And secondly, it will not be possible to alter the normal functioning of the sector through unfair competition because the fraudsters companies of tax authorities cannot reduce prices and displace the companies that fulfil their obligations, because if they reduce prices, they will not obtain positive benefits as it happened in the carousel fraud.

5.0 Conclusions

As we have seen, the European tax harmonization process regarding the VAT, it started with the European Directive 2006/112 EC which introduced the transitional tax system regulation for trade between Member States, characterized by the establishment of the destination principle, with a view to the establishment of a definitive regime afterward and which caused the birth of a new taxable fact, the intra-Community acquisition of goods.

The disproportionate use of the exemption from intra-Community deliveries of goods and the establishment of the destination principle which allows goods to leave the country of origin without taxation, gave birth to the so-called carousel fraud whose name refers to the fact that goods are being exchanged between companies of the same network that turn and turn like a carousel defrauding tax administrations before reaching an end user.

In particular, the carousel fraud occurs in intra-Community goods transactions, when a network of companies, the company acquiring the imported product from an intra-Community country self-bill the amount that would correspond to said product, so that it can be deducted simultaneously (in practice, it will not pay anything to the tax authorities). However, in the successive domestic deliveries of said goods, within a single Member State if VAT is charged, and the shell company keeps the VAT output without paying it to the corresponding tax authorities, giving the next acquirer the right to deduct the VAT that was not paid.

The consequences of the carousel fraud are, on the one hand, the loss of revenue of the tax administrations and, on the other hand, the distortion of competition between companies of the same sector, since the defrauding companies can sell the goods at a lower price, by appropriating the VAT that they do not pay to the tax administrations, and having an undue advantage over companies that meet their tax obligations

It should be noted that there has been significant progress in the fight against the carousel fraud based on administrative cooperation between Member States. The most important measures include the creation of VIES and the Regulation (EC) No. 904/2010 of the Council 7 October, on administrative cooperation and the fight against fraud.

However, despite these advances, they all have proved inadequate because the information systems are not properly developed and are not effective in providing immediate information between the tax administrations of the Member States.

The solution to eliminate the carousel fraud is the establishment in the European Union of the definitive VAT regime, with the country-of-origin principle and harmonized tax rates, so that goods do not leave the country without paying the tax, allowing to eliminate tax differences between domestic and intra-community operations.

It is therefore demonstrated in this research paper that, if the definitive VAT regime is established in the European Union, Companies would pay the VAT output in their intra-Community operations and then apply for said deduction and could not set lower prices on sales because they would not make any profits. Similarly, the elimination of the carousel fraud would allow the development of free competition in the European internal market and the strengthening of public revenue. An European tax harmonization must put the Community interest first over the national interest of the Member States.

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