VAT fraud prevention in EU

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INTRODUCTION

Over time, the illegal VAT refund from the budget has started to attract the attention of tax administrators, thus becoming quite a risky way of making money. However, there was a surge of popularity in less risky VAT avoidance schemes that are based on the misuse of the right to deduct VAT. The contents of frequent indictments and court verdicts show that, when qualifying one or another VAT tax fraud scheme as fraudulent activity, there is confusion on which specific fraud feature meets the contents of such a scheme. Meanwhile, such inaccuracies can determine the complete failure of the court case or significantly lengthen the process. In addition to the most important aspects, according to the specifics of the case, it may be necessary to justify other nuances that are significant for proper classification of offences, for example, that the fraudulent activity was completed or stopped in the preparation/attempt stage; that there was participation of accomplices and which circumstances show that one or another accomplice realized his involvement in a VAT fraud scheme; that all episodes are evaluated as one continuous fraud or vice versa – as several separate frauds. Due to the fact that several institutions are often involved in different stages of the fraud research, it is difficult to properly collect all the evidence. Due to the fact that VAT fraud cases often end quite favourably for VAT embezzlers, the number of VAT frauds, as shown by research, is not decreasing. In addition, professional auditors who carry out private company, mandatory or other chartered audits often do not cooperate with tax administrators after noticing the beginnings of VAT frauds or if they have any suspicions, thus enabling to continue such frauds further and increasing their amount. Absence of a unified and integrated system complicates the identification, proof, etc. of VAT frauds. It can be stated that there is an entire line of fields which must be smoothly coordinated with each other in order to prevent VAT embezzlement in EU. We believe that these fields should be coordinated by a single centre. This centre should coordinate VAT audit on EU level, as well as provide suggestions and recommendations regarding which specific fields of activity are in which companies and how should they be checked in order to achieve the implementation of the desired objectives. In order to systematically overview all possible fields for improvement to prevent VAT frauds, it is appropriate to form a map which would reflect all the acting persons and interactions between them (see Figure 1).

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Transactions between business entities (marked as Business 1 and business2) is the main field on which all efforts are focused to prevent VAT embezzlement. The risk that a transaction is carried out in order to embezzle VAT appears only in this field. It goes without saying that, in cases when transactions are not carried out between business entities, the risk of VAT embezzlement is equal to zero, since the embezzlement object itself simply does not appear. In order to prevent VAT embezzlement, it is appropriate to determine potentially risky types of transactions carried out by companies (business entities) and fields of activity in which the companies (business entities) operate and which are included in the risk zone, and the latter risk zone has a potential threat that the transaction is carried out with the aim to embezzle VAT. An analysis was carried out and revealed that a number of consistent and mutually coordinated actions must be carried out in order to prevent VAT embezzlement. The actions include prevention, capturing, recovering losses and coordination of activities.

**Figure 1.** Flowcharts of acting persons and their reciprocity in the field of VAT prevention

**Figure 2.** Mutually coordinated actions
It should be pointed out that VAT prevention includes both the creation of an atmosphere of intolerance in society and the creation of a legal environment preventing VAT embezzlement opportunities on EU level and on local state level. Whereas capturing is understood as determination of the VAT embezzlement fact which clearly indicates that preventative measures did not fully reach their aim. EU only provides recommendations in the existing system, due to the intensified efforts to combat VAT fraud by the governments, the cause effect an increase of tax authority scrutiny, to re-evaluate the prioritization of VAT overall and set up the right detection controls to manage VAT risks. Thus, VAT fraud identification and capturing is the responsibility of each country, and the worst part of this is the lack of a common unified system in this field. This results in the waste of a lot of funds when the work of certain institutions overlap. Currently, there is still a practice in nearly all Member States when tax inspection and criminal investigation institutions investigate VAT frauds. This results in a rather sharp controversial issue of what costs more – the fraud investigations or the losses caused by the fraud itself. Thus, in order to achieve a more efficient fraud prevention model, suggestions are made to not only centralize the system, but to also include certain institutions in it, for example, auditors who could serve as a supporting element. Hence, National Audit Organizations and individual auditors or audit firms could help determine cases of VAT embezzlement. Considering the fact that a fairly large problem exists in the field of VAT frauds, which requires changes both in legal as well as in cooperation fields, legislative adjustments as well as communication guidelines and possibilities between auditors and public institutions must be provided. So far, in the current stage, audit firms do not have sufficient authorizations to demand additional data in order to determine VAT embezzlement. In addition, this is not even the direct aim of their carried out work. Within the limits of their competence, audit firms can detect signs of attempts to embezzle VAT with the help of certain transactions. Currently, audit firms are in no way obliged to inform about their suspicions or carry out a more detailed investigation independently. It is likely that, using a certain risk approach, auditors could be obliged to perform additional procedures in companies that carry out certain activities and, as a result, additional signs may be determined indicating that VAT embezzlement is carried out as an outcome of specific transactions. After determining these signs, audit firms could be obliged under mandatory procedures to provide information to relevant institutions which would then be able to start an investigation within the limits of their competence on the basis of the received data. In order for such cooperation to become mandatory, member state audit firm associations that have the necessary powers, should request auditors to carry out certain procedures when performing an audit. It is likely that a requirement should be formed that, in cases when there are signs of VAT embezzlement, information would be transferred to relevant institutions under mandatory procedures, which would then make a decision to begin a more thorough investigation within the limits of their competence. For this purpose, a list of signs indicating an increase in the risk of VAT embezzlement should be prepared, which the auditors would have to use during audit performance and during audit planning. A questionnaire would also have to be prepared, which the auditors would have to fill if any signs are found indicating an increase in the risk of VAT embezzlement. The importance of cooperation between different state institutions should be noted, since VAT embezzlement is most often carried out with the help of companies of different countries and transactions between them, however, the lack of top to bottom approach continues to allow the existence of VAT frauds. Thus, it would be appropriate to systematically organize the cooperation links between separate
state institutions that are able to disclose the facts of VAT embezzlement. Cooperation between tax and criminal investigation institutions of different countries usually occurs in the exchange of information on unreliable companies and suspicious transactions. This is a very important element of the VAT embezzlement fact determination mechanism, without which the determination of VAT embezzlement on an international level would become practically impossible. Efforts to organize such a systematic link between auditors of separate different countries during the execution of a joint audit should be noted separately. The concept and standards of a joint audit were formulated in the sixth meeting of the OECD Forum of Tax Administration in Istanbul, September 2010. This approach was developed through a pilot project “joint audits” DE-NL 2014 and could be one of the possible examples of proper cooperation between auditors from different countries. As shown in the Figure 1, in the field of VAT embezzlement, systematic cooperation between auditors, tax inspections and criminal investigation institutions in countries is practically non-existent, since no mandatory provisions are formulated for such cooperation. Separate cooperation facts are more related to the expressions of goodwill instead of mandatory provisions. And this is where the main issue occurs – no external institutions, such as auditors operating in the private sector, are used in order to reveal VAT frauds. It terms of loss recovery, first it is necessary to note that the application of sanctions and liability for VAT embezzlement is related only to institutions which were given the legal power to carry out such actions. As stated previously, in Member States, these institutions are usually tax inspection and criminal investigation institutions. In the event of the compensation of losses incurred due to VAT embezzlement, an issue may be addressed on how effective is the work of these institutions and in what scope are the incurred losses compensated to state budgets. During the investigation, an issue may be addressed on whether the VAT embezzlement determination price is too high along with the recovered amounts returned to the state budget. In other words, it remains unclear whether the efforts made in order to determine cases of VAT embezzlement pay off, compared to the sizes of recovered fines and other penalties. On the other hand, the question remains whether the economic efficiency (return) approach can be applied to VAT embezzlement. There is also an idea as a counterargument to such an approach that future VAT embezzlement is prevented after unreliable market participants are determined, i.e. in a sense, post factum determination of VAT embezzlement becomes a preventive measure for future VAT embezzlement. It is likely that additional discussions and investigations in order to define whether effectiveness measurements are applied to VAT embezzlement prevention and, if so, what should they be – would be meaningful in terms of the entire discussed process. This research project, to a certain degree, aims at improving the cooperation between the coordinators of ITAS (smart tax administration system) and auditors from the private sector with the aim to facilitate the European Union VAT fraud identification process. Insight is to be provided into: the effectiveness of the present VAT control system; ITAS vision; cooperation plan between ITAS coordinators and private sector auditors.
CURRENT SITUATION IN CLOSER COOPERATION WITH THE AIM OF VAT FRAUD PREVENTION

VAT fraud is one of the most widespread types of fraud regarding taxes in the European Union and receives benefits from indirect nature of VAT. The taxpayer does not pay his VAT or claims a debt to the administration which is not actually due. Representatives of Europol estimated that organised crime groups cause losses of reserve estimated at 40-60 billion euro of the annual VAT revenue losses of EU Member States. 2 % of these crime groups reprecert 80% of the missing trader intra-community (MTIC) fraud. VAT represents approximately 20% of the total tax revenue of EU Member States, as well as around 12% of the total budget of EU.

Figure 3. Share of VAT in the tax revenue of EU countries and in the budget of the EU.
These fraud figures are causing a lot of concern, thus the VAT gap must be reduced.

No integrated policy or strategy exists at EU level regarding the investigation and prosecution of fraud. Law enforcement and judicial authorities often work independently and many times they fail to involve all the Member States that are affected. Other fraud cases do not require specific cooperation between the countries in Europe, however VAT fraud does require this, particularly intra-community VAT fraud. VAT fraud can be considered an issue that is specific to all the European countries because of the exemption of VAT on the intra-community supply of goods which has formed new patterns of fraud. Therefore, the current priority of EU countries is the fight against intra-community VAT fraud, as well as more extensive cooperation between EU Member States in this area. A report with the title “Tackling intra-Community VAT fraud: More action needed” was published by the European Court of Auditors of the European Union in 2015. This report states the regrets of the Court that there is lack of comparable data and indicators on intra-Community VAT fraud, however this should be partially resolved in a report which was prepared and published in March of 2016 by the Fiscalis Tax Gap Project Group. This report includes an introduction to the methodologies which are currently applied in each country in order to estimate tax gaps, while its main focus is the estimation of VAT gaps.

Regarding information exchanged electronically upon request, with such an exchange being already implemented between the Member States, a survey was carried out by the Court which then established that this procedure was a useful tool. However, 41% of the answers were late in 2013, even though Member States answered to the received requests. Efforts should be made to reduce such delays. Concerning information exchange without a request in advance (e.g., if there is a suspicion of VAT fraud), the performance indicators established by the Commission showed a 10% increase of exchanges in 2013. In terms of bilateral controls (i.e. simultaneous controls of a trader’s tax liability in two or more Member States), even in cases when they are considered to be more efficient than the controls performed by only one Member State, the survey revealed that this form is not fully used and their use is actually decreasing (52 in 2011, 42 in 2012 and only 33 in 2013). As noted by the European Court of Auditors of the European Union, such coordinated controls are particularly slow (most of these controls are not completed within the planned 1-year period), which might explain the fact that they are not used as they could be. The Court also criticized the functioning of the Eurofisc network which collects fraud signals from certain Member States and distributes the collected data to other Member States. Firstly, fraud signal processing and upload is a process that is currently too cumbersome (is long, includes rudimentary information on excel sheets, etc.). Secondly, separate risk analyses are carried out by each Member State without using any common criteria. There is also no feedback regarding the usefulness of the shared data (e.g., no feedback is provided for the non-dubious traders), therefore improvements cannot be made for these fraud signals. Furthermore, OLAF has no access to Eurofisc data. The Court expressed recommendations to implement a common risk analysis, set up the provision of feedback and provide OLAF with access to Eurofisc data. The Court expressed recommendations to implement a common risk analysis, set up the provision of feedback and provide OLAF with access to Eurofisc data. And finally, due to the fact that there is a need of efficient cooperation between the administrative, judicial and law enforcement authorities at a national and international level, suggestions were made by the Court to include VAT fraud within the scope of the directive on the fight against tax fraud to the EU Fi-
nancial Interests by means of criminal law and in the European Public Prosecutor’s Office (EPPO) regulation. This would result in considering VAT fraud to be a threat to the financial interests of the European Union. Both the European Parliament and the Commission are willing to consider VAT fraud as such, however this is strictly opposed by the Council which considers this to be a matter of national sovereignty. The Court of Justice of the European Union (CJEU) could have solved this debate, since, in its two recent decisions, the Court considered that VAT fraud did have an effect on the EU financial interests. Considering the fact that VAT fraud is a threat to the financial interests of the European Union, this could increase cooperation and improve the fight against VAT fraud. In the future, this would increase the competence of EPPO and enable it to help prosecute VAT frauds.

As shown by discussion results during training sessions, the largest issue in the fight against VAT fraud is fast and efficient exchange of information between Member States and relevant supervisory authorities such as EUROPOL, OLAF and similar.

Thus, three main disadvantages were distinguished in the exchange of information between EU Member States in the VAT field:

- Information stored in the VIES system is not always reliable or available when necessary;
- Information is not sufficiently updated due to the fact that procedures provided in EU legislation are not effective enough;
- Exchange of information on questionable transactions between EU suppliers is not sufficiently fast or intensive.

The current data exchange scheme is not effective and the entire chain is not visible “from above”, therefore it is rather difficult to identify frauds quickly (see Fig. 2).

![Diagram](image.png)

**Figure 4.** Ranking of administrative cooperation tools regarding speed and level of detail of the speed of information (source: European Court of Auditors, 2015)
“Administrative cooperation - Council Directive 2011/16/EU of 15 February 2011” on administrative cooperation in the field of taxation establishes a framework for organizing the administrative exchange of tax information between EU Member States. This directive forms an automatic mandatory exchange of information between the European countries which mainly concerns every type of income and capital held by taxpayers in EU Member States other than their country of residence. As a result, a wide tax range is targeted - from VAT to savings taxation. Throughout the years, this program of information exchange has been extended in order to integrate a large number of income and capital categories.

“Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU” regarding the mandatory automatic exchange of information in the taxation field improves the administrative cooperation established by the Council Directive. States that conditions in order for information to be shared, was eliminated by the 2014 Directive. The 2014 Directive also eliminates thresholds that should not be overtaken in order to avoid mandatory information exchange between EU Member States.

Tax authorities must establish systems for estimating VAT fraud in order to be able to fight effectively against it. They must set operational targets to reduce it. Quantifying and analysing VAT fraud together with the Member States is a common approach. The current information exchange situation is sufficient, however, it can be greater, as well as faster. It should be noted that, currently, there are two types of information exchanges using standard forms: Information exchange on request and information exchange without prior request. The requested information must be provided by Member State authorities as quickly as possible, but no later than 3 months from the date the request was received. The time limit is reduced to a maximum period of 1 month if the requested authority already has this information. Nevertheless, reply timeliness was unsatisfactory. Statistics were submitted to the Commission by EU Member States and reveal that,

Furthermore, six Member States submitted late replies more than 50% of the time. An analysis was carried out regarding the number of requests received by each Member State and shows that such delays were not in all cases proportionate to the workload caused by the amount of requests.

An electronic system (VIES) was implemented by the EU, under which information on traders registered for VAT purposes and on intra-Community supplies is exchanged among EU Member States. Information is stored and processed by each Member State, and collected from the statements that are submitted via intra-community suppliers within its area. Immediate and direct access to this information must be available to
other Member States. A comparison can be made of this information and ICA value declared on VAT regular returns. The assurance and quality of information included in VIES is the responsibility of each Member State which should implement procedures for checking data following the assessment of risks. Such checks should be mainly carried out prior to the issue of identification numbers for the purposes of VAT, when only preliminary checks are carried out prior to such identification, no later than 6 months from this identification.

VIES is considered to be a particularly useful data exchange tool for exchanging information on intra-Community supplies between Member States. Nevertheless, its use by Member States also has its weaknesses which can occasionally influence the accuracy, completeness, reliability and timeliness of VIES data, as well as its effectiveness in dealing with fraud. However, it should be noted that Member States do not have all the data on their operating business units. For example, Lithuania, as most EU Member States, does not have a smart tax administration system, therefore detailed information on specific business units, their trade chains, etc. is not available, while the existing information is limited only to declarations and statistical reports. An approach and investigation “from the top” having all the information is very necessary. Only a smart tax administration system including the information of all taxpayers of EU Member States without any exceptions will enable to promptly track down fraud. Discussions revealed that taxpayers are becoming more cunning and are carrying out long-chain frauds on an international level, which are quite hard to track down promptly when not all the information from other Member States is received. It is necessary to point out that neither Europol nor OLAF has access to Eurofisc data. In order to deny such access, Member States invoke Articles 35 and 55 of Regulation No. 904/2010, as well as the national tax secrecy rules. The exchange of data is applied in Eurofisc Working Fields 1-3, however, this is not the case for Eurofisc Working Field 4 - a fraud observatory where fraud trends are watched. Although there is no data exchange, access to this information is not given to Europol and OLAF, including access to VIES.

It should be noted that works are being carried out to solve this issue, thus resulting in the development of Eurofisc - a decentralized network of representatives of the tax and customs administration of EU Member States. The aim of this network is to organize exchanges of targeted and precise information on suspicious companies, as well as transactions that could be found guilty of VAT fraud. The European Commission provides Eurofisc with technical and logistical support. On one hand, VAT Information Exchange System in the European Union enables companies to check the VAT status of their customers established in another EU Member State. On the other hand, it provides information to tax authorities of the Member State of destination regarding the identity of customers receiving goods and services from suppliers that are established in another EU Member State. EU Member State tax authorities also have other channels besides VIES for sharing information related to VAT on a confidential basis, as well as obtaining customer information regarding their businesses that collect and remit VAT. Based on this context, in cases of suspected fraud, a network is formed by Eurofisc for the swift exchange of targeted information through designated Eurofisc liaison officials. However, the commission does not participate in Eurofisc activities on a daily basis and does not have access to the exchanged information. To achieve a continuous improvement of the quality of the exchanged information, the Member State receiving information on a possible fraudulent company must provide the Member State from
which information is received some feedbacks and a follow-up in order to be able to confirm or disprove the suspicion. A survey of the European Court of Auditors revealed that Eurofisc is considered to be an effective early warning system for the prevention of fraud by 27 Member States. However, the following weaknesses confirmed by the audit tests in Member States were still pointed out: (i) feedback was not provided frequently enough; (ii) the exchanged of data was not sufficiently targeted in all cases; (iii) not all of the Member States participate in all working fields of Eurofisc; (iv) information exchange is not user friendly; and (v) the exchange of data is too slow. Another significant obstacle in the exchange of information is a rather large number of tax administrators and other supervisory bodies. It should be noted that they do not have a unified information system even within a Member State, therefore it is rather difficult to talk about iTAS on an EU-wide basis. Main tax administrator and customs exist in most Member States. Some Member States also have several tax administrators that administrate payroll taxes, health insurance taxes, etc. Finland has a special tax inspection unit which specializes in tax fraud and cooperates closely with the police, customs, as well as other relevant authorities. In Greece, unannounced spot checks for the investigation and detection of tax fraud, including VAT offences, are carried out by a special body of tax inspectors of the Body for Prosecution of Financial (Economic) Crime (SDOE). Finally, in Ireland and the UK there are specialist investigation branches in separate units dedicated to in-depth investigations and the prosecution of VAT fraud. Besides administrative cooperation when trying to prevent fraud, cooperation can also occur between law enforcement agencies within a Member State, and judicial cooperation can occur between Member States. There were a number of conventions that focused on interstate cooperation in the judicial area. However, there is no specific convention on the fight against fraud in the area. Contrarily, because of fiscal crime exceptions, current conventions often hinder intra-Community cooperation in cases of fraud. Even though there are treaties providing mutual cooperation in house-searches and seizures, in cases of fiscal offenses such as VAT frauds, governments are not obliged to cooperate and are often prevented from cooperation. Therefore, EU Member States are faced with a rather difficult challenge. They must achieve international cooperation in their fight against VAT fraud, as well as fight this battle on the domestic front.
INSIGHTS AND PROBLEMS IN VAT LAW

Calculation of import taxes (import VAT) in Lithuania and the EU: customs value as a tax base

Under the Law on Tax Administration (2004), hereinafter - Law on Tax Administration; Article 15, para. 2), the customs authorities are responsible for the administration of import taxes, in particular, customs duties. Article 13 (para. 1 and 2) of the Law on Tax Administration also states that other tax charges (import VAT and excise duties, in case if the importation of goods is related to the occurrence of a customs debt) are also administered by the customs authorities, to such an extent that the customs authorities are entitled to charge them under the Law on VAT of the Republic of Lithuania (2002) and the Law on Excises of the Republic of Lithuania (2010). In the process of administering the customs duties and other import taxes, mentioned in the Article 13 of the Law on Tax Administration, the customs authorities are considered as the tax administrator, therefore all the tax authority’s rights and obligations (Articles 32-33 of the Law on Tax Administration) are assigned particularly to them. The Customs Department under the Ministry of Finance of the Republic of Lithuania is considered as the central tax administrator, and the regional customs authorities (regional customs) as well as special customs institutions (when their local regulations foresee functions which are related to the execution of tax administration) are considered as the local tax authorities. Therefore, Lithuanian customs authorities are responsible for the correct calculation of import taxes which fall within their competence, i.e. registration of the debt to the budget, accounting, collection, control and transfer to the treasury of the state and the budget of the EU. Thus, Lithuanian customs authorities play an important role in combating import taxes and import VAT fraud (fraudulent taxation of imports to the EU).

In order to investigate practical problems of the fight against import taxes (import VAT) fraud, we must note that first and foremost the element for the calculation of import taxes is the taxable value. This is the most important factor for the correct calculation of import customs duties: in 99 percent of cases, industrial goods imported to
the EU are subject to an ad valorem customs duty rate. In such cases, the taxable value of the ad valorem customs duty is considered as the customs value of imported goods and treated as the main factor of taxation. Calculation of customs duties is also closely related to the institute of customs origin of imported goods (legal regulations which define the determination of a certain country, considered as the country of customs origin). In this regard, it is important to note that the reduced or zero import customs duties under the preferential trade agreements between the EU and the third countries apply only to products which have the customs origin of the contracting parties. Therefore, the proper application of the rules on customs origin, the proper issuance and control of the documents which are used to justify the preferential origin of goods is also considered as another important factor for the fight against import taxes (in particular - customs duties) fraud. The relevance of these factors is manifested by the fact that the international trade operators mainly try to reduce import taxes according to these particular elements (such as artificially minimizing the customs value of imported goods or covering up the country of origin). On the other hand, customs authorities calculate the main part of import tax fees by carrying out additional checks on the import declarations on the basis of these above-mentioned criteria (by investigating the determination of the customs value and customs origin).

In order to examine the specificity of the problems of import VAT fraud, it is important to mention that the import VAT bears all the main characteristics of import taxes. The Law on VAT (2002), which was adopted on the basis of “The Council Directive 2006/112/ EC of 28 November 2006” on the common system of value added tax (2006), defines that the object of the import VAT is the importation of goods when the goods are considered imported within the territory of the country in accordance with the provisions of this Law and are not exempt from VAT (Article 3, para. 3). The import of goods is firstly defined as the entry of non-EU goods into the territory of the EU or the actions that caused their entry, and, secondly, entry of EU goods into the territory of the EU from third territories or actions that caused their entry (Article 2, para. 24). A particularly important link between the import VAT and other import taxes (customs duties) is observed by analyzing the definition of the importer of goods. Under the Law on VAT (2002), the importer of goods is defined as a person who imports the goods in the territory of the country and who is obliged to pay customs debt to the customs authorities for the goods imported to the territory of the country or to pay the import customs debt to the customs authorities in case the imported goods are subject to the import customs duties, agricultural and other charges (Article 2, para. 25).

This way, the calculation of the import VAT is linked to the occurrence of a customs debt and taxation of imported goods by customs duties. This aspect is very important as the Law on VAT establishes the rule (Article 15, para. 15) that the taxable value of the imported goods, from which the import VAT is calculated, is accounted on the basis of the customs value, determined in accordance with the Union Customs Code of the EU which was adopted on 9 October 2013 as Regulation (EU) No 952/2013 of the European Parliament and of the Council (2013) (hereinafter - the Union Customs Code) and the EU legislation which regulates its application. Other sums may also be additionally added to the value of the imported goods, such as the sums which are not included into the customs value: customs duties, taxes and other charges paid for the goods (both in the EU and the third countries, excluding the VAT itself), costs associated with the transportation of goods, their insurance, commissions paid or payable for the representation, the value of goods packaging services, if all the given costs are associated with the
transportation of goods up to their first destination in the country. The taxable value of the import VAT may also be increased by the value of the services (transportation, insurance, representation, packaging) related to the transportation of goods from their first destination to another destination within the EU Union, if the destination is known at the time of the chargeable event (the moment when the import VAT becomes chargeable). The taxable value of imported goods shall also not include any discounts or rebates which are known at the time of the occurrence of the chargeable event. In the case when the goods, which were temporarily exported outside the territory of the EU for repair, processing, adaptation or similar operations, are re-imported back to the EU, the taxable value of their supplies is the value of relevant services which were provided outside the territory of EU.

Therefore, while the customs origin of imported goods is not considered as a factor that may influence the calculation of the import VAT, the taxable value of imported goods is very closely related to the customs value which is determined on the basis of the Union Customs Code (2013) and other customs valuation rules established by the legislation regulating the determination of the customs value of goods. In some cases, the taxable value of the import VAT may exceed the customs value of goods (from which the customs duties are calculated), while in other cases, they may even be the same. In any case, the customs value is the key element of the taxable value of the import VAT, i.e. it always constitutes a major part of it. Hence, the proper calculation of the import VAT is not possible without adequate determination of the customs value of goods. The close link between the determination of the customs value and calculation of the import VAT is also being observed in the practice of the Court of Justice of the European Union (hereinafter - the CJEU), particularly in the case of Global Trans Lodzhistik OOD v. Nachalnik na Mitnitsa Stolichna, 2013. Here, the Court of Justice of the European Union (hereinafter - the CJEU) has stated (para. 28-31) that rectification, on the basis of Article 30(2)(b) of the Community Customs Code (1992; the version of the Customs Code which was in force before the Union Customs Code (2013)), the customs value of goods initially declared by the taxpayer, with the consequence that the declarant was served with a tax adjustment in respect of VAT, leads to a conclusion that the decisions at issue relate to the application of customs legislation. For this reason, such decisions relating to the application of customs legislation, which are detrimental to the persons to whom they are addressed, refer to the right of appeal provided for in Article 243 of that code (in other words, they may be challenged on the same grounds and using the same procedures as other acts related to customs activities).

Given the fact that the calculation of import VAT is always closely related to the determination of the customs value, it is necessary to note the
fact that the institute of customs value of goods itself is mainly imperatively regulated by the Union Customs Code (2013). Besides, as it was mentioned by the CJEU (cases Hauptzollamt Bremerhaven v. Massey-Ferguson GmbH (1973) and Komanditgesellschaft in Firma Geburder Glunz v. Hauptzollamt Hamburg-Waltershof (1982), determination of the customs value should be uniform in all EU Member States (throughout the whole Community). Therefore, the fight against fraud in the field of the import VAT in the EU, particularly regarding the incorrect declaration of customs value of imported goods, is always faced with the need to assess the legality and reasonability of one or another customs valuation method which was applied in a particular case. 

The transaction value of the goods forms the core of the main calculation method (this is noted by the CJEU in case Brown Boveri & Cie AG v. Hauptzollamt Mannheim (1991) and the Article 70 of the Union Customs Code deals with the main case of all calculations of the customs value under the transaction value method. The use of this method presumes that the seller and the purchaser aim to conclude a transaction in the customs territory of the Community. Considering the different legal systems of the Contracting Parties of the World Trade Organization Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade, the definition of a sales contract is interpreted broadly and may be described as any transfer of the ownership of goods for a certain remuneration. Therefore, the transaction value is the price agreed during the sale for export in the customs territory of the Community and has either been paid or is payable (Article 70 of the Union Customs Code). This way, the customs value shall be calculated on the basis of individual conditions of sales, even if they do not meet the trade practice or may seem unusual for this type of contract (see also the judicial practice of the CJEU - case Hauptzollamt Hamburg - Ericus v. Van Houten International GmbH, 1986, para. 13).

Subject to Article 70, para. 3 of the Union Customs Code, the transaction method cannot be used. This will be mainly the case if the seller and purchaser are connected and the connection has influenced the transaction value (Art. 70 para. 3 (d)). However, these cases may also include situations when the sale or price of goods is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued (the sale of goods or their price depends on some other conditions and circumstances according to which the value of the goods assessed may not be determined). The content of such cases and situations is evaluative and hasn’t been fully disclosed neither in the theory of customs law, nor in the practice of the CJEU. This way, adoption of a decision on whether there is a shortage of information on certain conditions and circumstances which has affected the determination of the specific customs value is essentially left to the discretion of the customs administration. In any case, according to most scholars, the transaction method also cannot be used, for example, in situations where there is a prior
agreement between the buyer and the seller on the price of the imported goods by correlating it with the execution of certain interpersonal commitments, such as the amount of the sold goods or the application of special schemes for the pricing of goods. Accordingly, in such cases, the determination of customs value should be based on other alternative methods, such as the value of identical goods, the value of similar goods, the deductive method or the computed value of the goods. To the extent that the customs value of goods cannot be ascertained by these alternative methods, the customs value may be determined using other evaluation (fall-back, default) methods, where the transaction value method and other methods are applied with a reasonable flexibility, if this is not contrary to the principles and general provisions of the Agreement on the Implementation of Article VII of General Agreement on Tariffs and Trade (1994) and the Union Customs Code itself. However, as noted by the CJEU, such determination of customs value should always exclude the use of arbitrary or fictitious customs value (cases Hans Sommer GmbH&Co KG v, Hauptzollamt Bremen, 2000; Unifert Handels GmbH v. Hauptzollamt Munster, 1990, etc.).

The principle that the transaction value method should (at least theoretically) be considered as the primary and the main method of customs valuation is also widely recognized in the Lithuanian national legal system. For example, the Constitutional Court of the Republic of Lithuania in the 27 January 2005 resolution “On the conformity of Article 30, paragraph 1, point 2 of the Lithuanian Customs Code to the Constitution of the Republic of Lithuania” (2005) pointed out that the procedure of calculation of the value of imported goods is based on the use of transaction value method using it as the main method for customs valuation. The Court has also noted that there may be cases where the declared customs value is different from the similar or identical customs value of goods, and the importer does not justify why that difference has emerged. In such cases, it is important for the customs officials to determine what conditions or circumstances had an impact on the value of the sales transaction and how the value was affected. If the above-mentioned circumstances or conditions affecting the sales transaction cannot be determined (are unclear), the customs authorities are obliged to use other methods for the calculation of the customs value of the imported goods.

Still, even before its accession to the EU, Lithuania has also enacted quite flexible rules, enabling the customs authorities to deviate from the use of the transaction value method. For example, according to the results of Uruguay Round multilateral negotiations (1994) and the decision of the World Trade Organization’s Customs Valuation Committee on the Cases where the customs authorities had reason to doubt the correctness of the declared value and its accuracy (1995), it was suggested that the burden to prove the non-recognition of the transaction value lies with the importer (not with customs authority). Since 1999, such provisions were included in the paragraph 59 of the Order of the Customs Valuation of Goods approved by the 9 June 1999 resolution No. 748 of the Government of the Republic of Lithuania (1999). While this can be seen as an anti-fraud measure in the field of import taxes, it is also noteworthy to mention that EU customs law does not provide specific rules for the allocation of the burden of proof of the determination of the acceptability of the transaction value. The problems of the practical application of such national rules, inter alia in order to assess their compatibility with EU law and inter alia to assess their efficiency in tackling the import tax fraud, will be further discussed in other sections of this paper.
As it was already mentioned, in order to check the reality of the transaction value of imported goods, Lithuanian customs do apply the PREMI database (database on customs valuation of goods), which includes the data collected over the last three months on the imports of goods: the value of the transaction of the consignment of goods and the value of the individual product (unit), the amount of imported goods and the country of export. The verification of the reality of transaction value of imported goods and the control of customs valuation is based on the data recorded in the PREMI database: this data is compared with other transaction values declared by different importers for identical or similar goods. In other words, the basis to call into question the transaction value declared in Lithuania is usually a non-compliance of the PREMI database and the declared value of goods. Therefore, the importer may be asked to submit additional documentation which supports the transaction value. On the other hand, the usage of the database causes some practical problems, such as whether the mere non-compliance of the declared transaction value of imported goods with certain comparative values (for example, the values recorded in the national PREMI database) should be considered as a sufficient reason for non-recognition of the declared value of goods as their customs value?

It is obvious that, on one hand, the usage of comparative prices of imported goods (Lithuania introduced this system since November 1997) has helped deal with import tax fraud and evasion of declaring the real customs value of goods: the flow of goods imported at low prices has gradually decreased and the average declared price has increased by up to three or four times. On the other hand, the methodology of comparative prices applied by the customs authorities received criticism, especially from small business representatives. In order to prevent the customs database from becoming unrealistically large, the database uses classifiers which scale most of the goods into separate groups which themselves include many varieties
goods. Subsequently, the comparative price of the certain position of goods is being applied separately to an individual product and, by making such a comparison, its value may increase unrealistically (this is especially noticeable in the area of imported electronic devices). In this case, the adjustment of prices is made between the goods which did not originate from the same country or from the same manufacturer. If the value of goods declared by the importer is lower than the comparable price, the importer will need a financial guarantee that the insurance company will provide only in case when its account will be credited by the amount of money required for the issuance of guarantee. It is obvious that not every entrepreneur has sufficient financial capital and the ability to pay the guarantee.

To address this issue, we must consider the fact that, according to the EU customs law, the determination of the customs value should always be based on the transaction value method as a priority, and cases for the inadmissibility of the transaction value for the customs valuation are strictly regulated. Thus, the Lithuanian administrative practice on the control of the customs value, according to the authors who analyzed it, points out that, although the commercial practice of different importers of the same product and the prices applied by them may vary, this should not be the sole cause of an argument not to recognize the value of the transaction. The practice of customs authorities confirms that the declared low or high transaction value of goods is one of the indicators of commercial or tax fraud, requiring a more detailed inspection of imported goods, i.e. additional or further investigation.

It should be noted that, according to this aspect, many authors have criticized the national customs valuation regulations in Lithuania adopted by the national customs authorities (Customs Department under the Ministry of Finance), for example, the Customs valuation rules for used motor vehicles (order of the Director General of Customs Department under the Ministry of Finance of 26 June 2009 No. 1B-361, hereinafter - Customs valuation rules for used motor vehicles) which stipulates that if, according to the property valuation report, the value of an imported vehicle is not close to the declared value (is above the declared value of the transaction), the transaction value method may not be applied (para. 7.2). Such rules may be treated as incompatible with the internationally recognized principle on the priority of the transaction value as a basis for customs valuation. The position that when the value of used or damaged motor vehicles may not be established by the transaction value method, their value is determined by the “last chance” (fall-

1 Lithuania uses separate customs valuation procedures for used or damaged motor vehicles, therefore they are subject to special rules on customs valuation (see also Radžiukynas, Bezūs, 2008).
back or default) method (i.e. Article 74, para. 3 of the Union Customs Code (2013)) is shared by the World Customs Organization’s Customs Valuation Committee in the Study on the Customs Valuation of used vehicles with an engine (2007). The study of the Committee does not indicate any specific customs valuation methods which should be used, but stresses that it must be prohibited to apply certain valuation techniques (for example, fictitious values or values set at the discretion of customs authorities). The World Customs Organization recommends that, as far as possible, customs valuation should be based on previously determined customs values and it is recommended to ensure the consultations between the tax authorities and the importer on the determination of the customs value.

So, even though the exclusion of the transaction value method begins when the customs officer has doubts on the declared customs value, consultations between the customs administration and importer should continue to take place, after which, if the customs authorities still have serious doubts, the final decision not to apply the transaction value method should be taken. For example, the importer could have information about the value of identical or similar imported goods, but it is not quickly available to the customs administration in the location where the goods have entered the customs territory. Customs administration may have information about identical or similar imported goods and their customs value, but such data is not quickly available to the importer. The consultations of both parties empower the exchange of information for customs valuation in compliance with the requirements of commercial confidentiality and in order to determine the appropriate basis of the customs value. However, as the Customs valuation rules for used motor vehicles directly provides the right to the taxpayers to be informed about the doubts of the declared transaction value and to provide its explanations (para. 8), and the general Rules on the Control of Customs Valuation of Imported Goods repeat this provision (para. 32), the term for the provision of such explanations is very short (five working days) and, therefore, it objectively cannot ensure the proper consultations between the customs authorities and the importer.

As we have mentioned, the presumption that the market value of imported goods which was established by the property assessment (and under it the value of import was recalculated) differs from the declared value of the transaction and such difference is the basis for the non-application of the transaction value method can be interpreted as contrary to the precedence of the transaction value method and the clearly defined exceptions for its application. It is possible to agree with the fact that a significant difference between these two values could be the basis for asking the importer to submit additional documents supporting the conditions of the contract - the conditions of sale, transportation, insurance, and other relevant circumstances. However, the mandatory rules which automatically deny the importer the right to calculate the customs value of imported goods according to the transaction value method may be interpreted as contrary to the common and internationally agreed principles of customs valuation. In addition, national case-law (2 March 2009 ruling of the Supreme Administrative Court of Lithuania in the administrative case no. A438-290/2009, 2009) has repeatedly noted that the value of the transaction and the value of imported goods described in the database (i.e. the value determined by the customs authorities unilaterally) can be the basis for raising the question on the non-compliance with the indicated value of the transaction, but could not be the basis for its automatic rejection. Accordingly, relevant national legal regulations (for example, para. 7 of Customs valuation rules for used motor vehicles) have to be essentially improved, indicating that the difference between the value of the transaction and, for example, the value in the property evaluation report where the imported goods were evaluated, is a basis for making a request demanding further evidence from the importer on the circumstances which have affected the transaction value, but not the sole basis for ignoring the declared value of the transaction.

In other cases, Lithuanian courts have noted that the transaction
value should be considered as the customs value only if it is possible to determine the conditions or circumstances affecting the price of the goods. Conversely, if the following conditions or circumstances cannot be established, the transaction value is not considered as the customs value (Ruling of the Supreme Administrative Court of Lithuania 8 March 2007 in the administrative case No. A³-240/2007, 2007). This does not mean that the customs authorities are not entitled to determine which specific circumstances raise doubts about the declared value of the transaction, on the contrary, the customs authorities should identify and provide evidence which proves the existence of such circumstances. The customs authorities are also required to highlight specific circumstances which they call into question, and, after making a statement that their impact on the customs value of goods cannot be identified, may abandon the use of the transaction value method on the determination of customs value of imported goods. So, on one hand, the customs authorities may verify the reality of the declared customs value of goods at any time, but on the other hand, in such case, the customs authorities are required to identify the specific cause by which they call into question the veracity of this value. Customs authorities, acting as tax administrators and, therefore, as some public administration entities, may not leave the refuse to apply the transaction value method unsubstantiated (the Law on Public Administration of the Republic of Lithuania (2006), Article 8, para. 1).

In all other cases of imports (not limited to the specific groups of products, such as used motor vehicles (passenger cars)), when the customs value of goods declared by the importer raises doubts to the customs, the importer must also be able to refute these doubts using appropriate legal means. Customs authorities have an obligation to provide reasonable doubts (stating specific facts and assessing the documents submitted by the declarant or possessed by the customs itself) and the importer has a duty to provide explanations and evidence to rebut the doubts raised by the customs authorities. However, if the customs authorities continue raising doubts about the declared value of imported goods (the justification and reality of it), the final decision should be taken only after notifying the importer about the reasons for such doubts and giving him the opportunity to respond. According to Article 127 of the Constitution of the Republic of Lithuania (1992) and Article 8, para. 1 of the Tax Administration Law, failure to comply with the general tax calculation procedure without a specific legal basis would mean the violation of the taxpayer’s obligation, as well as the right to pay only the statutory amount of taxes and only in accordance with the law.

Thus, when the transaction value declared by the taxpayer is not recognized and if the data provided to the customs authorities leaves rea-
reasonable doubt on the legitimacy of the estimated import tax base and it is not clear which data provided by different parties is correct, additional evidence supporting one or another circumstance should be collected. Tax authorities may not, without sufficient reason, refuse to recognize data provided by the other party as evidence if it directly confirms the presence of a certain fact. It should not be possible to require the submission of new evidence in such a situation, especially if the fact that the taxpayer will not be able to objectively provide more evidence is obvious to the customs authorities. Thus, in certain situations, the customs authorities cannot consider the evidence on the existence of certain circumstances as unproved without sufficiently strong arguments, if, based on the criterion of reasonableness, they should be considered as sufficiently validated. Therefore, the decision of the customs authorities not to apply the transaction value method for the customs valuation of imported goods and to use the alternative customs valuation methods may be challenged by the taxpayer during a tax dispute. In summary, it can be stated that, according to the existing legal acts in Lithuania, the burden of proof in these relations is distributed unevenly - a higher burden of proof lies with the importer (declarant), which alone has all the potential possibilities to reveal the circumstances related to the transaction. However, the allocation of the burden of proof has been more aligned recently as the current version of the Rules on the Control of Customs Valuation of Imported Goods (the actual version which is in force in 2016) doesn’t include the para. 49 of the former version of the Rules. The previously applied paragraph 49 of the Rules on the Control of Customs Valuation of Imported Goods has stated that if, during the customs formalities, customs authorities do not have an objective data, which can be used to make adjustments for the amount of imported goods, the level of their turnover, other costs, the distance of transportation and the types of transport, the customs value is generally determined in accordance with the Article 31 of the Community Customs Code (without the application of the transaction value method and using other alternative methods for the calculation of the customs value, currently they are described in Article 74, para. 3 of the Union Customs Code (2013)).

From a practical point of view, according to the customs valuation control system which is functioning in Lithuania, circumstances which raise doubts on the declared transaction value should be revealed and investigated in the second stage of customs valuation control, i.e. when the goods have been released for free circulation after the presentation of an additional financial guarantee. In such a situation, an additional customs inspection of imported goods is carried out by the customs valuation specialists of the territorial customs authorities who specialize by the types of different products or different areas of businesses. At this stage, the regional customs have more opportunities to make more detailed checks on the declared transaction value of imported goods. The overall situation in the import market is also examined by the customs valuation specialists. They have a greater chance to obtain data on the prices of goods in foreign markets, to require the importer to provide additional information on the transaction value, to apply to the customs authorities in the exporting country with the request to present the customs and commercial documents on a certain case of imports, etc. When the results of checks (inspections) on the reality of the declared price of the goods and the documents, provided by the taxpayer, give a reason to believe that the customs value of goods has been reduced by fraudulent activities, the importer may be required to provide the customs authorities with other accounting documents, information on money transfers and other documents related to the determination of the customs value. According to the results of the study, the territorial customs can make the following decisions: (i) to recognize the importer’s declared transaction value of goods or (ii) to apply the transaction value method with the addition of costs provided in Article 71 or 72 of the Union Customs Code (2013); (iii) to determine the customs value in accordance with the provisions of Article 74 of the EU Customs Code, i.e. by using alternative customs valuation methods.

On the other hand, the effective
functioning of that system in Lithuania was hampered by the fact that, as noticed by the authors who examined the decisions made by territorial customs authorities (Radžiukynas, 2005), the primary chain of customs officials working in the customs posts wrongly select the import cases for an additional customs inspection on the value of the imported goods because they lack the skills, knowledge and experience to identify the actual price paid or payable for the goods. This creates some additional barriers to the legitimate businesses because, in cases where a large number of customs declarations are directed for an additional verification after an additional inspection, the declared transaction value of imported goods is usually confirmed as legitimate (such cases constituted more than 70 percent of all cases when customs declarations were checked repeatedly). Therefore, the importer is unnecessarily losing financial resources in order to provide the bank with a guarantee or deposit and is faced with additional costs and losses of working time in order to prove the reality of the transaction value. It does not contribute to the improvement of the business environment and competitiveness.
The functioning of the customs valuation system in Lithuania as an instrument to combat import tax fraud: practical aspects

When analyzing the practical situations on the customs valuation of goods and the tendencies of the last decade (since 2005) which are reflected in the Lithuanian court practice in the tax dispute cases (which is formed by the Supreme Administrative Court of Lithuania), it is noted that, in cases when the contract value as the basis of the customs value cannot be objectively determined by the method of the transaction value, other methods are also very widely used by the customs authorities. As practice shows, Lithuanian customs authorities are usually using the “last chance” method, which means that the value of goods is calculated in relation to the comparable prices of goods which were applied by other importers who imported the same class or type of goods. It should be noted that, theoretically, this method should be used only in exceptional cases, i.e. when other alternative customs valuation methods cannot be applied objectively. However, the national court practice in Lithuania shows that the courts, which are hearing disputes on the valuation of goods, usually agree with the arguments of customs authorities (if such arguments are generally provided at all) that other customs valuation methods cannot be applied and do not analyze their essence (for example, was it possible to determine the customs value of goods based on alternative valuation methods, excluding the “last-chance” method). In addition, as it was already mentioned, the extensive use of the “last chance” method was approved by the provisions of paragraph 49 of the national Rules on the control of the customs valuation of imported goods (currently, this legal regulation is excluded from the actual version of the Rules on the control of customs valuation of imported goods). The most common use of the “last chance” or “fall-back” method were related to the situations when the customs authorities, after having established that there is no reason to recognize the transaction value of imported goods as the customs value, were making the decision to use the data which is accumulated in the national PREMI database of the Customs Department (see the Supreme Administrative Court of Lithuania, 1 February 2005 ruling in the administrative case. А4-163/2005, 2005; 26 January 2004 ruling in the administrative case А7-92/2005, 2005; 1 April 2004 ruling in the administrative case No. А4-13/2004, 2004; 1 April 2005 ruling in the administrative case. А8-429/2005, 2005, 8 March 2007 ruling in the administrative case No. А8-240/2007, 2007).

Although, as we have already noted, generally referring to the Law on Public Administration of the Republic of Lithuania (2006), the factors affecting the price of the goods cannot be related to the undetermined circumstances, such as the circumstances when the price of the imported goods does not comply with the comparative prices established by the customs authorities. Nevertheless, in Lithuania, as it can be evidenced from the practice of the Supreme Administrative Court of Lithuania, the discrepancy between the declared prices of goods and the comparative prices established by customs authorities was used as one of the most important arguments to raise doubt.

Initially, in its practice, the Supreme Administrative Court of Lithuania has also approved the argument of the customs authorities that, if the trading parties are operating in the market in good faith, the transaction value should not be objectively different from the value of similar or identical goods registered in the customs valuation database (i.e., PREMI database). Therefore, in the case when the transaction value of imported goods is significantly different from the value registered in the PREMI database, the customs authorities are authorized to make a binding conclusion that the sale of goods or their prices have been subject to a number of conditions and circumstances, the effect of which on the transaction value of the sale of goods cannot be determined (1 February 2005 ruling in the administrative case No. A4-163-2005, 2005). Such a position was widely criticized by Medeliené and Paulauskas (2008), because, objectively, all participants in the market cannot operate under the same conditions. It should be noted that the price always, more or less, varies while taking into account the importers who buy goods from different suppliers or even from the same supplier under different conditions. Also, in accordance with this ruling of the Supreme Administrative Court of Lithuania, the transaction value should not be recognized when the price of the imported goods are even higher than the price registered in the PREMI database, therefore, in such a situation, payable sums of customs duties or other import taxes duties should be converted into smaller sums of payable taxes.

However, such a categorical interpretation of the importance of data in the PREMI database was softened in another administrative case (the Supreme Administrative Court of the Republic of Lithuania 18 February 2005 decision in the administrative case No. A10-167/2005, 2005) where the court has ruled that, when the difference between the prices of imported goods and the comparative prices is established by the customs authorities, their decision on customs valuation should not be based only on the formal difference, but also on the nature of the imported goods (the volatility of their prices, depending, for example, on seasonal or other factors), as well as the scale of the non-compliance of prices (if the difference of the prices is not large, such a circumstance cannot in itself be considered as a sufficient ground to recognize the existence of certain circumstances, which had an impact on the prices of goods).

Still, it may be noted that the practice when national authorities continued to recognize an extremely wide application of the PREMI database for calculating the customs value of imported goods and liberally applied the exceptions of the transaction value method was continued in a subsequent period. For example, while maintaining the general position of the customs authorities, the Lithuanian Supreme Administrative Court has even pointed out that neither the national nor the EU legislation generally do not guarantee the importer’s legitimate expectation that the customs value of imported goods will always be calculated according to the transaction value method (16 July 2010 ruling of the Supreme Administrative Court of Lithuania in the administrative case No. A575-871/2010, 2010). The judicial practice also approved the shifting of the burden of proof in customs valuation, particularly to the taxpayer (importer). While the EU customs law doesn’t include such a general rule, the national courts held the position that the burden of proof to prove that the customs authorities reasonably questioned the value of the declared goods is always transferred to the importer (the Supreme Administrative Court of Lithuania, rulings in the administrative cases No. A442-715/2010, 2010; A143-1243/2010, 2010; and A575-144/2011, 2011). Finally, in some cases, the Supreme Administrative Court of Lithuania has also entrenched the principle that, if the taxpayer has declared the customs value according to alternative customs valuation methods, the customs value cannot be changed (cannot be recounted using the transaction value method or any additional method provided by the Union Customs Code; the Supreme

While, in national practices, the use of such strict rules of proof on the customs value can be regarded as a tool to combat import tax fraud by reducing the value of imported goods (especially in view of the extent of the problem in Lithuania), it can be stated that the spread of such practice raises questions about its full compatibility with the EU law. In particular, in this regard, it is important to emphasize the practice of the CJEU which states that the primary method of customs valuation should always be the transaction value method (see case Gaston Schul BV v. Staatssecretaris van Financiën, 2010). Therefore, a fundamental change of the national practices took place in 2013, when the Supreme Administrative Court of Lithuania has provided an explanation on the use of exemptions related to the application of the transaction value method in order to determine the customs value.

While assessing the legality and validity of the actions of regional customs authorities, the extended panel of judges of the Supreme Administrative Court of Lithuania has ruled that the burden of proving the existence of exemptions, which allows not to apply the transaction value method, lies primarily with the customs authorities. The Court emphasized that the proper application of the EU’s Customs Code requires for the customs authorities to lay out the facts established by them, and to provide an adequate explanation of the circumstances or conditions which, in their view, had an impact on the sale of goods or their price. The customs authorities should also substantiate and justify the circumstances or conditions which had an impact on the sale of goods or their value, and to prove that their exact impact cannot be determined. According to the Supreme Administrative Court, if the importer seeks to refute these circumstances which has been indicated by the customs authorities, the importer must provide additional explanations and evidence in order to convince the customs authorities that the declared value of the imported goods under the Customs Code reflects the prices which were actually paid or payable for the total amount of imported goods. If the customs authorities decide not to follow the importer’s explanations and arguments, they must state why these arguments and (or) explanations are inadmissible or unfounded. The extended panel of judges of the Supreme Administrative Court has also explained that, in this particular case, the circumstances which were established by the customs authorities didn’t justify its refusal to apply the transaction value method in accordance with the Customs Code. The Court, among other things, pointed out that a significant difference between the declared value of imported goods and the comparative value of the goods which are recorded in the special database (PREMI database) should not be considered as a factor that has had an impact on the sale of goods or their price in the sense of the EU’s Customs Code. The existence of such difference is a basis for the discussion on the existence of certain circumstances which exclude the possibility to apply the transaction value method.

By studying the significance of this case to the national legal system and the fight against the import tax fraud by reducing the customs value of imported goods, we should note that this has led to certain changes in the national legal regulations (Rules on the control of customs valuation of imported goods and Customs valuation rules for used motor vehicles) which abandoned the previous provisions on the automatic rejection of the declared transaction value due to its inconsistency with the PREMI database, and included additional regulations which formally allow the importer to make consultations with customs authorities. However, current terms for such consultations are short (for example, five working
days, see para. 32 of the Rules on the control of customs valuation of imported goods) and the Customs valuation rules for used motor vehicles still maintain certain legal regulations which state that the discrepancies between the value in the property assessment report and the declared transaction value could be considered as the basis to reject the use of the transaction value method (para. 7.2). The new practice approved in the administrative case No. A-442-709/2013 has also reduced the overall number of tax disputes on customs valuation (only one such dispute was examined in the Supreme Administrative Court of Lithuania in 2014 and in 2015; LITEKO Lietuvos teismų informacinė sistema (2016)). However, the most recent case law (such as 22 March 2016 ruling of the Supreme Administrative Court of Lithuania in the administrative case No. A214-261/2016, 2016) confirms that the courts and the national authorities, in practice, still retain quite a formal approach to the determination of the customs value under the PREMI database. In this particular case, although the importer implied that the PREMI database has been used improperly and haven’t reflected the dispute situation, the court of appeal did not analyze these circumstances in detail and merely stated that the national authorities were entitled to use the data accumulated in the PREMI system for the customs valuation of goods.

In addition, it is possible to note the fact that the most recent case-law raises new problems in the area of customs valuation and the fight against tax fraud by reducing the customs value of imported goods. For example, it is debatable whether the customs authorities have the right to refer to the World Customs Organization’s interpretations and recommendations (for example, a National valuation database as a risk assessment tool. Access through the Internet: http://www.wcoomd.org/en/topics/valuation/instruments-and-tools/guidelines.aspx even though they are the sources of “soft law” and do not have an official status of a binding international treaty. According to the practice of the Supreme Administrative Court, which was formulated in the administrative case No. A442-709/2013, other sources of international law (such as the documents and recommendations provided by the World Customs Organization (WCO)) also have a binding legal effect on national customs authorities and should be applied for the purposes of customs valuation. However, neither the national legislation, nor the practice of the CJEU (see. e.g. the case Gaston Schul BV v. Staatssecretaris van Financiën, 2010) does not yet provide a clear answer to this question.

When summarizing the collected material, we can state that, on a practical level, in Lithuania, the use of customs valuation procedures for the combat against tax fraud has changed considerably. It is obvious that situations where customs valuation is used as an instrument of combating tax fraud always creates a certain opposition between the customs authorities
(acting on behalf of the state) and the trader (the importer). The aim of the customs authorities is to collect as many taxes on imports as possible and the aim of the importers is to have less formalized and more flexible rules, and to pay lower taxes. In this regard, it may be noted that such a conflict is always common in the legal relations regulated by the customs law, however, the goals (benefits) of different public and private entities should not be considered as mutually contradicting.

So, even though the customs legislation provides relatively clear rules for determining the customs value and makes a presumption on the use of the transaction value method, it is also important to apply them adequately and proportionately, without forgetting the general principles of law, and justifying the evaluation of the situation not in short, but in the long term. It is necessary to create conditions for the tax authorities and the importer (the declarant) to cooperate, as well as to ensure that the use of customs valuation rules doesn’t lead to an abuse of law and, on the other hand, to ensure that minor deviations in the declared customs value are not overstressed and evaluated too strictly. For this reason, it is possible to suggest that the Rules on the Control of Customs Valuation of Imported Goods and Customs valuation rules for used motor vehicles should include a general rule, that the alternative methods of customs valuation based on the data of PREMI database (Article 74, para. 3 of the Union Customs Code) cannot, in general, be used without performing a consultation with the importer on the determination of the transaction value of the imported goods. Such regulations would be in line with the provisions of the Union Customs Code on the right of the importer (declarant) to be heard before the adoption of any decision by the customs authorities against him (Article 24 of the Union Customs Code).
Discussion on the practical application of tax exemptions on imported fuel products (study of tax dispute cases) has already helped to single out the tendency that, in order to prevent tax evasion and combat tax fraud, the proper application of these tax exemptions is ensured by a rigid interpretation of tax laws, according to which tax exemptions are to be interpreted narrowly. For example, it is prohibited to add new products to the list of tax exemptions, because their properties or the circumstances of their import are similar to those products which fall into the category of goods entitled to the objectively recognized exemptions. In addition, it is also prohibited to amend or to change the list containing the products entitled to the tax exemptions by making adjustments in the secondary legislation or executive legal acts.

In the most recent tax administration practice, especially the one which not only relates to the taxation by the VAT or customs duties but also to the excise duties, some visible and conflicting tendencies can be distinguished. They are linked to the fact that, in a certain part of tax disputes which are settled in courts, the provisions of tax exemptions on the imported fuel products are interpreted by using a non-constrictive, but on the contrary, an expansive method of law interpretation, thus creating legal uncertainty. For example, in the administrative case No. A-602-879/2014, the Supreme Administrative Court of Lithuania has examined the application of excise tax exemption on imports of fuel products and has held that a broad interpretation of tax exemption conflicts with both the provisions of tax laws and the general
principle of law, which states that the exceptions must be interpreted narrowly, in other words, for any tax exemption which constitutes an exception to the general rules, a broad interpretation is not allowed (the ruling of the panel of judges of the Supreme Administrative Court of Lithuania of 3 November 2004 in the administrative case No. A-692-879/2014, 2014). It should be noted that the CJEU has also consistently emphasized that the terms used to describe the set of tax exemptions are to be interpreted strictly, since they should be considered as a derogation from the general principle, according to which specific tax goods or services must be taxed (see case Staats-secretaris van Financiën v Velker International Oil Company Ltd NV, 1990; case C-395/04, Ygeia, 2005; case Commission of the European Communities v Federal Republic of Germany, 2002; case Kingscrest Associates Ltd and Montecello Ltd v Commissioners of Customs & Excise, 2005; case BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise, 2006; case Silvia Hosse v Land Salzburg, 2006). In addition, the interpretation of the tax law (tax) system in Lithuania, in general terms, is also based on the assumption that a broad interpretation of those provisions would be contrary to the general principles of public law (the ruling of the panel of

In some recent cases, such as in the administrative case No. A-261-852/2014 (the ruling of the panel of judges of the Supreme Administrative Court of Lithuania of 3 November 2014, 2014), we can observe opposite trends, for example, a recent practice includes statements that the legal gaps in the regulations, according to which the taxpayer could not properly mark the fuel product intended for release into market or consumption, shall not preclude the application of the tax exemptions on the imported fuel products, if the properties of the product and the intended purpose of its use are generally in accordance with the features of the fuel products which formally are covered by the tax exemptions. We may conclude that this case was related to a special legal situation (inability to properly label the fuel product for the application of tax exemptions) and the decision of the national court can be justified in the context of the judicial practice formulated by the CJEU (case Hauptzollamt Köln and Kronos Titan GmbH and Hauptzollamt Krefeld v Rhein-Ruhr Beschichtungs-Service GmbH, 2014). However, the tendency to expand the interpretation of tax exemptions
has been followed by the Supreme Administrative Court of Lithuania in some other recent cases, such as in the administrative case No. A-143-1770/2014 (the ruling of the panel of judges of the Supreme Administrative Court of Lithuania of 13 January 2015 in the administrative case No. A-143-1770/2014, 2014). In this case, the Court has stated that tax exemptions cannot be evaluated formally and narrowly, i.e. they cannot be associated with the execution of certain formalities or procedures (such as proper labeling or marking of fuel), but they, first of all, should be related to the objective purpose of the imported fuel products. It is obvious that compliance with such a position in a specified case has led to the withdrawal of additionally registered tax debt for the taxpayer.

In these circumstances, we encounter the need to re-raise the issue on how the use of tax exemptions is interpreted and used in the Lithuanian tax system, specifically, import tax exemptions on the imported fuel products which are considered as particularly sensitive and risky to the tax evasion or tax fraud related to avoidance of VAT, customs and excise duties. Therefore, this raises the necessity to have a unified view on how to interpret tax exemptions and how to apply them properly. Broad extension of conditions for the application of tax exemptions which are enshrined in the EU legislation makes it difficult to deal with the concealment of the true purpose of the imported fuel products and their characteristics, mixing them with other tax-exempt products (so-called “illegal cocktail or blending”) and other related problems. On one hand, the solution to this problem may lie in the formal narrowing or even abolishment of certain tax exemptions for fuel products in the EU directives themselves (which should be decided at the EU level). On the other hand, it is also possible to take some additional measures at the national level. It is suggested that, for the solution of the general abuse of tax exemptions to avoid taxes (such as taxes on imported fuel products), the national legislator could ensure a uniform interpretation of the conditions of tax exemptions in tax disputes. Therefore, the provision that tax reliefs and exemptions must be interpreted strictly (or that of their expansive interpretation is not allowed) should be established directly in the Law on the Tax Administration of the Republic of Lithuania (2004), in particular, in its Article 9, which currently governs the order of the interpretation of taxation rules and declares that, in all cases, all uncertainties in tax laws should be interpreted in favor of the taxpayer.
The European Union is losing billions due to VAT evasion each year. Lost revenues have become a significant burden to the governments of most Member States. What actions can be taken in order to curb VAT fraud and make a step towards transparency? VAT fraud is widely used among business units, trying to either evade paying the tax or fraudulently trying to claim a refund for VAT they had never paid in the first place. Considering the Missing Trader Intra-Community (MTIC) as a most severe type of fraud, three main schemes causing most harm can be distinguished – missing trader, transit and carousel fraud.

It is a threat not only for the state or the government – being involved in VAT fraud, such as MTIC, may cause serious harm for the business itself. Moreover, businesses involved in VAT fraud scenarios potentially would not be allowed to deduct input VAT, apply exemptions on EU supplies of goods or refund input VAT. It should be mentioned that identifying VAT fraud is not an easy task. It does take time and preparation – criminal groups invest more and more money and effort to set up complex schemes that, at a glance, would seem as normally operating businesses. However, acknowledging the significant numbers of VAT fraud, it becomes quite obvious that the actions from governments or Tax Authorities alone is not enough to tackle the fraud and, therefore, additional assistance from the business becomes inevitable. Along with the European Commission’s measures and efforts performed by the local Tax Authorities, businesses can help fight VAT fraud in significant ways. Business entities should be the first ones to be able to detect suspicious activity within their related parties and take appropriate actions. Accepting the fact that VAT fraud remains a high risk for all business, it could be said that financial controllers of business entities should be applying new anti-fraud procedures inside the companies, as well as imposing very clear procedures for employees to follow in terms of fraud prevention.

VAT fraud has been an enormous threat to the European Union’s fiscal system for years. The European Commission as well as the Member States in the desperately fail against fight VAT fraud while the extent of fraud is still significant. The following paper seeks to present an overview of the main VAT fraud methods, risks and the alternative measures that business entities and governments might take in order to tackle VAT fraud.
General overview

VAT evasion costs billions of euros for the European Union each year. European Commission Taxation and Customs Union issues VAT gap reports annually, which indicates the difference between the expected VAT revenues and actually collected amounts of VAT. According to the European Commission, tackling VAT fraud and evasion is a top priority, seeking to maintain fair competition on the market and fair taxation of the business.

The governments are affected significantly in terms of lost revenue. According to the latest European Commission statistics, EU Member States are losing billions of euros due to VAT fraud each year. In the Baltics, VAT gap was estimated to be around EUR 2.3 billion in 2014, where Lithuania amounted to EUR 1.6 billion, Latvia – EUR 0.5 billion and Estonia – EUR 0.2 billion gaps of VAT.

It is widely acknowledged that VAT fraud is mainly caused by the system itself, as the business entity is entitled to possess the VAT collected and transfer it to the budget, which is not always the case. Therefore the questions arise what to do to protect the VAT system of the European Union? How to protect fair traders of becoming part of the fraud? What alternative measures should be applied to reduce the extent of VAT fraud? In the following pages we will try to provide the answers to these questions as well as an overview of the most common VAT fraud examples causing the biggest negative effect in the European Union.

In total VAT gap amounted to EUR 2.3 billion in 2014. Out of which tax gap in Lithuania constituted EUR 1.6 billion, in Latvia – EUR 0.5 billion, and in Estonia EUR 0.2 billion.

Figure 5. VAT gap in the Baltics.

Methods of VAT fraud

VAT is commonly used in fraud schemes where businesses try to either evade paying the tax, or try to claim refunds for VAT they had never paid in the first place. Through the time, different fraud methods have been identified and the most common ones were observed. The most severe and harmful type of fraud is considered to be Missing Trader Intra-Community (MTIC). MTIC requires an organized network of individuals and/or enterprises (in most cases – fake ones) working on well prepared schemes. The network is not limited to the borders of one country and can involve several countries at a time.

Regarding other types of VAT fraud, the International Monetary Fund (IMF) provides clear definitions of the main VAT fraud types in the working paper reports on VAT fraud and evasion. Considering the MTIC, three most well known schemes causing the greatest harm can be distinguished – as missing trader, transit and carousel fraud.


Missing trader

This type of VAT fraud is widely common, even though it takes a lot of planning, preparation and agility. This scheme regives fake enterprises trading in goods or services are established in different, usually in European Union, countries. High-demand goods are supplied from one Member State and quickly sold in another Member State at relatively low prices. Having charged, the VAT traders quickly disappear without paying it to the budget. The reason why this type of tax fraud is usually performed within intra-EU boundaries is due to relatively favorable intra-EU trade policy among the EU member countries, allowing the transactions to be performed in an easy and timely manner.

In transit, goods are moved through several Member States. In addition to the missing trader scheme, at the end of the scheme, the goods are fictitiously supplied to another EU Member State reporting an intra-EU movement and applying 0% VAT rate. Once the goods are sold to the final customers with VAT, the supplier disappears without paying VAT.

The general idea of this type of VAT fraud is that the goods are moving in a circle – from the distributor, through a number of traders (not necessarily fictitious) and come back to the initial distributor. Like in the aforementioned schemes, the movement of those goods is usually performed between the neighboring EU Member States.

Figure 6. Transit scheme.
Figure 7. Carousel scheme.

Figure 8. Carousel scheme.
Risks of being involved in VAT fraud

VAT fraud is a threat not only to the state or the government. Being involved in VAT fraud, such as MTIC, may cause serious harm to the business themselves. Firstly, it may destroy the reputation in the industry resulting in losing suppliers and customers. More importantly, businesses involved in VAT fraud scenarios would potentially not be allowed to:

- deduct input VAT; or
- apply exemptions on EU supplies of goods; or
- refund input VAT.

The taxable entity may be subject to the above mentioned VAT risks if he “knew or should have known” that it was involved in a fraudulent transaction.

A “Knowledge test” principle is implemented by the Court of Justice of the European Union (hereinafter – CJEU) in a number of cases (e.g. Joined Cases C-440/04 (Recolta Recycling) and C-439/04 (Kittel), Case C-273/11 (Mecsek-Gabona), Joined Cases C-80/11 and Case C-142/11 (Mahagében and Dávid), Joined Cases C-131/13, C-163/13 and C-164/13 (Italmoda) and others) and widely applied by the Member States of the European Union. The concept of the “Knowledge test”
may be defined as follows:

"The national authorities may refuse to deduct input VAT if it is shown, in the light of objective evidence, regardless of whether tax evasion has been carried out by the taxable person itself or whether that person merely knew, or should have known, that, by the transaction concerned, it was participating in a transaction involving evasion of VAT carried out by any other trader acting upstream or downstream in the supply chain, and whether occurring in the same Member State or not." 1

Also, it is worth mentioning that the above applies in those cases where there is no national legislation establishing third party liability, even if the evasion was carried out in a different Member State and all formal obligations have been complied with (Joined Cases C-131/13, C-163/13 and C-164/13 [Italmoda]).

The term “should have known” should attract an attention of every tax payer, since it indirectly presupposes that every business entity should have a backgound knowledge about its business’ partners. Otherwise, it might not be able to use the right of VAT deduction, which would basically mean that the business have difficulty operat- ing. The term “should have known” commits the taxable entity to perform certain review procedures in order to evaluate if its business partner is related to the fraud or not. Nevertheless, it should be mentioned, that identifying VAT fraud is not an easy task. Criminal groups put more and more efforts and money in to setting up tricky structures that would seem as normally operating business. Fraud schemes are now more complex and consist of many companies registered for VAT in a number of countries. The fraudulent companies obtain effective EU VAT num- bers that are used for a long time until the fraudulent activities become clear. It is also custom that VAT fraudsters specialize in one type of goods/services at one time due to detailed knowledge of the sector and contacts with suppliers or purchasers. Taking this into account, business entities should be aware and mindful regarding every transaction performed.

In a number of cases, CJEU concluded that it is the responsibility of competitive authorities to ascertain whether the taxable person should have known that, by his sale or purchase, he was participating in a transaction connected with fraudulent evasion of VAT. Consequently, the tax payers should not only have checked that procedures, but that they also should have certain proof that such procedures are completed (e.g. business partners checking policy, filled in checklists, obtaining of identification proves, etc.). In failing to perform verification procedures, it may be considered that the business entity should have known that the performed transaction was concluded with a fraudster.

1 Ben Terra and Julie Kajus, A Guide to the European VAT Directives. Introduction to European VAT 2011, IBFD 2015, p. 297
Detecting VAT fraud

According to the Global Fraud Survey performed by EY\(^1\), representatives of business acknowledge that there are an increasing number of honest tax payers – businesses are operating in a more transparent manner, showing less tolerance for bribery and avoiding falsification of financial statements. However, only how many percent of respondents of the above mentioned survey claim to control the supply chain, choose business partners with care or perform internal reviews. Such contradictions between actions and statements most probably disclose the lack of self-criticism concerning fraud and the issue of its occurrence, as well as poor perception of tools enabling transparency. Having acknowledged that VAT fraud remains a high risk for business, it could be said that financial controllers of business entities should search for solutions by applying new anti-fraud procedures inside the companies.

The result of the survey is that 55% of the companies have whistleblowing lines installed for the purpose of encouraging employees to give notice of suspicious actions and violations anonymously noticed inside the company. Although some companies give financial bonuses to employees for the information, such policy is not always effective; 19 percent of respondents prefer good relationships with peers over informing of possible violations. Taking into account the results, the outcome of the survey is that the business should impose very clear procedures for its employees to prevent VAT tax. The procedures should be performed automatically without leaving the discretion right to reveal it or not. Otherwise, business will be in high risk of becoming a part of fraud and collapse.

VAT fraud prevention and risk management

Unlike any other taxes, VAT is relatively easy to abuse since it has two areas of fraud vulnerabilities which are aimed by fraudsters. They choose to either manipulate their VAT payable or aim to claim overstated amounts of VAT receivable. The European Commission has issued recommendations in decreasing the VAT gap, consisting of 20 measures which are divided into three groups: increasing administrative cooperation, improving tax administration and improving voluntary compliance\(^1\). This guide presents the intended actions to be taken by the European Commission in cooperation with the EU Member States and third parties interested in taking part in VAT fraud prevention.

In its report “Tackling VAT Fraud”, the International Bureau of Fiscal Documentation (IBFD) presents general strategies of fighting VAT fraud\(^2\), such as:

- **VAT refund delay**
- **Reverse charge mechanism**
- **Rate structure**
- **Chain liability**
- **Information exchange and checking**

Nevertheless, considering the significant numbers of VAT frauds, it is clear that the actions of governments of EU Member States or particular Tax Authorities are not sufficient to tackle fraud. For example, once the domestic reverse charge mechanism on certain goods or services is established in one Member State, it shifts immediately to another and continues the evasion of VAT. Thus, the procedure only protects certain jurisdiction but not the system itself. As such the government should introduce alternative measures parallel to the regulatory measures. The government should inter alia introduce alternative measures encouraging businesses to take part in the fight against VAT fraud.

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ALTERNATIVE ACTIONS IN FRAUD PREVENTION

Figure 9. Alternative action in fraud prevention.

**Business**

- Know your customer procedure
  - Review and monitor its procedures and transactions;
  - Create anti-fraud and business partner's verification policy;
  - Introduce the red flag notification system for transactions with ~20% margin.

**Government**

- Promotion of business verification procedures
  - Inclusion into trusted tax payer list;
  - Tax reliefs or simplification.

- Review of tax penalty system
  - Fixed penalty rate;
  - Target company officers responsible for fraudulent actions.

- Accounting data cross-check
  - A lot of transactions in a short period of time;
  - Abnormal discounts or deviations from normal values;
  - No staff (or very few) in the companies involved, etc.
  - Small profit margins or no profit.
Possible business actions in VAT fraud prevention

Together with the European Commission’s measures and efforts performed by the local Tax Authorities, the business can significantly contribute to the fight against VAT fraud. The businesses are the first to notice the suspicious behavior of its suppliers and the purchasers by performing business verification checks or the so-called Know Your Customer procedures. Having identified and reported the fraudsters to the competent authorities on time, the fraud would be spotted and suspended immediately. In order to achieve this, businesses should be encouraged by the government (but not enforced) to take additional actions and procedures and participate actively on a high scale. First of all, in order to identify VAT fraud in the supply chain, business entities should implement Know Your Customer procedures and apply them continuously.

Knowing your business partners is an essential attribute for successful business. Otherwise, it is a matter of time before the business will be involved in transactions that are shady and cause harm to the business itself. It is important to ensure that the procedures are performed in every stage and with respect to every transaction.

For example, the company should:

“Review and monitor its procedures and transactions;
“Create anti-fraud and business partner’s verification policy;
“Introduce the red flag notification system for transactions with ~20% margin.”
Alternative government actions in fraud prevention

Promotion of business verification procedures

Since the government represents a tax collecting authority, its initial concern is to prevent VAT fraud which directly affects its tax revenues, and implement procedures to minimize the VAT gap. As an alternative measure, governments could encourage taxable entities to apply the Know Your Customer procedures and report suspicious companies to the competent authorities once they are identified. However, since the taxable entities are more interested in higher margin, but not in the cooperation with the state, representative authorities should promote how the taxable entities could benefit from such cooperation. For example, taxable entities that apply the Know Your Customer procedures and cooperate with the state could be promoted as a trusted business or included in certain trusted tax payers list. Alternatively, certain tax reliefs or simplifications may be granted for such tax payers.

Review of the penalty system

In addition to that, Member States should adopt an aggressive penalty system for businesses and particular employees participating in VAT fraud. For example, UK Tax and Customs Authorities (HMRC) issued a proposal presenting possible options on how the government could penalize illegal activities and help protect honest tax payers 1. As one of the option, HMRC suggests applying a fixed rate penalty of 30% of the VAT due in case the business knew or should have known about a connection with VAT fraud. The penalty is presented to be collectable from responsible company officers when they knew or should have known about the tax evasion.

HMRC believes that the new penalty will be more effective if it also targets company officers. Without this, the individuals in the business who are responsible for or mastermind the VAT fraud are often able to walk away from company liabilities and start the process of participating in another fraudulent scheme all over again. Such approach would definitely make business and particular assigned employees more careful and aware of the transactions performed. Even if the penalty system proposed by HMRC is not fair at some point, it shows the alternative approach that might be taken by the Tax Authorities and how the knowledge test may become important even for individuals.

Accounting data cross-check

One after another, the EU Member States implement intelligent tax administration systems in order to obtain large data files including all accounting data from the tax payers. On October 1, 2016 such system was implemented in Lithuania. Lithuanian Tax Authorities present that the aim of the new system is to reduce the burden of taxpayers, increase the collection of taxes and taxpayers’ accountability as well as the efficiency of the tax administration2. It is important that the Lithuanian Tax Authorities, as well as the authorities of other Member States, would be capable to process the data properly so it would contribute to the general prevention of VAT evasion and identification of any tax losses.

The following indicators may be used by the Tax Authorities in order to detect the fraud:

- A lot of transactions in a short period of time;
- Abnormal discounts or deviations from normal values;
- Small profit margins or no profit;
- No staff (or very few) in the companies involved, etc.

Having performed the above mentioned measures, the VAT fraud would hopefully become a less attractive method of tax evasion. However, in order to protect the VAT system itself, rapid solutions shall be made from both sides - the business and the governments.


2 iMAS. State Tax Inspectorate. Link: https://www.vmi.lt/cms/en/i.mas
INSTITUTIONAL COOPERATION IN THE VAT FRAUD PREVENTION AREA: SOME IDEAS

CREATION OF ITAS (smart tax administration system) IN EU

The training course “International anti-fraud training of VAT fraud prevention as EU’s financial stability support measure” has revealed that the seemingly simple tax administration structure has, in fact, a number of drawbacks. As concluded during discussions, cooperation between the Customs and the Police, as well as between the Customs and Tax authorities is fairly good, however, there are still certain cooperation obstacles. The fight against intra-Community VAT fraud is hampered by the overlapping competences, lack of effective cooperation and information exchange between the administrative, law enforcement and judicial authorities at a national and international level.

A situation occurred between Europol, Eurojust, and OLAF in 2013 which was described as a ‘tangled web’ and contributes to the lack of appropriate coordinated response to fraud. The most significant are information exchange restrictions, lack of connected databases and structured systems. Information is also often of poor quality, is not provided on time, and there is also a lack of necessary feedback. Overlapping and duplication are also recurring risks. Effectiveness of the fight against fraud is reduced by the lack of data exchange between the customs and the tax, police and prosecuting authorities. Belgium succeeded in reducing the losses related to fraud by 85 % in only 2 years by adopting a ‘joined up’ approach with better cooperation between authorities which allowed a focus on the disruption of organisers rather than targeting missing traders. Today, fraud is no longer considered to be an internal issue specific to one or several individ-
VAT fraud prevention in EU

Failures and the lack of cooperation systems between Member States are often used in the operations of fraudsters in order for them to reach their objectives. Thus, prior to increasing the burdens of tax compliance for taxpayers, the revenue services should consider all measures available to them, including administrative cooperation improvement between EU Member States and third countries. The following are the fundamental rules as defined in the regulation governing in EU mutual assistance:

- Provide clear and binding rules for the facilitation of the exchange of information in VAT investigations;
- Entrust direct cooperation between tax officials from different EU Member states, while at the same time retaining the pivotal function of the central control offices;
- Indicate when EU Member States should (at least) exchange information which is considered to be spontaneous;
- Indicate the exchange of information that is specific to the intra-EU traffic, through the VAT Information Exchange System (VIES).

Regarding VAT, considering that quick access to information is essential in the fight against fraud, more effective ways of exchanging information should be provided, with regard to the latest technological developments and equipment used by traders.

For this purpose, considerations should be made regarding automated exchanges between EU Member States which are more detailed and more frequent, as well as direct access to national databases. An opportunity to implement some of these improvements is presented through the required VIES system modernisation. However, in turn, Member states cite the issue of language, insufficient human resources, and lack of knowledge on the cooperation procedures at the level of their own tax audit personnel. The personnel which is assigned to carry out administrative assistance, contribute to the tax receipts of all other Member States excluding those of the State that remunerates them. This results in the lack of the necessary personnel due to the fact that it is difficult to measure indirect benefit resulting from reciprocity. Moreover, there will be a reduction of financial soundness of companies bearing the payments of back-taxes of various EU Member States. It is the responsibility of the Member State where these companies are established to undertake all indirect consequences such as staff reduction and other. There is also an indirect benefit for the Member State where the company is established - the company does not pay taxes to other Member States due to the fact that these funds remain in the Member State and contribute to the local economy. There is a possibility that the examples above go some way in order to explain the inertia within the respective revenue administrations towards administrative cooperation. But this should not serve as justification. There are two main solutions to solve this issue: The establishment of a supervision system ensuring that each Member State provides effective assistance to its counterparts; and the development of ITAS which would store the information of all the taxpayers of EU Member States.

Quick access to information is essential in the fight against fraud, more effective ways of exchanging information should be provided, with regard to the latest technological developments and equipment used by traders.

There are two main solutions to solve this issue: The establishment of a supervision system ensuring that each Member State provides effective assistance to its counterparts; and the development of ITAS which would store the information of all the taxpayers of EU Member States.
to its counterparts; and the development of ITAS which would store the information of all the taxpayers of EU Member States.

But where is the “perfect” solution? It is necessary to extend the use of technology in order to provide businesses with free access to global markets. On the other hand, it should be used as a valuable control measure by the revenue services. Examination is necessary on the further and wider use of existing techniques and risk analysis, validation of VAT registrations and payment requirements for blocked accounts. However, this should be done on a coordinated and consistent basis across all the EU Member States. Considering the fact that almost 75% of the budget was devoted for communication and information exchange systems, the existence of a unified system and prevention of money wasting would be the most effective way to fight against frauds. Such a unified System would enable to analyse data in real time. Processing of VAT transactions in real time would enable to overcome fraud due to the fact that quick reaction is necessary in order to catch the chain of fraudulent transactions. To process transaction in real time, it is necessary to have technological support, as well as improvements in procedures.

It is particularly important that, in addition to the data on the part of tax administrators and taxpayers, there is also data on their assets, incurred costs, etc. (see Appendix 1). Only this type of database would enable to reveal VAT and other tax frauds, would help fight corruption, shadow economy and solve similar problems. EBPO suggests learning about tax fraud reduction methods from the successful experience of foreign countries. For example, Slovakia, which implemented the “Tax cobra” system (promoting close cooperation between the police, the prosecutor’s office and tax authorities) has proven its success: VAT gap was reduced by 8 percent over the period of two years. This only proves the idea provided during discussions that ITAS should include all the data currently used by different institutions and stored in information systems. A decision was made that the best information collection method would be if all natural persons and legal entities carrying out business activities would provide their complete accounting data, and the tax administrator would upload, manage and process such data. For this purpose, several levels of digitization could be distinguished (see Figure 10).

The third and fourth levels are the most significant to a unified system in EU countries and should use big data analysis models which would help determine the risk level and its source, as well as identify the “location” of dubious activities in accounting which would then be marked with red flags.

The worst part is that the current practice of the determination of red flags shows that a Member State carries out its own risk analysis.
For example, in Belgium, before registering foreign companies for VAT purposes, tax inspectors carry out detailed reviews on the registrants in order to prevent carousel fraud, e.g., by carrying out interviews, detailed questionnaires or actual visits on site. In Denmark, a company registering as a VAT payer must provide guarantees, unless its business assets are worth at least Dkr125,000 ($16,915) on the date of registration. In France, companies that are established outside the EU and want to claim a VAT refund may have to provide a bank guarantee and assign a resident tax representative. In Germany, VAT invoice details are scrutinized by tax authorities who reject VAT deduction if a required “mention” is missing. They are able to perform spot audits for VAT purposes from 1 January 2002. In the Netherlands, VAT payment is shifted to the principal in order to secure the collection of VAT from subcontractors in the building, textile and shipping industry. The latter receives an invoice from its subcontractor without Dutch VAT and must pay and recover the VAT in the same VAT return. In the UK, detailed information is requested by the tax authorities prior to the registration of foreign companies for the purposes of VAT, particularly in high-risk sectors like mobile phones.

This implies a tax risk evaluation system in order to control high-risk companies more frequently. Frauds related to VAT are particularly common in these sectors: construction industry, cars, textiles, phones and electronic devices.

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**Figure 10. Levels of digitization (source: EY)**

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<tr>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Level 4</th>
<th>Level 5</th>
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<tr>
<td>Corporate entities required or have the option to use a standartized electronic form of filing tax returns. Other income data (e.g., payroll, financial) filled electronically and matched annually.</td>
<td>Corporate entities required to submit accounting or other source data to support filings (invoices, trial balances, etc.) in a defined electronic format at a defined frequency. Additions and changes at this level occur frequently.</td>
<td>Corporate entities required to submit additional accounting and source data (bank statements). Government begins to match data across tax types, potentially across taxpayers and jurisdictions in real time or near real time.</td>
<td>Corporate entities’ Level 2 data is analyzed by government entities and cross-checked to filings in real time to prevent fraud, unintended errors, and to map the geographic economic ecosystem. Governments send taxpayers electronic audit assessments with a limited window to respond.</td>
<td>Government entities use submitted data from corporate entities to assess tax without the need for tax forms. Taxpayers have a limited window of time to audit government-calculated tax.</td>
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“This implies a tax risk evaluation system in order to control high-risk companies more frequently. Frauds related to VAT are particularly common in these sectors: construction industry, cars, textiles, phones and electronic devices.”
In Luxembourg, analysis and risk management techniques are being implemented by the administration for achieving a more efficient determination of which companies should be controlled. In the UK, large companies, which are considered to have potentially higher risks, are the focus of tax authorities. Also, in the UK and the Netherlands, almost 20% of all tax administration personnel are used on tax audits at businesses premises. Whereas in Sweden, this amounts to less than 1%, and it is below 5% in most of the EU Member States. On average, tax audits are carried out for each VAT payer once every 40 years. Important information is provided in VAT declarations which are submitted by taxpayers. The latter information should not be exploited by tax authorities, e.g., for gross margin checks (though the suppression of both sales and purchases will not be detected) and benchmarking. This is being improved in countries such as UK and France, where more use is being made of the declared information to control the collection of taxes and speed up the refunds of VAT. Greece uses the Taxis Net software which enables to electronically crosscheck data and invoices provided on a yearly basis by all taxpayers via an electronic form (Accumulative Customers and Suppliers Listing Declaration). Belgium also has a similar system. To improve its control methods, Luxembourg implemented ESKORT software. Member States use different VAT control systems partly due to the fact that different legal environments exist, thus approaches are not harmonized. However, there is a concern that the proposed solutions are becoming more radical, e.g., solutions in Austria and Germany, which essentially modify the current EU VAT system by excluding the fractionated method of VAT due payment by the final consumer in stages.

No common criteria or sources of information exist in order to carry out this risk analysis. Moreover, there is little feedback on the usefulness of the exchanged data. This results in the fact that Member States participating in different fields of work often exchange information which includes non-dubious traders, thus wasting resources. It should be noted that it is not sufficient to simply have a unified system which would store internal and external data of business entities. It is important that the big data system would form data from external sources such as social media (government records, watch lists, etc.), unstructured sources (images, email, voice, web interactions, telematics, location, etc.), investigative data (case management, known fraudsters, documents and reports, etc.) and line-of-business applications (payments, billing, underwriting, etc.) (see Figure 10).

The main idea related to the implementation of a unified fraud search system is ensuring promptness and reducing costs related to fraud identification and prevention.

It should be noted that the main idea related to the implementation of a unified fraud search system is ensuring promptness and reducing costs related to fraud identification and prevention.
During discussions, it was revealed that sometimes fraud search in Member States results in more costs than benefits, i.e., search and damage recovery costs are often greater than the scale of the VAT fraud itself. Therefore, it is believed that the centralization of the search for VAT and other frauds on the EU level would enable to achieve a high level of cooperation and save a significant amount of funds. As mentioned previously, the assistance of auditors is also used for the research process and the red flag search. In order to achieve full centralization, the primary issue is importing data to the new software intended for fraud search.

**Figure 11.** The basic model for identifying red flags in iTAS of EU Member States

In order to achieve full centralization, the primary issue is importing data to the new software intended for fraud search.
During discussions, it was revealed that sometimes fraud search in Member States results in more costs than benefits, i.e. search and damage recovery costs are often greater than the scale of the VAT fraud itself. Therefore, it is believed that the centralization of the search for VAT and other frauds on the EU level would enable to achieve a high level of cooperation and save a significant amount of funds. As mentioned previously, the assistance of auditors is also used for the research process and the red flag search.

Most European States already have or are still implementing smart tax administration systems which are aimed at not only ensuring the collection of taxes, but also the improvement of internal organization, assurance of greater accountability, integrity and transparency, improvement of taxpayer compliance and service delivery to taxpayers, as well as performance of a more efficient and prompt tax payer supervision and control, and the identification of frauds. As shown by the KfW Development Bank, an analysis of tax software used in various different countries around the world was carried out. All of the softwares have several similar functions, as well as different ones adapted according to the needs of one or another country. Comparison of results of the scoring against the ATO Capability Model versus observations onsite has revealed that there is a significant gap between ITAS capacity (as they are marketed) and its implementation degree. There are two possible explanations for this situation: In scope of this study, tax administrations have not yet finished the implementation phase and some of the functionalities still have to be deployed. Logically, an indicator is provided by the latter observations that the implementation of highly complex software will be more difficult to achieve, or simply that new modules have been implemented by Senegal since 2006. The important lesson is that proper conditions formed by considering local circumstances will enable to achieve the successful implementation of ITAS. There are several factors influencing successful ITAS implementation, beyond the technical aspects of ITAS (its functionalities and their implementation). Site visits were useful in order to shed light on the matter. It is appropriate to consider the latter factors as the readiness conditions for successful ITAS implementation. Due to the fact that different data in different formats are stored in tax administration software in different countries, a data import issue occurs when developing a unified system for tax fraud search. However, these are only technical matters, as the process itself, such as how will frauds be identified and found in the new ITAS, is much more important. An analysis was carried out and revealed that most Member States where ITAS is used collect and store the following VAT-related data: identification number of the VAT payer, invoice number, VAT payable amount, taxable amount, date of issue and industry classification code. There is a practice where it is required by the general
VAT taxpayers to upload data on a monthly basis to local tax authorities when filing their monthly VAT returns. The proposed system requires companies to use a special tool that loads XML files that contain invoices, applies secret sharing to each input value and uploads the shares of each value to the servers of the state tax administrator.

Companies can audit this tool in order to ensure the use of good randomness and connection to correct servers. If parties that have clearly non-collusive relations receive all submitted shares, the direct perception of security is significantly improved for the owners of data.

Tax authorities store this data in the cross-checking inspection subsystem. When the cross-checking model is applied, VAT becomes payable by the supplier at the time payment is provided for the transaction by the customer.

Still, the customer’s VAT deduction right will arise with payment of the tax to the State by the supplier. Thus, a default in the VAT payment paid by the supplier results in the loss of the customer’s right to deduct the VAT, regardless of the fact that the VAT price was paid by the customer to the supplier. It is required by the cross-check mechanism that an individual return for the operation is filled in electronic format, when the supplier receives the payment. The cross-check enables the comparison of the individual return information with VAT turnover return data. It also enables the identification of transactions that have not yet been paid by customers of the supplier. Nevertheless, such signal does not indicative fraud due to the fact that the taxable person may simply be late in providing an individual notification or payment, etc. Otherwise it enables to compare VAT paid by the seller with VAT that was declared to be received by the buyer, as well as compare various declared turnover amounts. It should be emphasized that fraud can be carried out through the issue of several invoices and payments that are below the threshold and, secondly, the cross-check is not reliable enough to be used for the identification of fraud. It is simply a tool used for identifying the default. The use of this method can also increase the cost of compliance for companies, due to the fact that these companies are required to file several individual returns per day, depending on the number of customers. And this will be even more tedious for medium and small businesses that are currently able to enjoy simplifications. The r-check method could be another method of fraud investigation in ITAS. When applying reverse-charge, economic transactions are taxed all at once in the chain, at the retailer level.

The reverse-charge can be applied only between taxable persons from which the recipient has the right to deduct (prorated) 100% of VAT. The aim of r-check is to enable the supplier to verify the quality of the customer in real-time by using a reliable computerised method — verification of the validity of the r-number, name and address provided by the customer. With the...
help of this verification, all transactions that were subjected to the reverse-charge system have to be communicated in real time by the seller to the revenue service, via the return. The r-check is necessary when applying the reverse-charge mechanism in order to check the exemption of the transaction against the quality of the customer. It does not significantly differ from the verification of the VAT number which is already available for intra-community deliveries. At present, the supplier does not have access to the company’s name or address to exempt the intra-community transaction in order to verify the customer’s VAT number. It should be mentioned that this method is rather limited due to the fact that it enables to prevent only one type of fraud - provision of a false VAT number or r-number. Even though the use of a real r-number for final consumption purchases is not prevented by it, this method is still useful enough for the identification of red flags. The cross-verification of invoices is a third method that could be used for cross checking.

To a certain extent, advantages provided by new technologies were beneficial to Latin American countries, particularly Brazil, Mexico and Chile. These technologies enabled the countries to develop a method of cross-verification of electronic invoices with the aim to reduce fraud. In Brazil, cross-verification of electronic invoices corresponds with the broader aim of simplifying and reducing the administrative costs of companies, particularly regarding turnover returns, registrations in various States, etc. Computer resources applied for bookkeeping are already used by most large and medium businesses. Therefore, issuing of electronic invoices is preferred due to the fact that it is consistent with this simplification context through the use of data processing. An “approval” in real-time is received by such electronic invoices from the revenue service, enabling the recipient to carry out VAT deduction and the supplier to carry out the delivery without the need to pay the VAT at that time. The revenue service of the State of the supplier confirms the latter’s status, his integrity vis-à-vis payment of the VAT and the existence of the deductible VAT that can be compensated with the VAT of the transaction in question, all of which is carried out in real-time. When this method is applied for all transactions, the information system of the revenue services is then able to track which invoices were received from which companies based on purchases and the invoices that were issued at the time of its sales. Therefore, the company is no longer required to provide turnover returns and returns for exchanges of goods (for example, for statistical purposes). The use of this method is a way to protect public revenue in real-time: payment in advance for the transaction, communication with the customer that the VAT will not be deducted, establishment of the recipient’s responsibility, etc. As a matter of fact, companies receive a dual benefit: reduction of administrative tax costs and reduction of unfair competition within the sector caused by fraud. It should be noted

"The cross-verification of invoices is a third method that could be used for cross checking."

"If all the aforesaid data was collected in a centralized way on the level of the entire EU, then the cross-checking algorithm used in the verification system would help find the early stages of possible frauds quickly and effectively. If the data in companies of both the buyer and the seller match, then no further action is taken. If data does not match, then an invoice copy is forwarded to the investigation subsystem for further investigation."
that this method does not prevent all fraud. For example, this method is still not able to tackle the fraud of selling and purchasing without the issue of invoices (black market). The initial set-up costs associated with implementing a cross-checking solution are substantial and would require wholesale changes to the methods of conducting business in the EU. If all the aforesaid data was collected in a centralized way on the level of the entire EU, then the cross-checking algorithm used in the verification system would help find the early stages of possible frauds quickly and effectively. If the data in companies of both the buyer and the seller match, then no further action is taken. If data does not match, then an invoice copy is forwarded to the investigation subsystem for further investigation.

To expedite the process, cross-checking and investigation is carried out at the central government and provincial level instead of the local level. In the case when a VAT invoice is found to be fraudulent or otherwise invalid, it is submitted to the subsystem for investigation coordination. There are, of course, certain risks, however they are significantly lower than when acting on a local level, due to the fact that cross-checking and inspection functions are not carried out in real time, but may take several weeks to complete. Such time lags result in the fact that some companies can issue large quantities of fraudulent VAT before closing. ITAS administrator usually suffers large loss of revenue by the time the fraud is found, as well as trouble apprehending the issuers. Another risk is related to the fact that most countries use several different internal system intended for tax administration. Because of this, all systems are currently operating independently and cannot share data. Thus, when planning a unified system between EU Member States, it would take time for countries to prepare for the export of necessary documents to a unified system.

The tax fraud analyst will receive only the risk scores, who will then be able to request the detailed records for companies that are at risk. This, it turn, protects the rights and information of taxpayers who are honest. In terms of the role of auditors in this process, it can be very significant. Auditors could be certain assistants in the process of trying to identify frauds as fast as possible. When intending to audit a company and having more information related to certain VAT fraud risks, auditors could inspect the audited target area thoroughly. A set of tools that are able to navigate through data and sort it is necessary for processing large quantities of extremely complex and various data. Data sorting methods differ from one data type to another. Sorting is a multi-level process in terms of Big Data, where data type is not singular. It is very important to mention that the entire utilisation of analytical tools will depend on the database structure. It should be noted that it will be relatively easy to collect data in the iTAS system. The data would be submitted by all the institutions of Member States.

Another risk is related to the fact that most countries use several different internal system intended for tax administration. Because of this, all systems are currently operating independently and cannot share data. Thus, when planning a unified system between EU Member States, it would take time for countries to prepare for the export of necessary documents to a unified system.

It is possible to design a system that is able to collect VAT declaration annexes from companies in a protected form and perform a risk analysis while transactions are in an encrypted domain.
The specially designed software will have a task for each cluster to sort data according to various different key elements set by the user. Clusters are also able to basically analyse the stored information in order to enable the “mainframe” to act as the system’s control centre.

OLAP tools can be used to process a set of data in the Big Data environment. The latter process creates connections between data.

States in, for example, XML format. This format is supported by most systems and is used very widely in order to achieve the import of data from, for example, taxpayers. Thus, it could also be adapted for data export from the system to iTAS. One of the solutions to treat Big Data is to develop a system that would be able to make differences between various data types. It is easier to search through one type of data than to search through different types of information. For example, it is easier to find answers when searching through a full text file instead of searching through a text file that also contains images providing answers to questions. This technique is known as “divide et impera”. By doing so, video files will be handled by one cluster with a special software design, 3-D models will be handled by another cluster, while plain text files will also be handled by a third cluster, etc. This system will enable the fragmentation of data which will be faster to process. MapReduce can be used to achieve the software solution that would be able to handle the fragmentation of data. In addition to its main function of dividing data, MapReduce can also be configured to recognize data type that is mapping. The specially designed software will have a task for each cluster to sort data according to various different key elements set by the user. Clusters are also able to basically analyse the stored information in order to enable the “mainframe” to act as the system’s control centre.

This will be helpful in order for the analysts to achieve quick and accurate results, and will also enable real-time updates on ongoing information. The stored data quantity is not always 100% useful. On the other hand, in most cases, the stored data is not yet sorted and represents files of data that may include location information, financial data, web traffic log, etc. In order for it to become useful, specialists must sort it, so that information can later be analysed and have some kind of value. According to IT specialists, the most time-consuming process is the “cleaning up” of data than needs to be analysed. The process of cleaning up and sorting data is quite a challenge that is hard to overcome. Nevertheless, in order to overcome it, trained people are often hired by companies to manipulate the data type that will be used further by executive employees or higher management. This process requires a lot of time, while its costs are proportional to the amount of data. Insufficient skills in sorting Big Data will most certainly lead to faulty results and/or truncated data that is not able to serve its purpose. In order to eliminate the “need” to seek the help of specialists, it is necessary to implement software solutions that would not require special skills in order to understand how to operate it. However, to do that, it is necessary to overcome an additional obstacle: quality and data. In order to achieve this, the architecture of the source collecting the data must already be able to logically sort it. To accomplish this, the collected data must be received in a way that would be understandable for the software that is sorting the data.
These obstacles will not be easily overcome due to the fact that the idea of a “controlled environment” does not exist in the context of the World Wide Web. It is possible to solve this issue only if the sets of data come. In the latter case, data is already manipulated, easy to understand and analyse in order to create projections. OLAP tools can be used to process a set of data in the Big Data environment. The latter process creates connections between data.

The objective of this set of tools is to rearrange the data presented in “cubes”, which represents an IT architectural design with a meaning of forming sets of data that are assembled logically, so that it can be accessed easily. The latter enables specialists to achieve higher speed and shorter waiting time when large amounts of data are processed. The usefulness of information processed in the OLAP environment may still be questionable due to the fact that all the provided data is being sorted and analysed. If the general EU system would implement an algorithm which would assess the VAT risk and its level, and the auditor would have the right to familiarize with it, the latter could confirm or deny the risk after performing an audit.

In terms of the VAT fraud investigation, we believe that, first of all, it is necessary to find high differences between the transactions of partners, the values of the company’s sales invoices per partner are added together and totals of the partners’ purchase invoices connected to this company are added together. It is considered that the purchasing partner carries a risk if the difference between sales and purchases is determined to be negative. The second algorithm should find the proportion of the sum of all sales invoices declared by taxpayers from the total sales declared in the main part of the declaration. If it is determined that the percentage is lower than some estimated fixed amount, it shall be considered as a risk, implying that some invoices were left out of the declaration. And finally, if the company’s partner has a risk, it should be noted that the company is also considered to be potentially risky. The aforesaid algorithms will, of course, run on secret-shared data and produce secret-shared results. The parts of these results will be published only to the Chamber of Auditors.

If, according to the results, the company has a risk, the Chamber of Auditors will need to acquire transaction data from a secure multi-party system (under an agreement with other computing parties) or the company directly. Specific algorithm components should include all the following fields:

1. **Management of risks and regulatory reporting:**
   - enterprise risk detection across risk dimensions;
   - regulatory reporting with reinforced agility to change the regulations.

2. **Monetization of customer data:**

"If the general EU system would implement an algorithm which would assess the VAT risk and its level, and the auditor would have the right to familiarize with it, the latter could confirm or deny the risk after performing an audit.

It should be noted that, in practice, more than one algorithm is often used in order to achieve optimality.

The aforesaid algorithms will, of course, run on secret-shared data and produce secret-shared results. The parts of these results will be published only to the Chamber of Auditors."
It is necessary to properly oversee the transition to a definitive system. And it is also crucial to improve the performance of national tax administrations, including their cross-border cooperation, as well as address the susceptibility to fraud of the system.

3 Operations and transactions:

- Centricity of customers: customer’s single view development;
- Analysis of customer risks: behaviour profile analysis, customer spending habits and cultural segmentation;
- Retention of customers: analysis of logs and activities of internal customers in social media in order to achieve the early detection of dissatisfaction.

In order to improve the collection of VAT and fight against fraud, it is necessary to encourage developing and exchanging best practices across the EU. For instance, setting time limits for VAT accounting between EU Member States could be a possibility worth considering. Every effort should be made in order to close the VAT gap as much as possible. This should be beneficial for authorities (in terms of correct VAT receipts) and make the playing field more even for all the suppliers. In this area, the cooperation between auditors and ITAS administrators can be carried out in several ways using several methods.
AUDITOR AND ITAS COOPERATION
VISION

Since the EU management structure is multi-layered, cooperation and coordination of actions of EU and Member States, as well as smaller governmental levels within the Member States is necessary. Such cooperation should include thorough VAT accounting inspection, including ensuring financial account accuracy, checking whether the operations comply with the existing rules and evaluation of the achieved results (cost-efficiency, effectiveness, etc.) It would be beneficial for both parties and the undertaking if the two groups would be able to coordinate their actions and work plans, as well as express their understanding, appreciation and trust in each other’s work and abilities.

During discussions, it was found out that, by considering risk assessment results based on certain mentioned algorithms, auditors should check the selected companies more thoroughly and, in all cases when there is a suspicion that VAT embezzlement activities are, were or will be carried out, perform an audit in the company by applying a minimal audited selection interval, despite the monetary operation amount or other exceptions. During the execution of customer business relationship monitoring, audit firms would have to determine cases when several interrelated suspicious purchase and sale operations are carried out. An unanimous opinion was reached during discussions, that, when the risks are higher than average, audit firms should always have to carry out continuous customer business relation monitoring, including the investigation of transactions that were carried out during these relations, in order to ensure that the carried out transactions comply with the audit firm’s knowledge regarding its customer, its business (its type, business partners, activity area, etc.) and nature of the risk.

For this reason, it would be appropriate if, in order to assess the VAT fraud existence risk, the audit firm would set risk assessment and management procedures which would enable the audit firm to efficiently manage the suffered VAT fraud risk by focusing on high-risk fields. To achieve this objective, it would be appropriate to use chambers of auditors of Member States which would be responsible for ensuring support for VAT fraud detection.

Auditors should also ensure that the latest and accurate information (which would be periodically updated) would be used when carrying out the assessment of VAT

“When the risks are higher than average, audit firms should always have to carry out continuous customer business relation monitoring, including the investigation of transactions that were carried out during these relations, in order to ensure that the carried out transactions comply with the audit firm’s knowledge regarding its customer, its business (its type, business partners, activity area, etc.) and nature of the risk.”

“it would be appropriate to use chambers of auditors of Member States which would be responsible for ensuring support for VAT fraud detection.”
fraud existence risk. When carrying out VAT fraud risk assessment, the audit firm should pay particular attention to customer activities which, according to the firm, may be related to the existence of VAT frauds due to its nature.

**This could be:**

- **Specific common characteristics of the supplier** – for example, invalid intra-community VAT number, dealing with operations that are unrelated to its normal activities, working in a sector inclined toward carousel-type fraud.
- **Transaction characteristics** – for example, price which is abnormally below the market, absence of sales contracts, large down-payments when comparing to the total invoice amount.
- **Payment terms** – for example, no bank account, cash payment demands or quick payment demands.
- **Unusual characteristics of the company** – transactions carried out with companies which are new on the market without a clear track record or with a virtual office, unsolicited approaches from organizations offering an easy profit on high-value/volume deals for no apparent risk.
- **Purchased and sold product quantities and prices** – for example, companies selling products for unusually low or high prices, trading in unusually large product quantities, products that remain in the same logistic centre during all transactions, traders repeatedly offering their trade via new companies.

And similar (a sample audit questionnaire form can be found in annex 2)

It is believed that if the auditor has suspicions but not sufficient proof, he must carry out the continuous monitoring of risky companies and report suspicious operations to relevant local services as soon as the auditor notices such operations. It should be noted that various objective and subjective circumstances may cause suspicion, for example, the customer carries out operations not typical to its activities, provides false data about himself or about the operation itself, etc. A very important aspect is ensuring that the audit firm does not have to find out whether there are elements of fraud in the customer’s activities, and if there are suspicions that there are traces of fraud in the operation, such an operation must be reported to a relevant service which would then carry out a more detailed investigation.

It is believed that such cooperation between auditors and ITAs would provide the most benefits. Thus, an audit firm should prepare clear and specific internal regulations that would provide who must carry out which specific functions during the implementation of VAT fraud investigation in the audit firm. It is also very important to provide clear procedures related to the provision of reports and information to relevant services regarding the noticed suspicious operations.
picious operations.

The audit company should assign a managing employee who would organize VAT fraud investigations, carry out the continuous monitoring of operations carried out by high-risk companies, and would maintain relations with relevant services. Meanwhile, in addition to the audit firm, the chamber of auditors of that country would also have to ensure that such an employee or employees would have the possibility to receive all the information necessary for carrying out their functions, including access to information related to the carried out purchase and sale transactions.

After determining that the operation could be suspicious or noticing any possible traces of VAT fraud, audit firm employees should report this to the aforesaid responsible employee of the audit firm. The latter should then register information about the customer and its carried out operations, check the operation and information related to it once again, and inform the relevant services if there are remaining suspicions regarding frauds. The latter could in turn continue the investigation by using all the possibilities provided by ITAS. However, auditors should in no way let the company know or inform it that it is being monitored or is included in the high-risk subject list. During discussions, it was found that the following supportive actions could be conducive to good cooperation and coordination between the ITAS and auditors: 1. An examination methodology which would be uniform, meaning that similar auditing procedures and standardised audit working papers regarding the performance of the financial and tax audit process would be used by both groups. 2. Direct support, meaning that the audit personnel and the working papers are at each other’s disposal. However, such proposal will probably not receive enough support. ITAS will probably not be inclined to issue their working papers for the purpose of assisting the auditors due to considerations of confidentiality. Moreover, it is doubtful that the auditors and ITAS will agree working under each other’s authority. 3. Joint training programmes and (or) participation in each other’s training programmes. Such actions are useful only if they happen selectively and mainly deal with matters related to mutual interest. 4. Exchange of audit reports on matters of mutual interest. In the process of improving coordination and cooperation between auditors and ITAS, effective communication becomes crucial and requires that certain conditions should be met, such as - should be frequent, direct, open, and timely.

Such communication can be in a written form; face to face; electronic, telephonic or a combination of all the above. During discussions, it was found that: there might be periodic meetings between the auditors and ITAS; the auditor is given access to relevant ITAS reports and should be informed on matters that may have an impact on his/her work, and, in turn, the auditor provides information to ITAS on matters that could have an effect.
This coordination includes periodic meetings between the management institution, ITAS and auditors in order to discuss matters of mutual interest.

Moreover, coordination and cooperation improvement could also be carried out by establishing the overall tone of acceptance in the organization, appreciate its results, and implement its recommendations. However, there is still controversy in the decision to encourage the participation of auditors in the detection of fraud. During discussions, it was found that auditors would not appreciate cooperation with ITAS. Furthermore, auditors believe that ITAS would not use the works of auditors to the maximum. In order to make this coordination effective, findings of both the auditors and ITAS should be regularly shared with each other and, in accordance with the discussion results, the auditors would not see the need to have regular meetings with ITAS and also they would probably not rely too much on the findings and evaluations of ITAS in order to make the maximum use of their limited time. In this case, it is more important to also clearly define and regulate guidelines (on the level of the entire EU) which should be followed by auditors when carrying out audits in companies and, of course, clearly define the process of cooperation itself between ITAS and the auditors.

Sample directions formed during discussions are provided annex 3. It is very important to also provide another aspect, which is the security of such a database. The issue of security is relevant when considering such a big data cache including the data of legal and natural persons of all the countries. First of all, it is necessary to determine where the data will be used, who will manage the data, what and whose accesses will be developed in the system, how will data security be ensured and, most importantly, whether there will be a threat of massive general tracking.

First of all it should be noted that the applied security measures would have to fully comply with the EU data security standards.

The new system would have to be coordinated with the requirements established in the decision of the European Court of Justice of 6 October 2015. All, without exception, EU authorities that have access to the information system would have to undertake the obligations to implement the protection of privacy and make sure that national security authorities will not carry out general or mass tracking. This aim will be reached by using measures such as strong obligations of organizations managing personal data, as
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well as the strict assurance of their fulfilment. The new procedures will be transparent and there will also be effective supervision mechanisms in order to ensure that the companies follow their obligations. Otherwise, they will be subject to sanctions or participation prohibitions.

The new rules tighten the conditions for the participating company data transfer partners; - clear security measures and transparency obligation applied to EU Member State government access to the data of natural persons and legal entities. - effective protection of EU citizen rights, by providing various possibilities for the protection of rights.

There are often thoughts on how to find frauds as fast as possible and we have proposed one method – development of a unified system which would be used by administrators trying to detect fraud. As shown by practice, there is another method that could be even more effective and cost-efficient. This method is the encouragement of taxpayers themselves to become more transparent and refrain from carrying out fraud. For example, in 2007, an incentive scheme was started by the Brazilian state of Sao Paulo - the Nota Fiscal Paulista, which was designed for the purpose of encouraging customers to collect VAT receipts from their suppliers. In the lottery system framework, social security numbers are provided by customers to suppliers who register the numbers on receipts. All receipt information (including or excluding social security details) must be provided by suppliers to the tax authorities, who form separate accounts under each social security number and reward the customers via a 30% tax rebate and by enabling them to participate in a lottery: per each 50 USD expenditure, consumers receive a lottery ticket in order to become a potential winner of one of the 1.5 million prizes distributed on a monthly basis. These prizes usually range from 5 to 25 USD, however, the largest prizes can reach up to 500,000 USD. After expense deduction (1.6 billion USD), the incentive scheme resulted in a net increase of tax revenues of 400 million USD over a period of four years. Argentina can provide another example. In Argentina, final consumers paying their suppliers via debit or credit cards are able to receive a 5% VAT refund. Such an incentive scheme has been used since 2001

The issue of security is relevant when considering such a big data cache including the data of legal and natural persons of all the countries. First of all, it is necessary to determine where the data will be used, who will manage the data, what and whose accesses will be developed in the system, how will data security be ensured and, most importantly, whether there will be a threat of massive general tracking.

The preferred options are measures encouraging the compliance of VAT and reducing the burden of VAT on compliant businesses.
and is obviously successful due to the fact that the application period has been extended, each year, by another year since the introduction date. Governments across the globe have implemented various measures aimed at combating VAT fraud and encouraging the compliance of VAT. Adverse economic effects are much less pronounced in some measures instead of others. The preferred options are measures encouraging the compliance of VAT and reducing the burden of VAT on compliant businesses.

We are clearly entering a new era of record keeping computerization and information exchange, which can result in more effective enforcement and collection of VAT without needing to impose economically adverse obligations on businesses. Nevertheless, even though all jurisdictions are happy to receive information from foreign countries, the provision of own information to the tax authorities of another jurisdiction is a different matter, due to the fact that it does not result in tax revenues in the jurisdiction that must carry out all the information gathering works. The more stringent the financial tax authority targets, the more difficult it will be for them to devote their limited resources to investigative activities that are “non-productive”.
UNIFIED SYSTEM – A BENEFIT FOR THE SELF-CONTROL OF TAXPAYERS

As it was already mentioned, since the import customs duties and other import taxes are calculated depending on the customs value of the imported goods, accordingly, its reduction (or increasing) is one of the varieties of commercial fraud. The exposure of commercial fraud is an important area of work, not only in terms of tax collection, but also in order to ensure the equal import conditions for all importers, as well as fair competition. Precisely such violations of law cause the most damage to the foundations of economic security: customs authorities collect less taxes, less taxes fall to the state budget and the budget of the EU. It also becomes impossible for legal Lithuanian businesses as well as honest traders to compete with goods which were imported by deceit and released for free circulation while reducing their customs value as they were not subject to the import VAT and other import charges in accordance with the law.

The broader research of the control on customs valuation in Lithuania and its relevance. They identified the main causes of motivation to reduce the customs value of the imported goods and described various ways (methods) traditionally used for the unreasonable reduction (or, in some cases, increasing) of the transaction value of the imported goods. For example, according to their study, the aim to minimize the toll of the import customs duties and other taxes (what is relevant and important for the prevention of import VAT evasion and fraud) is among the main motives for the reduction of the customs value of the imported goods. Other motives are mostly important for the prevention of the import customs duties fraud, such as to avoid applying the tariff quota restrictions, to ensure the application of more favorable customs duty when the classification of goods and customs duty rates depend on the value of the goods.

The transaction value is reduced (increased) by importers in different ways, among which the most common are:

- resale of goods in transit, in customs warehouses and free economic zones, as well as the resale of goods through offshore companies;
- falsification of documents (customs authorities are presented with one invoice and the seller of goods is paid according to another invoice, or the buyer pays the seller the difference in price in cash);
- the appendices to the cus-
toms value are not added to the transaction value (payments for the materials, tools, license fees, etc.);

“the purchaser’s share of transport and insurance costs are not included in the transaction value of the goods (the goods from the countries which are more far away are transported to the country which is nearer, and, after the changing of documents, from them they are imported to Lithuania while concealing the real transport costs);

“the goods are wrongly described on the invoice (for example, the invoice wrongfully indicates that they are used, defective, etc.);

“the reduction (or increase) of the customs value also happens in transactions between related persons: the difference in price, which is concealed from the customs authorities, is paid in cash or the payment is being made for a fictitious service (therefore, the prices of the goods which are sold between related persons do not meet the prevailing market price level of such goods, which is reached while operating on the conditions of free competition).

The specified authors (Radžiukynas and Belzus, 2008) point out the fact that, in some cases, the fight against tax fraud on the taxation of imported goods may face not only the problem of the reduction of the customs value of imported goods, but also the problem of unjustified or artificial raising of the customs value. The following problem occurs when the taxpayer seeks to avoid anti-dumping or countervailing customs duties or seeks the application of a more favorable customs duty when the classification of imported goods and duty rates are set as depending on their value (the higher value of the imported goods is subject to a lower duty rate). In addition, transactions between related persons can also be used to increase the customs value artificially in order to reduce the base of internal taxes, such as corporate (profit) taxes and other charges. In some cases, importers, in order to avoid import customs duties in Lithuania, apply a tax evasion method when in the invoice, which is presented to the customs authorities, the customs value of the goods which are subject to a lower customs duty rate is increased, and the customs value of the goods with a high rate of customs duties - reduced.

In this regard, it is noted that, sometimes (especially in the period (first decade) after the restoration of independence in Lithuania (since 1990), the customs value in the agreements with the seller was usually reduced by dozens of times, and sometimes it was even declared to be lower than the price of the materials used to manufacture the product. Therefore, customs authorities faced an objective necessity to deny the transaction
price as unfounded and to use other customs valuation methods on the imported goods. Most of such cases were related to consumer goods (mainly footwear, clothing and textiles) which were imported at unrealistically low prices. From a practical perspective it is important to note that the studies done in Lithuania after its entry to the EU (in 2005) shows that, out of all the cases of reduction/increase of the customs value, 54 percent of cases consisted of situations when the customs value was artificially reduced or increased because of the resale of goods. 37 percent of other cases were related to the situations when the buyer didn’t include all of the transportation costs under the Community Customs Code (1992) to the price of the transaction and 6 percent of cases were related to the situations when the forged documents were presented to the customs authorities.

Figure 12. Reasons for adjusting customs value of goods upon entry into EU, Lithuania, 2005.¹

1 Source: Lithuanian Custom’s Department, 2005.
In addition, according to the same author, there is a noticeable tendency that from all of the customs irregularities which are detected, more than 50 percent of them amounted to violations related to the improper declaration of the customs value of the imported goods (incorrect indication of the customs value in tax declarations). In the Republic of Lithuania, the proportion of additionally calculated import taxes (taxes which were calculated after additional checks and audits on the customs value) amounted to 56.9 percent immediately after the entry to the EU (in 2004). In the subsequent later periods, problems of import tax fraud and improper declaration of the customs value were dealt that the reduction of the customs value of the imported goods is the most common form of customs fraud and one of the most acute problems faced by the customs authorities of Lithuania.

The efficiency of tariff regulatory measures, the actual level of the taxation of goods, i.e. the actual amount of collected customs duties and import taxes (import VAT) depends mostly on the customs value of goods. This is confirmed by the relevant empirical data, for example, as it is indicated in the Report on the Activity of the Lithuanian Customs in 2015 (2015), in 2015, the largest amount of additionally calculated import taxes (43 percent) still account for taxes which were calculated precisely by adjusting the declared customs value of the goods. After inspections were carried out on the customs value of the imported goods, in 2015, territorial customs offices additionally calculated 1 million 340 thousand EUR of import taxes (in comparison, import taxes additionally calculated
due to the wrongful classification of goods amounted to 1 million 011 thousand EUR, while checks on the origin of goods lead to the calculation of only 156 thousand EUR of import taxes). Thus, the control of the customs valuation of imported goods and the improvement of fiscal business environment in Lithuania remains a highly topical issue.

It should be emphasized that, already, in the report of the European Commission of 19 December 2002, which has defined the program “Customs 2007” and tasks in the customs policy up until 2007, the European Commission has emphasized the priority to implement the improvement of the control procedures for the identification of tax fraud. This is related to a more standardized control procedure for documentary and physical inspection, as well as audit; the overall improvement of customs inspection in every area of the existing controls (this includes the management of tax fraud and the risk of fraud).

The latest action program for the customs in the European Union for the period of 2014-2020 (Customs 2020) adopted by the Regulation (EU) No. 1294/2013 of the European Parliament and of the Council (2013) also provides legal regulations which the aim to identify, develop, share and apply the best working practices and administrative procedures, in particular, further to the benchmarking activities.

However, customs valuation and processes of its control are quite complex and require a lot of knowledge and experience, thus Lithuanian customs authorities are rationally organizing the customs controls of imported goods while carrying out customs valuation controls at local, regional and central customs administration levels, as well as applying different control types (documentary, physical inspection, tax inspection and simplified tax inspections). The most important issue in this field is to minimize regulatory costs and to balance the forms of control with the financial, social and business interests so that they may not lead to additional obstacles for the legitimate business.

In order to determine the customs value of imported goods and cases of improper reduction or increase of the customs value, as well as to ensure the disclosure of tax fraud, a customs control assessment is carried out in accordance with the Rules on the control of the customs valuation of imported goods, approved by the Director General of the Customs Department on 28 May 2004 by the order No.1B-431 (2004). According to these Rules, the control of the valuation of imported goods is intended to improve the enforcement of the basic duties and functions of customs authorities and to strengthen the fight against tax fraud related to the reduction of the customs value (hereinafter - the Rules on the Control of the Customs Valuation of Imported Goods).

Regardless of whether the customs value of imported goods is controlled by the customs authorities during customs clearance or...
post-clearance stages, their control in Lithuania is based on the following main elements (section III of the Rules on the Control of the Customs Valuation of Imported Goods):

- verification that the transaction value of the imported goods declared by the importer complies with the customs legislation;
- carrying out of a documentary inspection on the declared imports: this includes checking whether the customs clearance and the declared value of the transaction is based on the submitted documentation and data which are complete, correct and consistent with each other;
- verification that the transaction value declared by the importer of the goods is real, compared to the transaction values declared by other importers for identical or similar goods (comparative prices of imported goods which are used for customs control purposes);
- the use of a computerized data base for the customs control of imported goods;
- the analysis of risk factors and criteria for the goods which are the object of customs control.

During the stage of customs clearance (Section IV of the Rules on the Control of the Customs Valuation of Imported Goods), customs valuation and its control is based on the documents presented by the declarant and their verification. During the post-clearance checks, when the customs value of goods, which are released for free circulation, is controlled, the taxpayer must provide additional documents and information to the customs authorities in order to justify the customs value. Therefore, during this exact stage, the customs authorities are entitled to carry out a more detailed inspection of its economic and commercial activities which are related to its customs procedures.

The main principle for the control of the reality, the value of imported goods is the comparison of the declared transaction value with the transaction value declared by other importers for the identical or similar goods, i.e. the comparison of the value which is investigated to the calculated comparative prices of the imported goods (Rules on the Control of the Customs Valuation of Imported Goods, para. 15-16). The comparative price of the goods is calculated on a monthly basis for each item described in the 10 character subheading of the Combined Nomenclature of the EU, using the declared transaction values of previously imported identical or similar goods. It should be noted that the comparative prices are not used to calculate the import customs duties and import taxes (import VAT) directly. They are used only for the control of the customs value of imported goods, i.e. for performing the checks on the reality of the declared transaction value. In commercial practice, prices applied on the same product by different importers may vary, and this cannot be used as the sole argument not to recognize the value of the transac-
tion. However, the practice of customs authorities confirms that low or high value of the declared transaction value of goods is one of the indicators of commercial and tax fraud, requiring a more detailed inspection of imported goods and an additional or further investigation (Rules on the Control of the Customs Valuation of Imported Goods, para. 16.1; 21.3).

Thus, in order to check the reality of the customs value of imported goods, the customs officials are using the Customs Valuation Database of Goods (hereinafter - PREMI database), which is formed using the procedures set by the Director General of the Customs Department (Rules on the Control of the Customs Valuation of Imported Goods, para. 16). The data in the PREMI database and includes data on at least three months of import transactions of goods, classified by the requirements of the CN (using its ten-digit code). The data of the PREMI database is also used to calculate the amount of additional bank guarantees required from the taxpayer (importer) and for the use of alternative customs valuation methods (Rules on the Control of the Customs Valuation of Imported Goods, para. 16.2. para. 33). In practice, the customs valuation is controlled in accordance with the principles described above and depending on the complexity of an import case, the commercial and transport documents provided by the importer and the correctness and accuracy of the data provided in them. In cases of reasonable doubt on the declared transaction value of the imported goods, the customs official could decide whether the goods should be released for free circulation only after the importer provides a bank guarantee, at least for the amount of the possible customs debt, and the transaction value of the declared goods is additionally verified.

In order to ensure the effective functioning of this system at the central customs administration level, i.e. in the Customs Department under the Ministry of Finance, a special Customs valuation department was established and this structural division of the Lithuanian Customs is the main division responsible for the formulation of a policy on the customs valuation and the organization of its control. One of the main functions of the Customs valuation department is to analyze the situation on the declared values of imported goods and to identify high-risk goods and importers. In addition, it examines the complex cases of customs valuation, preparing draft legislation on the customs valuation and customs valuation control, determines the risk factors in the customs valuation of goods, investigating cases of a large-scale customs value reduction or its increase, and the mechanisms of fraud in order to provide suggestions on prevention, as well as examines individual complaints concerning the decisions of territorial customs which are made on customs valuation, according to its competence coordinates, and methodically manages inspections which are carried out by the territorial customs authorities on the customs value of goods, cooperates with the Lithuanian state institu-
tions, business associations and foreign customs authorities on the methods of detection and prevention of the improper reduction or increase of the customs value and tax fraud related to these violations, participates in the commissions, committees and specialized working groups in the EU, the World Customs Organization (WCO), performs other activities which are described in the plans of the work of the Customs Department and implements other assignments.

Besides, before the entry to the EU (in 2002), the system of the Lithuanian customs authorities underwent a reorganization: the number of territorial customs was scaled down (five regional customs were set up instead of ten) and the Divisions on tariff and customs valuation control were established as their integral structural part. The main task of these divisions is to examine such cases of imports when the goods were released for free circulation after the customs clearance and the importer did provide additional financial guarantees, however, the declared transaction value was directed for additional auditing (inspection) by the customs office or an individual customs officer. Based on the results of the subsequent inspection, the Divisions on the tariff and customs valuation control prepare a draft decision declaring the goods which approves the declared transaction value or sets that the customs value should be determined by other customs valuation methods. The specialization of the customs officials by working with different groups of commodities is one of the most effective assumptions for efficient customs valuation control. The distribution of functions on the valuation of goods and customs valuation control between these structures depends on the entire customs infrastructure, their computerization level, specialization of customs offices (posts), training of customs officers and other factors. So, the organization of customs valuation control may vary depending on the functions of the customs officers and their centralization level. The model for the control of the customs valuation in Lithuania could be generally described as the model based on the essential role of regional customs authorities. For this reason, at the moment, the regional customs are the most important chain in the system for the control of the valuation of imported goods in Lithuania and the fight against tax fraud by concealing the import customs value directly, which depends on the competence of their officials and the proper organization of their activities.
JOINT AUDITS TO TACKLE VAT FRAUD: MORE THAN THE SUM OF 28 APPROACHES

Each year, Member States (MS) in the European Union (EU) lose billions of Euros of Value Added Tax (VAT) due to the fact that the present VAT system within the EU is susceptible to fraud. In recent years, the EU, like other international organisations, presented numerous measures to realise a fundamental change in the global tax climate. Part of these measures focus on better cooperation between tax authorities. After all, aggressive tax planning, harmful tax practices and tax evasion thrive in a particularly complex environment with no cooperation. Better cooperation could be established by means of the so-called joint audits, which go a step further than the current forms of cooperation between tax authorities. In this contribution, the added value of joint audits in preventing or combatting VAT-fraud will be discussed. Although there is still a long way to go, such an instrument – if applied as it is meant – could help prevent and combat VAT-fraud and bring the EU supervision on VAT to the level where it is more than the sum of 28 national approaches.

Recently, in its yearly VAT gap study (2016), the European Commission (EC) reported that “A staggering €159.5 billion in Value Added Tax (VAT) revenues were lost across the EU in 2014 according to figures released by the European Commission today.”

Numbers like this raise a lot of questions in the society and could negatively impact the behaviour of those taxpayers that lawfully pay their taxes due. It also triggers the debate between tax authorities and politicians about ways to recover the missing revenue. In the eyes of politicians, life is quite simple: against an amount of extra staff, tax authorities should recover an amount of the tax gap.

Off course, if things were that simple, tax authorities would act accordingly and collect the missing VAT revenues. In reality, however, this problem is as old as the way to Rome and does not seem easy to solve. VAT fraud exists as long as the current VAT system exists due to the fact that the VAT system itself gives opportunity to fraud. In the last decade, the EC recommended numerous measures to solve the problem, either regarding changes in the legal system, in the administrative and in control processes of the tax administrations, and changes in the international cooperation.

An analysis – in two recently published articles – of the effect of these measures to combat VAT fraud shows that MS seem to address this ‘European’ problem mainly on a national level. It is argued that a coordinated international approach could be the solution to effectively fight VAT fraud within the EU. An analysis of the developments in international cooperation, however, shows that MS underuse other means of international cooperation – the presence of audit officers abroad, simultaneous audits and joint audits - that currently exist besides the exchange of information. The exchange of information on its turn seems to be mainly used within the national context of the MS. The final conclusion is that, due to a lack of coherence in the supervisory systems of MS and due to the fact that MS are not really working together on the international level, this ‘European’ problem is still not resolved.

These findings are supported by the recent VAT gap study (2016) that once again shows an unacceptably high figure of the EU VAT gap. The VAT gap is a measure that demonstrates to what extent taxpayers are non-compliant with the VAT rules, and are not paying their VAT due. The VAT gap percentage ranges from 37.9% in Romania to 1.2% in Sweden. In absolute terms, the highest VAT gap of € 36.9 billion was recorded in Italy, with Luxembourg having the lowest of € 147 million. The reasons for non-compliance, resulting in VAT losses, are numerous, varying from tax evasion (fraud) and tax avoidance, bankruptcy and financial insolvencies to errors. The EC states “the findings support recent calls by the Commission to overhaul the EU’s VAT system to tackle fraud and make it more efficient.” The EC also encourages MS to follow up on the EC’s Action Plan towards a single VAT area (2016). The Action plan is divided into four areas with different types of measures (figure 14).

The second area of the Plan “Urgent measures to tackle the VAT gap” recommends ‘improving cooperation within the EU (and with non-EU countries)’ as a means to decrease the VAT gap. Looking more in detail, one of the measures in this area is “Evaluate Regulation (EU) No. 904/2010 on administrative cooperation and combating fraud in the field of value added tax, and propose legal and operational solutions to address the weaknesses of the current legislation, including by introducing joint audits.” So, joint audits are considered as an (future) instrument to combat VAT fraud.

In August 2016, I had the honour to discuss the use of joint audits as a means to combat VAT-fraud at the international two-day Anti-Fraud

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Training event “VAT Fraud Prevention as EU’s Financial Stability Support Measure” at Mykolas Romeris University in Vilnius (Lithuania). In the remainder of this contribution, I will elaborate on the discussion during this event. In section 2, the term ‘joint audit’ is explained because this term can have different meanings and can easily cause misunderstanding. In the context of international administrative cooperation, joint audits stand in contrast to the more typical situation in which taxpayers in different countries are subject to separate tax audits. In practice, however, the difference between joint audits and the existing means of international cooperation seems not always clear. Subsequently, in section 3, some practical experience with joint audits will be described from a pilot project between Germany and the Netherlands. In this section, both the opinion of business taxpayers and the opinion of the staff of the tax authority will be considered. Based upon a real-life case, section 4 will discuss the question of what could be the added value of a joint audit and whether the instrument is suitable for preventing or combatting VAT fraud. In the last section 5, the final conclusions and recommendations of the discussion are summarised.

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1 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT. Towards a single EU VAT area, Com (2016) 148 final.

In the world of administrative cooperation between tax authorities, the so-called joint audits are rather new but at the same time seen as a solution for various existing problems, as e.g. a measure to tackle the VAT-gap. The term ‘joint audit’ is a term with different meanings, which find its existence in the accounting profession. In 2010, the Organisation for Economic Cooperation and Development (OECD) issued a report in which it introduced joint audits as a new means of coordination between tax authorities, which would go beyond the existing means of international cooperation.

The term “joint audit”

OECD describes joint audits “as two or more countries joining together to form a single audit team to examine an issue(s) / transaction(s) of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, perhaps including cross-border transactions involving related affiliated companies organized in the participating countries, and in which the countries have a common or complementary interest; where the taxpayer jointly makes presentations and shares information with the countries, and the team includes Competent Authority representatives from each country.”

Looking more closely at the description of a joint audit, 4 core elements can be discovered:
- a single audit team;
- a common or complementary interest;
- a joint information position, and
- active presence of auditors.

Carrying out joint audits according to the OECD principles, therefore, means that the auditors are part of one single audit team and that they are allowed to actively participate in the audit held in the jurisdiction of another participating country (having the necessary powers to do so). The question that arises is if carrying out joint audits is realistic in a (political) climate where countries have a strong autonomy when it comes to fiscal policy? The answer to that question could depend on the benefits of joint audits for both taxpayers and tax authorities.

1 A joint audit can be defined as an audit of a legal entity (the auditee) in which financial statements are audited by two or more auditors to produce a single audit report, thereby sharing responsibility for the audit. E.g. Ratzinger –Sakel et all, What do we know about joint audit? The Institute of Chartered Accountants of Scotland (ICAS) (2012).


Benefits of joint audits

According to the OECD report (2010), joint audits could – for taxpayers - result in quicker issue resolution, more streamlined fact finding and more effective compliance, compared to the existing forms of mutual assistance in tax matters. Joint audits also have the potential to speed up Mutual Agreement Procedures (MAP) and – based upon that –, to reduce the administrative burden for taxpayers and avoid or reduce the double taxation risk. For tax authorities, benefits could be the better overview of international tax risks, a more effective and efficient treatment of cross-border risks and avoiding or reducing non-taxation. Tax authorities could also benefit from learning from each other’s strategies, audit methods and techniques, and gaining experience with working in multidisciplinary teams. The OECD report describes the potential benefits from a theoretical perspective, because, at the time the report was made, participating countries did not have experience on carrying out joint audits in practice. In section 3, the (dis) advantages of joint audits are described based upon practical experience from a pilot project between Germany and the Netherlands.4

Legal framework

When the OECD report (2010) was presented, the OECD members committed themselves to intensify the international cooperation to achieve better tax compliance. The basis for international cooperation in tax matters is the international network of bilateral and multilateral treaties. That raises the next question: what is the position of the joint audit within the legal framework? A joint audit is surprisingly not a legal term. The OECD report states that countries have to conduct joint audits within the existing national and international legal framework, which allows the exchange of information, the presence of audit officers and simultaneous examinations. And, although OECD indicates that joint audits are a more extensive form of cooperation than, for example, ‘simultaneous audits’, whether or not combined with the ‘presence of foreign tax officers’, no separate article for joint audits has been included in the existing multilateral treaties. Countries that want to conduct joint audits are challenged to encounter whether the existing legal framework is sufficient.5

The Regulation 904/2010/EU is the core of the legal framework for VAT. In the Regulation, the exchange of information, the passive presence of officers abroad and simultaneous examinations provide the current basis for international cooperation. If we look more closely to simultaneous audits - that are momentarily the most far-reaching way of international cooperation - and joint audits, the following differences show up (figure 15).

Figure 15 – based upon the differences - clearly highlights the impediments in the existing legal framework and/or practice to carry out joint audits. One striking point is the difference in the presence of tax officers abroad. Article 28 of the Regulation 904/2010/EU allows tax officers from the MS that is requesting information for that specific purpose to be present at the offices of the requested MS and have access to copies of documents containing the information requested. These officials may also participate in the administrative enquiries carried out in the requested EU MS; however, they may not exercise the powers of the inspection conferred on the tax officers of the requested MS (passive presence). A recast of the Regulation 904/2010/EU would be necessary to – at least – provide for active presence of the tax officers abroad to make joint audits possible.

The OECD report (2010) stated that countries that want to conduct joint audits are challenged to encounter if the existing legal framework is sufficient. The OECD is aware of the problems this could cause and recommends to ask prior permission from a taxpayer for the implementation of a joint au-
dit, to prevent problems.¹ This recommendation could be followed up in a situation when countries are 'experimenting' with joint audits. In the long run, however, this could not last, because it could give non-willing or fraudulent taxpayers the opportunity to avoid being audited jointly within an international context which would not serve the purpose of this instrument, especially not when it comes to fighting VAT fraud.


Practical experience

In 2013, Germany and the Netherlands started a pilot project in which they conducted five joint audits at five internationally operating companies, according to the OECD principles.¹ The scope of the pilot project was limited, focusing on the transfer pricing issues (direct taxation).² In 2014, the project was concluded with a comprehensive evaluation, in which both the audited companies (by means of interviews) and the auditors of both tax administrations (by means of an online survey) gave their opinion on joint audits. Finally, in the evaluation the research question was answered, leading to conclusions and recommendations that are important for the further development of joint audits.³ The results of the evaluation are described in the article: “Joint Audits: Next Level in the Cooperation between Germany and the Netherlands?”⁴

Main conclusions of the pilot project⁵

The pilot project between Germany and the Netherlands seems to date the only project in which countries have gained experience with joint audits – in the area of direct taxation – which, moreover, also has been evaluated. In the pilot, the OECD description of a joint audit has been used as a benchmark.

¹ In Germany two states are involved, namely North Rhine-Westphalia and Bavaria.
² The legal basis for the pilot project had to be found in Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation.
³ Research question: Can the tax authorities from Germany and the Netherlands add a new means of international cooperation [i.e. Joint Audits] to the existing means?
The joint audit, therefore, had to meet the key elements of the OECD description (see section 2). In practice, the participating companies and staff of the tax administrations experienced enhanced cooperation in the pilot, but no joint audit, as described in the OECD report.

A more detailed evaluation showed:

“Auditors did not operate as a ‘single’ audit team, but as two teams acting in their own interest. Not all auditors had sufficient skills.

“Selection had been the result of ‘negotiations’, so, consequently, the participating tax authorities did not always have a common or complementary interest. There was no joint selection process.

“The auditing processes showed differences in planning, fieldwork and reporting. There was no standard audit approach. The quality control of and the responsibility for the joint audit were unclear.

“The legal framework was insufficient due to the fact the consent of the taxpayer was needed, and the (auditing) powers of the tax officers differed. The current legal framework was not really tested within the pilot, but it was clear that it is not built for joint audits. Issues that arose were solved in a practical way.

“All participants experienced enhanced cooperation, because all cases were finalised as satisfactory. Therefore, the joint audit was seen as an advantage compared to (cumbersome) MAP.

Advantages of joint audits

Companies in the pilot considered ‘sharing the information with the auditors of both tax authorities at the same time’, which, according to them, is a big advantage that saved them time and money. Tax auditors had a better overview of the case and the related problems. Companies and tax auditors experienced ‘more’ cooperation in the joint audit, compared to the previous experiences. More cooperation seemed to refer to joint fact finding and taking a joint position as a result of the fact-finding process (to prevent a MAP). Companies, however, clearly stated that their positive feeling about the joint audit largely depended on the result of the joint audit, which is perceived as positive if it leads to a joint position of both tax authorities about the tax issues at stake and, preferably, for future (legally) binding agreements. The overall feeling was that it would probably have been more complicated to reach the same results if there would not have been a pilot project (for which there was a lot of (management) attention within both tax administrations).”

Despite the limited scope of the pilot, the results of the evaluation could also be useful in the VAT area. Speeding up the exchange of information and having a better overview of the tax issues are elements that are important for combating VAT fraud as well. In the VAT area, the legal framework certainly needs attention, because the Regulation – in contrast to the Directive – does not allow the active participation of tax officers abroad. The next section will discuss the question on whether a joint audit could be useful in preventing or combating VAT fraud.

To support the discussion on the usefulness of joint audits in the VAT fraud area, a case study on VAT fraud in the ‘computer sector’ is used. Figure 16 illustrates the scheme that is used in the fraud.

**Explanation:**
The computer parts that are subject to fraud travelled directly from Denmark, Belgium and the Netherlands to Spanish logistic centres that sent the goods to retailers who sold the computer parts to consumers (red line in figure 16). In order to enable the fraud, a series of (fake) companies were created in Portugal, Romania and Spain. Despite the direct transport of the goods to Spain, the invoices of the Danish, Belgian and Dutch companies were addressed to (fake) companies in Portugal and Romania (grey dotted line in figure 16). These companies did not receive any goods, but invoiced the goods to Spanish (fake) companies, which also did not receive any goods. These Spanish companies invoiced the goods to the Spanish logistic centres that, in the end, invoiced and delivered the goods to retailers.

7 Regulation 904/2010/EU, article 28 and Directive 2011/16/EU, article 11 paragraph 2.

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**Case study**

To support the discussion on the usefulness of joint audits in the VAT fraud area, a case study on VAT fraud in the ‘computer sector’ is used. Figure 16 illustrates the scheme that is used in the fraud.

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The computer parts that are subject to fraud travelled directly from Denmark, Belgium and the Netherlands to Spanish logistic centres that sent the goods to retailers who sold the computer parts to consumers (red line in figure 16). In order to enable the fraud, a series of (fake) companies were created in Portugal, Romania and Spain. Despite the direct transport of the goods to Spain, the invoices of the Danish, Belgian and Dutch companies were addressed to (fake) companies in Portugal and Romania (grey dotted line in figure 16). These companies did not receive any goods, but invoiced the goods to Spanish (fake) companies, which also did not receive any goods. These Spanish companies invoiced the goods to the Spanish logistic centres that, in the end, invoiced and delivered the goods to retailers.

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**Figure 16. Case Study: Computer Sector**
International cooperation

The start of the current international cooperation (if any) is based upon mismatches in the VAT Information Exchange System (VIES) system. The Danish, Belgian and Dutch companies in the case study are each obliged to submit a (monthly) tax return, including all intra-community deliveries of a specific period. This information will be processed in the national systems of the respective tax authorities (blue line in figure 16) and made available in the VIES system to check for administrative mismatches.¹ The detected mismatches could lead to numerous requests for information from Portugal and Romania — independently from each other — to Belgium, Denmark and the Netherlands. These countries could carry out administrative enquiries to collect the requested information and/or could be triggered to start their own enquiries to check the situation at the suppliers’ site. To make sure that all relevant parties in this scheme are informed, Portugal and/or Romania have to inform the Spanish tax administration spontaneously, when the information they received points out that the computer parts were transported to Spain instead of Portugal and Romania. If they do so, both administrations have to inform the Danish, Belgian and Dutch tax administrations about this or even get permission from these administrations.² So far, tax authorities are mainly operating individually, on a national level.

A thorough analysis of the case study shows that a number of issues regarding cooperation between MS could impede an effective and efficient fight against VAT fraud. Issues are lengthy administrative processes, and there is lack of awareness to exchange information spontaneously or permission to do so must be acquired. Other issues that could arise — particularly regarding joint audits — are a lack of possibilities for the presence of officers abroad (if the national law is not allowing this) or their ability to act actively, no common risk analysis in Eurofisc, a lack of cooperation within simultaneous controls and no legal basis for carrying out joint audits.³

Applicability of joint audits

Applying a joint audit in the case study would enable the tax authorities of Portugal, Romania, Belgium, Denmark, Spain and the Netherlands to create a single audit team to examine the whole fraud-scheme, instead of each of them focusing on its own part, with the

¹ Mismatches refer to differences between the deliveries in Denmark, Belgium and the Netherlands and the acquisitions in Portugal and Romania.
² Article 55 paragraph 4 Council Regulation 904/2010.
³ For more details I refer to Van der Hel and Griffioen, Tackling VAT-Fraud in Europe: The International Puzzle Continues... (2016) (Intertax, Volume 44, Issue 6&7).
risk of not being able to detect the fraudsters or with the risk for the fraudsters to disappear. In a joint audit, tax officers would be allowed to audit in all participating MS - having the same powers - and exchange the information amongst them, which would speed up the information exchange and limit the chance of money disappearing. Especially within the VAT area, a joint risk analysis (including social network analysis to detect relationships between companies in an early stage) would create signals and provide the basis for considering a joint audit, because, without a joint risk analysis, the initiative to start a joint audit could easily be made too late. The goal of the joint audit would be to avoid non-taxation and make tax assessments in line with the neutrality of the VAT system. In this way, a common problem would be solved, using a common approach.

Currently, however, there is no sound legal basis in the Regulation for a joint audit, which also does not allow active participation of tax officers abroad. So far, only criminal cases there provide an opportunity to start a joint investigation team. To be able to unravel the VAT fraud scheme like in the case study in a timely manner, a joint risk analysis (including a social network analysis) would be necessary to create an early warning system, detect dubious cases and subsequently carry out a joint audit. However, performing a joint risk analysis is not common practice within the EU, although Eurofisc, in theory, could be the basis for such a joint risk analysis. Eurofisc, however, is established as a de-centralised network in which MS work from their own national perspective and, despite the alarming signals of VAT fraud, MS are not taking steps to change this ‘de-centralised way of working’ to a ‘joint’ one. In 2016, the European Court of Auditors (ECA) underpins this conclusion, “There are no common criteria or sources of information to perform this [joint] risk analysis. Furthermore, feedback on the usefulness of the data exchanged is scarce.” As a result, MS could be spending resources inefficiently, bothering non-dubious traders and missing out on dubious traders.

5 Regulation 904/2010/ EU, article 33 provides for a de-centralised network for the swift exchange of targeted information between MS.

6 European Court of Auditors, Special report No 24, p 27.

4 Mutual Legal Assistance Convention, Article 13.
Case study

During its presidency (spring 2016), the Netherlands asked to be alert on VAT fraud and be aware of its impact on the society (see figure 17).

Figure 17. Info graphic, The Netherlands

The effects of carousel fraud are clear: market distortion, financing criminal or terroristic activities, the loss of billions of Euros every year that could be spent on health care, education, infrastructure, etc. To fight VAT-fraud, individual MS are taking all kinds of measures, but, in my opinion, a European approach to tackle VAT fraud is not the sum of 28 national approaches. Only a genuine joint approach – of which joint audits could be a part of - could help tackle VAT fraud. To enable MS to actually work together to combat VAT fraud efficiently and effectively, the application of a common compliance risk management system would be a step forward. In such an approach, MS jointly carry out a risk analysis followed by the application of joint audits, in which a single audit team – with sufficient power – is operating.

Conducting joint audits in practice seems to be difficult, just as doing administrative enquiries and simultaneous audits. At this point, a number of ‘threats’ are to blame: particularly the lack of a legal framework and the (political) question of whether MS really want to cooperate and put the international interest above their national interest. The question is whether politicians as well as tax administrations want to invest in the long term and accept the fact that short-term joint audits sometimes could create extra workload, must be incorporated in national audit plans and will not always lead to additional revenues for all the participating MS. Particularly regarding the VAT area, it would be shortsighted to think in the short term, because a VAT gap in other countries – indirectly – also has an impact on the budget of the home country (by a higher contribution to the EU budget).

Finally, in my opinion, the existing forms of administrative cooperation will bring no change in the level of international cooperation. Joint audits, on the other hand, offer a chance to bring international tax supervision to the next level in which European tax supervision is more than the sum of 28 supervisory approaches of individual MS.
SUMMARY

Each year, multi-billion amounts of tax revenue is lost all over the European Union. Due to its specific nature, VAT is vulnerable to illegal manipulation in several ways. Within time, different fraud methods were identified, revealing the organized networks of tax fraud and exposing the techniques beneath them. Gathered intelligence enabled the responsible authorities and institutions to develop new strategies and measurements of detecting and preventing VAT fraud, as well as improving present tools.

The carried out research has shown that information exchange deficiencies among EU Member States has been a long-discussed issue. Three main disadvantages were distinguished in the exchange of information between EU Member States in the VAT field. First of all, information stored in the VIES system is not always reliable or received on time. Secondly, information is not updated fast enough due to the fact that procedures provided in EU legislation are not effective enough. Thirdly, the exchange of information on questionable transactions between EU suppliers is not sufficiently fast or intensive. Thus, it can be stated that the current data exchange scheme is not effective and the entire chain is not visible “from above”, therefore it is rather difficult to identify frauds quickly. It is necessary to apply a new and innovative approach to the exchange of information both within EU and outside of it.

An approach and investigation “from the top” having all the information is very necessary. Only a smart tax administration system including the information of all taxpayers of EU Member States without any exceptions will enable to promptly track down VAT fraud. Discussions revealed that taxpayers are becoming more cunning and are carrying out long-chain frauds on an international level, which are quite hard to track down promptly “here and now” when not all the information from other Member States is received.

The best method for information collection in the system would be if all natural persons and legal entities carrying out business activities would provide their complete accounting data, and the tax administrator would upload, manage and process such data. If all the aforesaid data was collected in a centralized way on the level of the entire EU, then the cross-checking algorithm used in the verification system would help find the early stages of possible frauds quickly and effectively. There are, of course, certain risks, however they are significantly lower than when acting on a local level, due to the fact that cross-checking and inspection functions are not carried out in real time, but may take several weeks to complete. Such time lags result in the fact that some companies can issue large quantities of fraudulent VAT before closing.

It is proposed to include auditors
to the VAT fraud identification and prevention process. For this purpose, it is necessary to prepare a plan for the cooperation of ITAS and the auditors, as well as provide clear interaction rules and provide the rights and obligations of both parties.

Development of a unified system will enable the possibility to develop an automated mechanism that would allow a cross-matching between the data reported by each party of every single transaction. This would also enable to detect fraud in its early stages and ultimately prevent a missing trader fraud (be it intra-Community).

The system will enable to have deeper cooperation between different authorities. In order to fight organised crime networks associated with carousel fraud, it is important that joint efforts are made by tax administrations and law enforcement authorities within and among the EU Member States. Missing trader frauds require smooth information exchange between tax authorities and customs authorities.

The system will help tax administrations to obtain more data on non-established traders liable for VAT in the EU, as well as help fight VAT frauds more effectively, notably to ensure effective e-commerce taxation.

ITAS development would enable to improve cooperation between tax administrations and customs administrations within the EU and with third countries, which would result in more efficient tax administrations and strengthen the role of Eurofisc.

It is necessary to encourage the society’s intolerance toward VAT frauds by including the society itself. This could be achieved through the cooperation with market players, e.g. trade organisations, regulators and others in order to prevent the fraudsters from entering new markets.

It is recommended to include questions related to VAT fraud identification in questionnaires intended for auditors.

While some of the implemented strategies are effective, there is still an area for improvement. A key task to consider, both for business and governmental sectors in the European Union, is improvement of information exchange, communication tools and procedures on the intra- and inter-community level. Elaborating these measurements, as well as improving IT-related and data monitoring tools can make VAT fraud detection faster and help save bigger amount of tax revenue losses for EU Member states.

Along with the state actions, the main concern should be on how businesses can contribute to the detection and prevention of VAT fraud, as well as the improvement of VAT fraud risk management. Management and employee knowledge is an important step in the prevention process. Performing (at least) the basic Know Your Customer and business partners’ due diligence procedures can strongly influence the company’s exposure to tax fraud and provide knowledge which can be used to identify and manage the arising risks. Business entities may face serious limitations if turning a blind eye on illegal activities, not to mention the negative consequences on its operational activities and prestige.

Altogether, the anti-fraud system as a whole is often put to the test and not always manages to react accordingly, which creates a difference between the expected VAT revenues and the actually collected amounts, costing billions each year. Therefore, when pursuing to minimize VAT revenue losses or, in an ideal situation – eliminating them completely, constant improvements and new adoptions are necessary.

Calculation of the import VAT and other import taxes (customs duties), i.e. the taxable value of imported goods is very closely related to the customs value, which is determined on the basis of the Union Customs Code (2013) and other customs valuation rules established by the legislation, regulating the determination of the customs value of goods. Therefore, the fight against fraud in the field of import VAT in the EU, particularly regarding the incorrect declaration of the customs value of imported goods, is always faced with the need to assess the legality and reasonability of one or the other customs valuation method which was applied in a particular case. According to the national law in Lithuania, Lithuanian customs authorities play the most important role in combating import taxes and import VAT fraud (fraudulent taxation of imports to the EU).
The transaction value method should be considered as the primary and the main method of customs valuation. However, even before its accession to the EU, Lithuania has enacted quite flexible rules, enabling the customs authorities to deviate from the use of the transaction value method and stating that a burden to prove the non-recognition of the transaction value lies with the importer (not with the customs authority). While this can be seen as an anti-fraud measure in the field of import taxes, it is also noteworthy to mention that the EU customs law does not provide specific rules for the allocation of the burden of proof of the determination of the acceptability of the transaction value.

Reduction of the customs value of imported goods is the most common form of customs and import tax fraud and one of the most acute problems faced by the customs authorities of Lithuania. In order to combat this problem, customs valuation control is carried out by the customs authorities during both the customs clearance and the post-clearance stages. The most important stage for customs valuation control is the post-clearance stage and the main principle for the control of the reality on the value of imported goods is the comparison of the declared transaction value with the transaction value declared by other importers for identical or similar goods, i.e. the comparison of the value which is investigated for the calculated comparative prices of imported goods. Thus, in order to check the reality of the customs value of imported goods, the customs officials are using the Customs Valuation Database of Goods (PREMI database).

The effective functioning of this system and the PREMI database is ensured at the central customs administration level, i.e. in the Customs Department under the Ministry of Finance of the Republic of Lithuania where the special Customs valuation department is established. However, in practical terms, regional customs are the most important chain in the system for the control of the valuation of imported goods in Lithuania and the fight against tax fraud by concealing the import customs value directly depends on the competence of their officials and the proper organization of their activities.

The usage of the PREMI database (which started in 1997) causes some practical problems in Lithuania, such as whether the mere non-compliance of the declared transaction value of imported goods with certain comparative values (for example, the values recorded in the national PREMI database) should be considered as a sufficient reason for the non-recognition of the declared value of goods as their customs value. The declared low or high transaction value of goods should be considered as one of the indicators of commercial or tax fraud, requiring a more detailed inspection of imported goods, i.e. additional or further investigation.

However, according to the basic provisions of the EU customs law and the practice of the Court of Jus-
tice of the European Union, such circumstances when the customs officer has doubts on the declared customs value shouldn’t be interpreted as automatically excluding the application of the transaction value method for customs valuation. In such consultations between the customs administration and importer should be initiated, after which, if the customs authorities still have serious doubt that the final decision not to apply the transaction value method should be taken. These requirements aren’t properly incorporated into the national legislation - the Rules on the Control of the Customs Valuation of Imported Goods and Customs valuation rules for the used motor vehicles: according to the existing legal acts in Lithuania, the burden of proof in these relations is distributed unevenly - a higher burden of proof lies with the importer (declarant).

The effective functioning of the customs valuation as an instrument of import tax prevention in Lithuania is negatively hampered by the fact that, in many cases, the primary chain of customs officials working in the customs posts unsubstantially selects import cases for an additional customs inspection on the value of the imported goods, because they lack the skills, knowledge and experience to identify the actual price paid or payable for the goods. This creates an additional barrier to legitimate businesses because, in cases where a large number of customs declarations are directed for additional verification after an additional inspection, the declared transaction value of the imported goods is usually confirmed as legitimate.

The position was based on the consideration that, if trading parties are operating in the market in good faith, the transaction value should not be objectively different from the value of similar or identical goods registered in the customs valuation database (i.e. PREMI database). Therefore, in situations when the transaction value of the imported goods is significantly different from the value registered in the PREMI database, the customs authorities were generally authorized to make a binding conclusion that the sale of goods or their prices have been subject to a number of conditions and circumstances, the effect of which on the transaction value of the sale of goods cannot be determined, and other alternative customs valuation methods. The most recent case-law raises new problems in the area of customs valuation and the fight against tax fraud by reducing the customs value of the imported goods. For example, it is debatable whether the customs authorities have the right to refer to the World Customs Organization’s interpretations and recommendations as they are the sources of “soft law” and does not have an official status of binding international treaty.
APPENDIX 1

Some Data Ideas for ITAS

File Analysis

1. Variables that are offensive: Criminal Organization and Methods
   1. Code name per each case
   2. Criminal offence description
   3. Transfer and use of real products or fictitious transactions?
   4. Organization’s history
   5. Which measures were used?
      a. how were contacts initiated/ maintained?
      b. warehouses / product storage
      c. subsidiary company
      d. mailbox-incorporated enterprises
   6. Period of time during which the organization was operating?
      a. start date
      b. end date
      c. suspected period during which the organization was operating
      d. time frame that can be proven

II. Characteristics of the offender per one offender
   1. Involved persons
   2. Age
   3. Gender
   4. Nationality
   5. Antecedents
   6.
      a. criminal career, i.e. involvement in previously carried out criminal activities
      b. history of the use of alcohol or drugs
      c. history of financial difficulties
      d. known by tax authorities or law enforcement authorities

Place and function in the group
   a. inner or outer circle
   b. leadership role
   c. bookkeeper or financial advisor
   d. helper or strawman
   e. courier
   f. driver (chauffeur)

7. In which companies/businesses was he/she involved?

8. Penalties
   a. administrative court
   b. criminal court
      1. fine
      2. prison sentence
      3. other

III. Criminal Enterprise Organization and Environmental Variables per enterprise
   1. Organization’s theoretical structure
      a. hierarchy
      b. labour division
      c. family relations / organization
   2. Practical structure
      a. decisions were made by who?
      b. orders were given by who?
      c. mutual relationships
      d. sanctions
      1. violence
      2. threats
      3. Connections/agreements with other Criminal matters/networks
   4. External links with legitimate networks and businesses
V. Investigation
1. Investigation cause
   a. first fraud sign
   b. date of the first fraud sign
   c. did the investigation start as VAT fraud or did it lead to the investigation of other offenses (drug-related)

2. Agency carrying out the investigation
   a. tax authority
   b. law enforcement (special fiscal police)
   c. cooperation with other (foreign) countries

3. Investigation duration

4. Investigation size
   a. number of involved agencies
   b. number of involved officers

5. Investigation description
   a. special tools used for the investigation
      1. wiretaps
      2. officers working undercover

VI. Other

IV. Financial Overview
1. Source of capital to begin fraudulent practices
2. Criminal gains
3. Expenditure
4. Criminal company’s investments
   a. reinvestment in the operation
   b. investment in other operations
   c. investment in drug-related operations
   d. foreign banks
Questions recommended for auditors during audits, in order to achieve VAT FRAUD PREVENTION

Questions recommended for the Chamber of Auditors in order to find out whether all audit firms follow the necessary indications to achieve VAT fraud prevention:

1. Did the audit firms, prior to carrying out an audit, have a risk assessment report and a list of transactions that caused suspicion, both of which are generated by ITAS?

2. Did the auditor, prior to carrying out an audit, thoroughly familiarize himself with the risk assessment report and the list of transactions that caused suspicion, both of which are generated by ITAS?

3. Does the audit firm have established procedures for the compliance with VAT fraud prevention requirements?

4. Did the audit firm assign employees who make sure that the procedures are followed?

5. Is the Chamber of Auditors informed about the assigned responsible employees?

6. Did the responsible persons inform the Chamber of Auditors on the results of the continuous monitoring of the customer’s business relations, if such was carried out?

7. Does the audit firm have a suspicious transaction and operation register where the firm registers all suspicious operations and transactions?

8. Were any procedure violations found when performing the quality check of the carried out audit?

9. Do language issues result in an international cooperation barrier? If so, how are these issues solved?

10. Is there a specific unit in the investigative (audit) firm which is responsible for operation in the field of VAT fraud?

11. How many mismatches are found and what percentage of these mismatches is related to fraud?

12. What are the work procedures and the concerned audit company’s authority?

13. What are the actions taken after discovering a fraud signal? What kind of authority and what measures/resources are available in order to handle the situation? Which area has lack of authority or measures?
Questions that are recommended to be included in the auditor questionnaires:

1. Is there insistence to provide payment in cash or provide very quick payment?
2. Is there no bank account or the bank account is abroad?
3. Is the invoicing circuit different from the delivery circuit?
4. Is the down payment high compared to the total invoiced amount or is there absence of an invoice when the invoiced amount is high?
5. Is canvassing carried out by a business finder/intermediary looking to establish links with unknown suppliers?
6. Is there no indication of a sales contact or a contact that is difficult to identify?
7. Is the transaction price abnormally below the market price?
8. Are there indicators regarding the characteristics of the transaction, the agreement and invoicing?
9. Is the company operating in sectors prone to carousel-type VAT fraud?
10. Is the company engaging in operations unrelated to or far removed from its habitual activity?
11. Is the supplier’s intra-community VAT number invalid?
12. Are there unattributable cash withdrawals?
13. Do third party payments exist?
14. Does the company have offshore accounts?
15. Do split payments exist?
16. Are there no sales contracts?
17. Are the down-payments large compared to the total amount of the invoice?
18. Are there payments and transfers that direct to overseas?
19. Are there demands for cash payments or for quick payments?
20. Are transactions concluded with companies that are new in the market, that do not have a clear track record or that have a virtual office?
21. Do back to back money transfers within 24 hours exist?
22. Are there unsolicited approaches from organizations that offer easy profit on high-value/volume deals with no apparent risks?
23. Is the daily closing balance small c/w the turnover?
24. Is the account highly active for only a period of 3-6 months?
25. Do dormant accounts suddenly become active?
26. Is the account activity inconsistent with routine business (no payments for utilities, wages, rent)?
27. Are the VAT identification numbers of foreign enterprises inspected by the company?
ANNEX 3

VAT FRAUD prevention guidelines for auditors

Before inspecting a company, auditors must receive a risk assessment report and a list of transactions that caused suspicion, both of which are generated by ITAS, from the Chamber of Auditors.

1. When the risks (determined by ITAS) are higher than average, audit firms must carry out continuous customer business relation monitoring, including the investigation of transactions that were carried out during these relations, in order to ensure that the carried out transactions comply with the audit firm’s knowledge regarding its customer, his business (its type, business partners, activity area, etc.) and nature of the risk.

2. By considering the risk assessment results, auditors must check the selected companies more thoroughly and, in all cases when there is a suspicion that VAT embezzlement activities are, were or will be carried out, perform an audit in the company by applying a minimal audited selection interval, despite the monetary operation amount or other exceptions. Meanwhile, it is mandatory to check the list of transactions that caused suspicion without carrying out audit selection.

3. During the execution of customer business relationship monitoring, audit firms must determine cases when several interrelated suspicious purchase and sale operations are carried out, and inform the relevant services.

4. Auditors must ensure that the latest and accurate information (which would be periodically updates) would be used when carrying out the assessment of VAT fraud existence risk.

5. When carrying out VAT fraud risk assessment, the audit firm should pay particular attention to customer activities which, according to the firm, may be related to the existence of VAT frauds due to its nature, by paying particular attention to “red flags”:

- Insistence to pay in cash or provide very quick payment;
- There’s no bank account or the bank account is in a foreign country;
- There are differences between the invoicing circuit and the delivery circuit;
- The down payment is high compared to the total invoiced amount or there is absence of an invoice when the invoiced amount is high;
- Canvassing is carried out by a business finder/intermediary who is looking to establish...
links with unknown suppliers;  
There is no indication of a sales contact or the contact is difficult to identify;  
The transaction price is unusually below the market price;  
There are indicators regarding the characteristics of the transaction, the agreement and invoicing;  
The company is operating in sectors inclined towards carousel-type VAT frauds;  
The company is involved in operations unrelated to or far removed from its habitual activities;  
The supplier’s intra-community VAT number is invalid;  
There are unattributable withdrawals of cash;  
Payments of third parties exist;  
The company owns offshore accounts;  
There are split payments;  
There are no sales contracts;  
The down-payments are large compared to the total invoice amount;  
Transfers and payments point to overseas;  
Demands are being made for payments in cash or for quick payments;  
Transactions are concluded with companies that are new in the market, that do not have a clear track record or that have a virtual office;  
There are back to back money transfers within 24 hours;  
There are unsolicited approaches from organizations that offer easy profit on high-value (or volume) deals with no apparent risks;  
The everyday closing balance is small c/w the turnover;  
The account’s activity is high for only a period of 3-6 months;  
There is sudden activity in dormant accounts;  
Account activity is inconsistent with the routine of the business (there are no payments for utilities, rent, wages).

7. Audit firms must set risk assessment and management procedures which would enable the audit firm to efficiently manage the suffered VAT fraud risk by focusing on high-risk fields.

8. If auditors notice any features of VAT fraud, they must inform the audit firm’s employee responsible who must then register the information about the customer and his/her carried out suspicious operations or transactions in the register. Head of the audit firm must once again check the material collected by the audit firm’s employees. If finding even the slightest features of VAT fraud, audit firms must immediately inform relevant services.

9. Audit companies must have and fill out a register of suspicious transactions and operations.

10. The Chambers of Auditors of all EU Member States check whether the audit firms are following these directions and inform the ITAS administrator on the results of the check.