

Third-Party Risks and Liabilities in Case of VAT Fraud in the EU

By Robert F. van Brederode

1. Introduction and Summary

VAT fraud is an issue of growing concern for the tax authorities in EU countries, because of its size and frequency, the increased sophistication of the fraud schemes and inherent difficulty of combating it, and its financial significance. This article's focus is on the position of a third party, who somehow gets entangled into the myriad of transactions that form what is generally referred to as Carousel fraud. First, a basic description is provided of the design of a carousel fraud, then a closer look is taken to how some individual member states of the EU have tried to combat this type of fraud. Finally, the latest developments in case law of the European Court of Justice and the acceptance of the principle of abuse of law and of joint and several liability are discussed, especially the severe consequences these concepts have on the position of a third party entangled in such a fraud scheme but acting in good faith.

2. Description of Carousel Fraud

From an economic perspective, the value added tax (VAT) as applied in the European Union (EU) is a consumption tax. It is charged at each stage of the production and distribution chain (output-VAT) but by allowing taxable traders a credit for tax paid on their purchases (input-VAT), the tax is in effect imposed on the final consumption of taxable goods and services. Under the destination principle, its aim is to tax domestic consumption only. In international transactions, therefore, border tax adjustments are required. In relation to third countries, imports will be subjected to domestic VAT when released into free circulation and exports should leave the country VAT-free, which is realized by not charging output-VAT on the export sale while the trader retains its right of input-VAT credit. For intra-Community transactions¹



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a similar system is in place. The supply is not taxed (zero-rated) and the recipient makes a taxable intra-Community acquisition in the country of arrival for which he has to account on his periodical VAT return. In principle, the recipient can claim the same tax as an input credit.

The value added tax is a significant part of total revenue for the EU member states, accumulating to 13 to 22 percent of total annual revenue.² With standard rates varying between 15 and 25 percent, the VAT also embodies a significant cash flow that has a fatal attraction to some operating in the shades of regular trade. The first cases of what is generally referred to as carousel fraud occurred in the 1980s in regard of transactions between the Netherlands and Belgium, but have, unfortunately, proven to be contagious. The cost of carousel fraud has been put around Euro 2.1 billion in Germany for the year 2005 and between GBP 1.12–1.9 billion in the U.K.³ The trade tends to be in high-value, low-volume consumer goods, such as mobile phones, computer components or other electronics. The fraud is usually carried out quickly, with the fraudsters disappearing before the tax authorities follow up with regular assurance activities.

In its most basic form, this fraud scheme is construed as follows. All parties participating in this scheme are registered as a taxable person, A in the United Kingdom, and B and C in Belgium. A imported a certain quantity—let us assume 10,000—iPods from the United States. The VAT paid upon importation is subsequently deductible as a tax credit on A's monthly VAT return. A sells the iPods to company B in Belgium, and charges zero percent VAT since it is an intra-Community supply. B needs to account for the intra-Community acquisition, but the VAT due in that respect is immediately and on the same return deductible as a tax credit. In turn, B sells the iPods to company C for Euro 100 each. This constitutes a domestic supply in relation to which he has to charge Belgium VAT at 21 percent, that is Euro 210,000. Company B does not remit this VAT to the tax authorities, but C who in turn sells the iPods back to the U.K.

with zero VAT, files a claim for refund of the Euro 210,000 invoiced to him by B. Thus, a circular chain of transactions (carousel) has been created whereby the goods start and end up with the same trader. The carousel is repeated several times, each time leading to a tax claim of Euro 210,000, after which the iPods are sold in bulk for cost price on the local U.K. market. The VAT collected on this domestic sale will, naturally, not be remitted to the tax office. Several variations of this basic scheme have been applied in practice. Clearly, no real transactions take place between the three related companies, the iPods stay in the United Kingdom and only a paper trail, suggesting transactions between them, is created. The only real transaction is the final bulk sale to an unrelated party.

No money is transferred between the three parties, and after a while the “businesses” will be closed and the companies dissolved. New companies are set up and the fraud scheme will be repeated. In case the authorities catch the scent of such a carousel before the companies are terminated, they will find the bank accounts empty and the directors to be mere frontmen. Over time, as

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the tax authorities became more aggressive in investigating this type of fraud, the carousel schemes have become more and more sophisticated. Smokescreens have been created to make it more difficult for the authorities to discover the fraud. This is done, for instance, by mixing low-volume legitimate transactions with high-volume artificial ones, by expanding the chain with *bona fide* unrelated traders, and by increasing the chain's geographical complexity, *i.e.*, adding more cross-border transactions, spread over more jurisdictions, including jurisdictions located outside the EU, such as Switzerland and Dubai.

For the purpose of this article, we are interested in the position of third parties who get involved in a carousel, and who may either be aware of this or may be acting in good faith. As we will see, this distinction may be relevant. Assume that company C in our example is a third party, a subsidiary of an American parent company. Again, company A sells the iPods to B, who in turn sells to C, who consequently sells to A. C may not be aware that B purchased the iPods

from the same party as he, C, is selling to. In this case, the goods are actually transported from the U.K. to Belgium and back to the U.K. Payments take place for the B-C and the C-A transactions. Again, B does not remit the VAT it has charged to C, and the latter files a refund claim for the same VAT. There is a difference though. In the first scenario, all parties involved being related, no payments were made between them, and C collects an input-VAT refund for VAT it did not actually pay to B. In the second scenario, C being an unrelated party, did pay the input-VAT to B.

C's position is precarious in this respect. Where the tax authorities are unable to collect the VAT from B, they may seek to mitigate the risk for the Revenue by denying C's refund, which would be particularly painful in case C is acting in good faith.

3. Counter Measures to Fraud

3.1. Civil Law Defense

Until recently, the Belgian tax authorities applied civil law rules in the fight against tax abuse and avoidance. According to the Belgian Civil Law Code contracts without a legal basis or with a false or unlawful legal basis are considered to be null and void.⁴ Transactions prohibited by law, violating good faith or public order have an unlawful basis.⁵ Defrauding the Belgian State of tax is conceived as a violation of public order. The tax authorities, supported by Belgium's Supreme Court,⁶ took the position that all sale contracts embodying the totality of the carousel transactions were null and void⁷ and, therefore, no transfer of ownership had taken place between either of the parties. As a result, neither party could legitimately claim an input-VAT credit.

The legal reasoning by the Belgian authorities is questionable. Its emphasis on domestic Belgian law seems to ignore the primacy of European Community law.⁸ Concepts of national civil law are in fact irrelevant since European legislation constitutes a separate system of law, which has its own concepts and context.⁹ Interpretation of Community concepts on the basis of national law is, therefore, prohibited. In defining taxable transactions, the VAT Directive does not rely on contract law concepts, but instead employs an economic approach. A taxable supply of a good is the right to dispose of a good as owner,¹⁰ which is much broader than the mere transfer of legal title.

Effective November 2005, Belgium has introduced a general anti-VAT avoidance provision.¹¹ Under that

provision, the tax authorities for VAT purposes can re-characterize a contract or series of contracts if they suspect or have established that the purpose of those contracts is avoiding VAT, unless the party or parties involved prove or sufficiently demonstrate that these contracts serve or also serve legitimate economic or financial purposes. Again, there is no basis for the re-characterization in European law, which avoids civil law concepts.

3.2. Noneconomic Defense

During 2006, the European Court of Justice decided several cases involving carousel fraud brought by the U.K. High Court. In the *Optigen* case,¹² the Revenue Service had taken the position that under a carousel scenario the chain of transactions should be considered in its entirety and the fraudulent intentions of one of the traders would derive all transactions from being qualified as economic transactions in terms of article 5 of the Sixth Directive, and as a result would remain outside the scope of VAT. As a consequence, under such reasoning, company C in our example would lose its right to deduct or reclaim the VAT it paid to company B.

The U.K. High Court asked for clarification regarding to whether a transaction, which in itself was not fraudulent and where the trader was acting in good faith, should be regarded as supply and an economic activity within the meaning of the Sixth Directive, when the transaction formed part of a chain in which another prior or subsequent transaction was vitiated by such fraud and whether the trader under such circumstances is entitled to input-VAT recovery.

The European Court of Justice rejected the approach taken by the U.K. Revenue Service to consider the chain of transactions in its entirety. Each transaction must be considered objectively and on its individual merits and characteristics, which can not be altered by earlier or subsequent events in the chain. In line with earlier rulings,¹³ the European Court of Justice noted that the terms "economic activity" and "supplies of goods and services" are wide in scope and objective in character, in this sense that activities are considered *per se* and without regard to their purpose or results. The European Court of Justice also rejected the view that carousel transactions should remain outside the scope of VAT because of their unlawful character. A general distinction between lawful and unlawful transactions would infringe the principle of fiscal neutrality of the tax. In line with earlier rulings,¹⁴ the Court pointed out that such could only

be the case in limited cases, where no competition between a lawful economic sector and unlawful sector can exist. Finally, the European Court of Justice observed that the right to recuperate input-VAT may in principle not be limited. Each transaction should be considered individually, and a party that acted in good faith should not be deprived of its right to recover VAT due to fraudulent activities by others.

Nevertheless, there seems some room left for the Revenue Services of the member states to maneuver, where the European Court of Justice conditions its ruling on the absence of mala fides on the part of the trader (in our example, company C). The Court states that:

transactions as those at issue (...) constitute supplies of goods and services and an economic activity (...), regardless of the intention of a trader other than the taxable person concerned (...) and/or (regardless) the possible fraudulent nature of another transaction (...) of which the taxable person has no knowledge and no means of knowledge. The right to deduct input value added tax (...) cannot be affected by the fact that in the chain of supply (...) another (...) transaction is vitiated by (...) fraud, without that taxable person knowing or having any means of knowing.

In many cases, the U.K. Revenue Service has permanently disallowed input-VAT recovery when a transaction appeared to be involved in a carousel, the total amount withheld being estimated to approach GBP 1 billion.¹⁵ Following the *Optigen* decision, in the majority of instances the withheld amount have been reimbursed, but the Revenue Service has refused to do so in a handful of cases where it believes it can reasonably make the argument that the trader in question had knowledge or means of knowledge of the fraudulent carousel trade.

The Belgian Court de Cassation has referred preliminary questions in four cases in 2004¹⁶ and 2005¹⁷ regarding carousel fraud. The 2005 cases have been suspended by the European Court of Justice until delivery of the earlier cases which the Court decided to combine.

The *Recolta* and *Axel Kittel* cases of 2004 are mirror images, in the sense that the appellant in the first case alleged to have had no knowledge of the carousel while in the second case awareness of the ongoing carousel remained undisputed. Although the Court has not as yet ruled in these cases, the Advocate General has delivered his Opinion and it is worthwhile to take a closer look at his approach. In summary, the A-G concludes as follows.

1. National law and qualifications of a contract are irrelevant.
2. A recipient of goods will not lose his right of input-VAT recovery if he entered into a contract in good faith.
3. A recipient of goods will not lose his right of input-VAT recovery even if he knew about the supplier's fraud, provided he did not himself participate in or benefited from the fraud.
4. A recipient of goods will lose his right to recover input-VAT when he is knowingly involved in a transaction set up for the sole purpose of tax fraud.

In light of earlier jurisprudence by the European Court of Justice, notably the *Optigen* case, the Opinion of the Advocate General does not surprise as to conclusions 1 and 2. Conclusion 3, however, exceeds the ECJ ruling in

Optigen in that it offers protection to the recipient even if he has knowledge of the fraud scheme as long as he does not participate in or benefit from it.

The criteria developed here are not totally clear, but it seems to me that the Advocate General is trying to find a balance in risk allocation. The right of input-VAT recovery is essential for the proper functioning of the value added tax because this mechanism guarantees that the tax is a consumption tax and not a business tax. For this reason, the input-VAT recovery can only be denied under special circumstances. Businesses acting in good faith clearly need protection where they get unknowingly involved in a fraud scheme. The Advocate General, however, does not elaborate on why businesses need protection when they know that they are included in a fraud scheme. The distinction between knowledge and participation seems very thin in my opinion. If a business knows it is participating in a fraud scheme, does that not automatically imply it is involved? Carousel fraud is not just a tax law is-

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sue, it is also, and perhaps primarily, a criminal law issue. In other words, culpability should play a role in determining the consequences of being involved in carousel fraud. From this perspective, there exists good reason to protect a business that is part of a carousel transaction scheme without knowing or having means of knowing of the existence of this scheme. But knowledge establishes a degree of guilt. The word involvement, in this context, includes the sense of knowledge. Participation may be passive; involvement, by its mere definition, assumes active collaboration. In my opinion, there exists no rationale for protecting a party involved in fraud, regardless of whether this party benefited from it. And, on the other hand, a party acting in good faith, that is without knowledge, should be protected even if it derived a benefit from the scheme. The Advocate General seems to be trying to make a fine distinction in relevant degrees of culpability. No knowledge of fraud intention and mere participation exonerates a trader under all circumstances; knowledge without participation will exonerate as well, even if the trader benefited from it; but knowledge and involvement removes protection when the scheme is set up for the sole purpose of tax fraud. The Advocate General, however, seems to offer more latitude than the European Court of Justice did in the *Optigen* case and it will be interesting to see whether the Court will agree with the Advocate General's opinion and approach.

In any event, issues of definition remain. What exactly constitutes knowledge in this context? And under what circumstances is a scheme set up solely for the purpose of tax fraud?

3.3. Abuse of Law Doctrine

In February 2006, the European Court of Justice rendered judgment in three cases, commonly referred to as *Halifax*,¹⁸ in which it recognized the principle of abuse of law in the context of VAT.

Abuse of law exists where specific transactions, notwithstanding formal conformation to provisions of VAT legislation, result in a tax advantage that is contrary to the purpose of those provisions, and where the essential aim of the transactions concerned is to obtain that tax advantage.

In essence, this is a substance-over-form rule that a number of member states already apply in the fight against tax avoidance and, especially, tax evasion. The prohibition of abuse rule is limited, however, by Community law *per se*, the effectiveness of which may not be undermined by national legislation. The

national anti-abuse regulations as well as national rules of evidence may not, in effect, prohibit or make it excessively difficult to exercise rights (such as the right of input-VAT reclaim) conferred by Community law. Moreover, the anti-abuse rule cannot be applied when other explanations than tax advantage can be provided for the alleged set up of transactions.

In its application, the abuse of law doctrine covers not only tax evasion (fraud) but also tax avoidance. Belgium has changed¹⁹ its anti-abuse rules to conform with *Halifax*. Interestingly, in the Explanatory Memorandum examples are given of unacceptable transactions, e.g., sales and lease back transactions, that have been found legitimate by the Netherlands Supreme Court under very similar anti-abuse regulations. For tax lawyers and consultants engaged in designing VAT planning for tax-exempt entities, the challenge will be to ensure the design has sufficient substance to withstand the scrutiny of the Revenue Service and the courts.

When in a framework of transactions the two conditions of *Halifax* (as to result and as to aim) are fulfilled and, therewith, it has been established that an unjustified tax advantage has occurred, the transactions must be redefined in order to create the situation that would have prevailed in the absence of the abusive practice, including reimbursement to the State of VAT improperly obtained in the furtherance of such an abusive practice.

In addition it is possible, if not likely, that penalties will be imposed in abuse of law situations, ranging from five percent or 10 percent of the tax amount to, in case of fraud, 100 percent (in the Netherlands), 200 percent (in Belgium) and 300 percent (in France). Fiscal penalties constitute criminal prosecution in the meaning of the European Human Rights Convention,²⁰ and must therefore, meet the criteria of fair trial laid down in that same Convention.²¹ It is beyond the scope of this article to elaborate on this aspect, but clearly an entity unknowingly entangled in Carousel transactions can counter the fiscal penalty on the basis of absence of culpability.

Although the abuse of law rule could be a strong weapon in combating tax evasion and avoidance, as a principle of Community law it could easily collide with other Community law principles, especially the principle of legal certainty. Certainly, the member states have good reason to seek protection against loss of revenue in cases of tax avoidance and evasion. On the other hand, a trader who gets entangled in carousel transactions must be allowed input-VAT recovery on the basis of the principle of legal certainty when

he is acting in good faith. It is for the courts to sail between the Scylla of abuse of law principle and the Charybdis of protecting good-faith traders. Finding the precarious balance between the legitimate interests of the Treasuries in protection against loss of revenue through applying the abuse of law rule (*Halifax*) and of legal certainty for third party traders acting in good faith (*Optigen*) will turn out to be quite an acrobatic tour de force and it is my prediction that we will witness a number of legal saltos mortales.

3.4. Joint and Several Liability

Another way to protect the Treasury's interests is to hold a third party liable for the tax lost. This is certainly a simple way, but whether this approach is ethically acceptable depends, in my view, on how broadly it is applied. The European Court of Justice in the *FTP*²² case held that member states are able to introduce joint and several liability in their respective legislation, provided the principles of legal certainty and proportionality are not breached. In essence, this condition is in line with earlier rulings by the Court discussed afore, especially *Optigen*. In case of carousel fraud this means that any party involved in the framework of transactions can be held liable for the VAT lost, unless he has been acting in good faith. That means that trader C in our example could be held liable for VAT that company B has failed to remit to the tax authorities, even if C had been invoiced properly and paid that same VAT himself to B, unless C has been acting in good faith. A liable person is defined by the European Court of Justice as a person to whom a supply of goods or services has been made and who knew, or had reasonable grounds to suspect, that some or all of the value added tax payable in respect of that supply or of any previous or subsequent supplies would not be remitted to the tax authorities. In short, a party involved in carousel fraud could be held liable for any unpaid VAT in the chain of transactions. Indeed, good faith becomes a valuable asset in value added tax. Crucial in this respect is the part of the sentence that reads: "*reasonable grounds to suspect.*" It remains unclear when that is the case. Obviously, there is reason for suspicion of a third party when the purchase price offered to him is significantly below market value, or when the supplier normally does not trade in that specific type of goods, or the quantities offered are much higher than justified by the supplier's size. When a third party has reason to believe that his supplier is related (legally, economically or otherwise)

to the subsequent purchaser, there is a strong reason for suspicion as well. Certainly there will be cases where grounds for suspicion are obvious. However, the sophistication of carousel schemes is found in the deliberate engagement of third-party traders by the fraudsters, who will, naturally, make efforts to hide their criminal intentions from the third-party trader. The liability, in principle, can be multitude, since it is not limited to VAT unremitted by his direct supplier. When a third-party trader is so unfortunate to become engaged in Carousel transactions, and value added tax in regard of each of the individual transaction has remained unpaid, he may, as the only genuine business, end up being held liable for all VAT payable on the total of transactions, previous and subsequential. Without doubt, in my mind at least, an element of overkill has found its way into the liability rules.

The concept of good faith seems to offer a degree of protection, but the rules of evidence in tax law are not as strict as in criminal law. Generally speaking, as the rules of evidence are determined on a national and not on EU level, the tax authorities have the initial burden of proof. If the authorities are able to offer at least initial proof that a third party should have been aware of the fraud scheme, the burden of proof can easily be reversed, and the third party will have to prove that he did not know nor have reasonable grounds to suspect that he was somehow engaged in a fraudulent carousel.

Interestingly, subsequent to FTI, the British tax authorities have developed a strategy of notifying third party traders when they suspect they are engaged in suspicious trade cycles. Ignoring such notification bears the risk that the recovery of input-VAT on future transactions with suppliers from the chain will be denied. Moreover, by issuing the notification the authorities believe to have established "knowledge" or "reasonable ground for suspicion" in the meaning of FTI and, as a result, the third-party trader is exposing himself to severe liability risks.²³ Even though the urge for the Revenue to prevent or reduce tax loss is understandable and justified, this practice is, however, questionable. Unclear is why from a legal perspective the notification by the tax authorities has to be accepted on face value and would shift the risk completely to a third-party trader when he does not immediately discontinue his trading with parties identified by the tax authorities as suspected. Such notification could prove to be extraordinarily disruptive of business when parties, who cannot bear the financial risk of third party liability,²⁴ terminate busi-

ness relationships on this basis. On the other hand, the tax authorities render the risk of being sued for damages in case their notification bears insufficient grounds and leads to loss of business revenue, termination of a legitimate business activity, bankruptcy, or loss of good standing and reputation.

Ultimately, it will be up to the national courts and the European Court of Justice to develop, on a case-by-case basis, a doctrine to clarify the extent of third-party liability, balancing the interest of revenue loss with the interest of free conduct of business.

3.5. Alternative Solutions

The approaches taken by national tax authorities seem to be rather rigid and to contain an element of overkill. In my opinion, feasible alternative solutions exist, although none of them may win the fiscal beauty contest. First, either on EU or national level, a *butoir* rule could be introduced. A *butoir* is a term coming from French legislation, and basically it limits the total input-VAT credit to the total output-VAT. In essence, a business cannot deduct more input-VAT than it is required to pay in tax over its sales. For example, when sales in a tax period are 100 at a tax rate of 20 percent, and purchases are 300, a seller will only be able to deduct input-VAT to the amount of VAT due on sales in the same tax period. Normally, a business would have a tax payable of 20 (20 percent of 100) and deduct 60 in input-tax credit (20 percent of 300), receiving a refund of 40. Under the *butoir* rule, the tax credit would be limited to the amount payable on sales. In other words, the seller would only be able to exercise its right to input-VAT credit to the extent of VAT due on sales. As a result the tax credit would be maximized at 20, and no refund would be paid. The remainder of the tax credit would be shifted forward to the next tax period. In effect, the seller would never receive an actual refund in monetary terms. So, in tax period 1, seller would have output-VAT of 20 and input-VAT credit of 60. His maximum deduction would equal the tax due on its sales (20) and the remainder of his input-VAT claim (40) would be applied to the output-tax due on sales in the next tax period. If the seller would make sales at 400 in the next tax period and incur purchases at 200, in period 2 he would have a tax payable account of 80 and a credit account of 40 + 40 input tax from period 1. As a result he would pay zero in tax in period 2, and he would not receive a refund.

This system works perfectly, except for net exporting firms. In Italy, net exporting firms are subject to a

deterred refund rule to the extent of 12 months. Basically, this provides the tax authorities with a 12-month window to determine whether the input-VAT claim is legitimate. In view of the serious tax fraud schemes, the application of these rules would not seem unreasonable. In addition, two more rules could be introduced to provide for an equal balance of risk distribution. First, a system of recognition for approved economic traders, who will be eligible for a full and immediate input-VAT credit deduction based on their proven bona fide tax payer reliability. This rule would protect any established trader with a sound track record and exonerate them from the tax credit limitation rules. New companies applying for this status would be held to strict bench mark standards. If a start-up company is unable to meet these standards, input-VAT credit would be limited according to the *butoir* rule or postponed according to the 12-month rule, but the state would be required to pay them a reasonable interest at the time a final refund is made to compensate them for their cash flow disadvantage.

The European Commission is contemplating a different approach.²⁵ Although the operation and management of tax systems is primarily the competence of Member States, the Commission plays a role in the free circulation of goods and services within the internal market and the globalization of the economy make it practically impossible for a Member State to act individually against this particular type of tax fraud. Her strategy is three-fold. First it aspires to enhance cooperation between member states in combating fraud. The other two alternatives imply substantial changes in the current VAT system. The Commission contemplates either taxing intra-Community supplies, which would eliminate the net exporting position for a firm and would render the carousel fraud scheme obsolete, or extending the reverse charge rule. The first option is feasible, but ignores the fact that fraud schemes involving sales to third countries (non-EU member states) such as Switzerland would replace the current ones. Extending the reverse charge rule makes more sense. Basically, under the reverse rule, a purchaser is liable for the output-VAT on its purchases in stead of the supplier. Since the purchaser is also eligible for an input-VAT credit, no actual obligation to remit tax to the Treasury would ever occur. In effect, this would change the EU VAT system from a multi-stage consumption tax into a single stage retail consumption tax, albeit while maintaining a paper trail to previous sales. This would be a remarkable policy change when one bears in mind that the VAT was chosen as the preferred con-

sumption tax system in the EU, *inter alia*, for its ability for fractioned tax collection, *i.e.*, collecting of tax on the value added of each stage instead of over the total value added at the final retail stage, to reduce, indeed, the risk of underreporting and tax fraud.

4. Conclusions

Revenue loss is a genuine concern for the tax authorities whether as a result of tax avoidance or tax evasion. In monetary terms the stakes are significant. National law approaches, as taken by the Belgian authorities, are ineffective because they are simply irrelevant. The British defense of declaring certain transactions to be non-economical, although European in essence, fails, because it is too broad and insufficiently specific. The Community concept of abuse of law as well as the

introduction of third party liability in case of tax fraud provide ample tools to the authorities for combating avoidance and evasion of VAT. The financial risks for third parties are considerable and third party liability, in my opinion, contains an unacceptable element of overkill. The European Court of Justice has provided some balance by exonerating from responsibility and liability third parties acting in good faith. The concept of good faith, however, is still too vague and needs to be further defined in future case law to offer business transactions protection against zealous assumptions by the tax authorities. Alternative approaches exist, however, that seem to offer a more balanced risk distribution. The approach recently suggested by the European Commission seems to entail a significant departure from the very reason the current VAT system was introduced.

ENDNOTES

- ¹ The EU is based on a Customs Union and is a single Customs territory. Imports and exports, therefore, refers to cross-border transactions with countries outside the EU. Cross-border transactions within the EU are technically not imports and exports, and are called intra-Community transactions.
- ² Source: OECD, Revenue Statistics of OECD Member Countries.
- ³ HM Revenue and Customs: Measuring Indirect Tax Losses, 2005; and: A Tax Net Full of Holes, THE ECONOMIST, May 13, 2006.
- ⁴ Article 1131 Belgian Civil Code.
- ⁵ Article 1133 Belgian Civil Code.
- ⁶ Cour de Cassation, Oct. 12, 2000, No. C.99.0136.F, Pasicrisie 2000, I, No. 543.
- ⁷ Where the public interest is concerned, it is sufficient that one of the parties involved in the complexity of transactions has unlawful intentions and good faith of one of the other parties involved does not lead to exoneration of that party.
- ⁸ European Court of Justice (ECJ), July 15, 1964, Case 6/64 (*Costa/Enel*), E.C.R. 1964 at 1255 ff. See on the relationship between national law and Community law, Robert F. W. van Brederode, *Justice and Judgment, Methods of Judicial Interpretation in Value Added Taxation*, INTERNATIONAL VAT MONITOR, 10-1990, at 13–20.
- ⁹ ECJ, Oct. 4, 1995, Case C-291/92 (*Ambrecht*), E.C.R. 1995, I-2775; ECJ, Jan. 16, 2003, Case C-315/00 (*Maierhofer*), E.C.R. 2003, I-563; ECJ Feb. 6, 2003, Case C-185/01 (*Auto lease Holland*), E.C.R. 2003, I-1317; ECJ Nov. 18, 2004, Case C-284/03 (*Temco*), E.C.R. 2004, I-11237.
- ¹⁰ Article 14 (1), Directive 2006/112.
- ¹¹ Article 59 (3) Belgian VAT Code.
- ¹² ECJ, Jan. 12, 2006, joint cases C-354/03 (*Optigen*), C-355/03 (*Fulcrum*), and C-484/03 (*Bond House*), not yet officially published.
- ¹³ ECJ Feb. 8, 1990, Case C-320-88 (*Safe*), E.C.R. 1990, no. 285; ECJ Dec. 4, 1990, Case C-186/89 (*van Tiem*), E.C.R. 1990, no. 4363.
- ¹⁴ ECJ Feb. 28, 1984, Case C-294/82 (*Einberger II*), E.C.R. 1984, no. 1177 in regard of import-VAT on illegal drugs; Case C-343/89 (*Witzemann*), E.C.R. 1990, I-4477 regarding import-VAT on counterfeit currency; Case C-269/86 (*Mol*), E.C.R. 1988, 3627 and Case C-289/86 (*Happy family*), E.C.R. 2988, 3655 in regard of VAT on domestic supplies of illegal drugs. See also, Paul Farmer and Richard Lyal, EC Tax Law, Oxford 1994, at 130–32. This does not mean, however, that illegal activity will remain out of the scope of VAT under all circumstances. Where legal and illegal transaction circuits of the same or similar products compete within the territory of a single member state (for instance sales of fire arms) or activities are legal in one state but illegal in another (as with some forms of pornography) it seems appropriate to levy VAT on both.
- ¹⁵ See Colin Woodward, *The New UK Approach to Carousel Fraud*, INTERNATIONAL VAT MONITOR 2006 (4), at 240–41.
- ¹⁶ Case C-439/04 (*Axel Kittel*) and Case C-440/04 (*Recolta*).
- ¹⁷ Case C-42/05 (*Ring Occasions*) and Case C-378/05 (*Samotor*).
- ¹⁸ ECJ Feb. 21, 2006, Case C-255/02 (*Halifax*), Case C-419/02 (*Bupa*), and Case C-223/03 (*Huddersfield*), not yet officially published.
- ¹⁹ Article 1 (10) Belgian VAT Code, introduced by Law of July 20, 2006, Staats Gazette July 28, 2006, in effect as of August 7, 2006.
- ²⁰ Netherlands Supreme Court (*Hoge Raad*), June 19, 1985, BNB 1986/29. See R.F.W. van Brederode, *De rechten van de mens in het belastingrecht (Human rights in tax law)*, Weekblad voor Fiscaal recht, 1987, 5779, at 749–59.
- ²¹ Such as the right of a public hearing by an independent tribunal within a reasonable time, dual jeopardy and the presumption of innocence.
- ²² ECJ March 11, 2006, Case C-384/04 (*Federation of Technological Industries and others*), not yet officially published.
- ²³ See note 15.
- ²⁴ Please bear in mind that Mr. Axel Kittel, in the case that bears his name, is the Receiver in bankruptcy.
- ²⁵ Opening speech of Commissioner Kovács at the conference “Tackling VAT Fraud: Possible Ways Forward,” Brussels, Mar. 29, 2007.

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