

The Carousel Fraud The Most Avoided Type Of Organized Fraud By The Valued Added Tax

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Abstract. This article, in an optimistic view, intends to prove that it is necessary the introduction of a European Union common system, by implementing at the community level some quota of taxation generally valid for all the Member States. This is an essential condition for the reduction of the phenomenon of fiscal evasion, including here the VAT evasion in the intra-community transactions.

Keywords: Carousel Fraud, deduction right, fiscal obligations, interstate cooperation, intra-community transaction

1. Introduction

The Carousel Fraud regarding the value added tax associated with intra-community purchases is an undeniable, though unwanted, presence in the community space. The mechanism itself is shaped on the current transitory taxing system of intra-community exchanges, which, as a general rule, implies taxing the intra-community exchange of goods, done amongst taxable persons in the member state of destination. Since our country's integration in the European Union, a part of the economic agents in Romania have sought to assimilate the wrong use of defrauding of fiscal bonds “as they went”, very often successfully “experimented” for several years in the community space. The phenomenon itself being of certain actuality, in the following we have set out to treating it, although, because of the complexity of the analyzed phenomenon, we are aware that the present approach can be neither exhaustive nor perfect, but perfectible.

This type of fraud is based on a quite simple mechanism, at least apparently: the economic operator from the country of origin invoices without VAT (because they make an intra-community delivery¹, that falls into the VAT-free operations category with right of illation), and the economic operator from the country of destination will apply the reversed taxation system for this operation (because they make an intra-community purchase, calculating and registering the VAT associated with intra-community purchases at the taxing share of their country, both as collected and deductible VAT, although without actually paying it). After making the intra-community purchase, the economic operator in question disappears without registering, declaring and paying the VAT collected from the subsequent deliveries done in their domestic market (the so-called “canister” firms, collectors of some fiscal bonds regarding the VAT, that will never be paid for).

The carousel fraud regarding the VAT for intra-community transactions implies a chain of successive operations of cross-border selling and purchase, done inside the community market (without overruling the possibility of the interposition of some link-firms outside the Community) by a group of economic operators

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¹ Corduneanu Carmen, The Fiscal System in Finance Science, Codecs Publishing House, Bucharest 1998, page 266

who sometimes seek to exploit under an apparent hue of lawfulness, and the differences between the taxing shares made the EU member states.

In conformity with the Fiscal Code stipulations, which are operational since the 1st of January 2007, a Romanian firm, that makes an purchase from a firm in an EU member state (the goods being actually transported to Romania), does no longer need to physically pay the respective VAT, but to register it by the reversed taxation mechanism (both as deductible and collected VAT), as it appears from the verified stipulations of article 146, paragraph (1) letter e) and article 157, paragraph (2) in the Fiscal Code., including the methodological norms that implement the two legal articles. As a matter of fact, in article 146, paragraph (1) letter e) in the Fiscal Code regarding the terms of prosecution for the right to deduct the tax afferent to an intra-community purchase of goods, it is mentioned that the purchaser is obligated to have a justificatory purchase document and to register the tax as collected tax in the expense account afferent to the fiscal period where the exigibility appears.

2. Ways of manifestation of the “carousel” fraud

Regarding the defining of “intra-community delivery” notions, “intra-community purchase” notions, the obligation to register and report the persons who make intra-community transactions, all these representing the theoretical foundation for the instrumentation of “carousel” fraud, we will continue by presenting some ways of manifestation of this type of fraud.

A first method, frequently found in our country and therefore called the “**classic method**”, refers to the intra-community purchases done by an economic operator in Romania. The firm A in Romania, registered because of the VAT in article 153 in the Fiscal Code, wants to make a intra-community purchase from firm B situated in a member state. From the above mentioned, it results that firm A could very well make the respective intra-community purchase², had they been an honest and decent economic agent, and had they consented to register their fiscal obligations concerning the VAT. In reality, in order to dodge these fiscal obligations, the decisive factors of firm A will create another “arrow-type” firm, firm C, whose only associate and administrator is a “puppet”, firm C actually being controlled by the representatives of firm A. When being created, firm C declares itself as a VAT payer by option, but declares an annual turnover under the value limit of 100.000 euro, in order to benefit of the possibility of trimestrial deposit of the VAT expense account (code 300 form), according to the stipulations of article 1561 paragraph (2) and (3) in the Fiscal Code. Subsequently, firm C makes the intra-community purchases from firm B, applying the reversed taxation system to these operations. The thus purchased merchandise is then invoiced by their actual beneficiary, respectively firm A. For these domestic delivery operations, firm C (hypothetically) collects the afferent VAT and firm A will deduct it, using as justificatory document the invoices made by firm C, according to the stipulations of article 155 paragraph (5) in the Fiscal Code.

The above-described operations have a clearly determined “life span”, respectively maximum 3 months, until the deadline provided by firm C’s obligation to deposit their VAT expense account; not long before meeting this deadline, firm C “disappears”, without anyone being able to identify it and without registering, declaring and paying the VAT collected from the domestic deliveries made by firm A. Practically, firm C’s “only object of activity” is the provision of justificatory documents by firm A, in order for the latter to deduct the VAT. Certainly, the firm that commits the fraud is firm C; nevertheless, one may ask whether firm A can deduct the VAT afferent to the supply invoices from its direct supplier, firm C? This way, the European law stipulates the fact that if a taxable individual participates at the “carousel” fraud involuntarily (without knowing it), that person has the right to deduct (and implicitly to compensate or reimburse) the VAT afferent to the prior operations. From this perspective, each firm from the transaction chain associated with intra-community operations will be analysed individually, distinctively, especially because, practically, a series of other commercial societies may interpose (obviously, only at the level of registration of the document circuits) between firm C (the registered intra-community purchaser) and firm A (the actual intra-community purchaser and the “brain” of the whole mechanism) in order to dissociate the illegal character of the deeds and to dissipate the hazardous connection between firm A and firm C. Considering the above, it

² Having been attributed the registering code for the VAT, according to article 154 paragraph (1) in the fiscal Code

results that the participation at the carousel's fraudulent mechanism is not presumed, but tested, starting with the correlative analysis of the cash flow, the registered circuit of the documents and the actual track of the products. The conclusive clue could be the following:

- the correspondence regarding the delivery and payment terms is made, from the very beginning, between the representatives of firms A and B and the merchandise is transported directly from firm B to firm A (where they are also received at the date of the transport accomplishment), and their equivalent value payment is made directly by firm B to firm A under the "orders" of firm C;
- the data concerning the means of transportation or the delegates, written on the invoices/delivery notes made by firm C for firm A, do not reflect a real state of things and the persons authorized to make operations in firm C's bank accounts are actually the representatives of firm A, who withdraw the amounts of money in cash, having various explanations: input withdrawal, payment of natural persons according to the purchase registers (obviously, containing false data), quota payment etc.;
- the amounts of money received in Firm C's bank accounts from the client or firm A, "return" to firm A, directly or by the means of other firms, according to some service performance invoices that do not reflect real economic operations (normally, service performance);

A **second method** regarding the "carousel" fraud is, in fact, a form of "**perfecting**" the aforementioned, in the way that the merchandise finally arrive from firm A to firm B, their initial sender. This method can be identified as the self-generating mechanism of the "carousel" fraud, having notable effects of cheapening the products that represent the object of these transactions. This mechanism is based on the fact that the delivery price of firm A to firm B (and we consider the delivery price without the VAT, because, when firm A sells to firm B, firm A makes an intra-community delivery, which falls into the category of VAT-free operations having the deduction right) is inferior to the selling price originally offered by firm B to firm C; firm A can "support" this delivery price with the "VAT profit" that comes from the prior transactions with firm C. Besides the poisonous fiscal implications at the level of the consolidated general budget incomes, this method induces distortions (by prices) and at the level of economic competition, so the honest firm become uncompetitive on the market (because of the real market prices) in favour of the dodger firms (because of the "trick" market price).

A third method of this type of fraud refers to the simulated deliveries made by an economic agent in Romania registered for the VAT according to article 153 in the Fiscal Code, to another economic agent from a member state, registered for the VAT according to the specific member state law. On this line, the Romanian firm makes an intra-community delivery, invoices without VAT according to the VAT code of an external economic agent in the community space, but, in fact, it sells the respective goods on the domestic "black" market. This method can be done either by the complicity of the external partner (who shares his VAT code) or without him knowing (for example, getting the VAT code from other means of information). Sure enough, the so-called "intra-community delivery" will have to be shown by the economic agent from Romania in the VAT expense account, the recapitulative declaration and the Intrastate declaration and the data reported to the Romanian public authorities will subsequently be dealt with, together with the ones reported by the external partner to the public authorities in his country.

Nevertheless, in the meantime, the economic agent in question will ask for the reimbursement of the VAT and will subsequently "volatilize" (by changing the social headquarters and the cession of social parts by persons hard to identify and who, in general, are no longer in the country at the date of the fiscal verifications). However, in reality the reverse situation may appear, when an external economic agent from the community space invoices to a firm in Romania, either with its participation or without it. Finally, a **fourth method**, found at the extremely sensitive limit between legal and illegal (as regards the power of probation) refers to the situation when an economic agent from Romania, registered for VAT according to article 153 in the Fiscal Code, makes an intra-community purchase and legally declares all related operations. Then, he registers an unnoticeable trade margin and simulates the retail sale, by the means of electronic cash registers. In fact, the respective goods are commercialized on the "parallel market" at much higher prices than those registered in the accountancy (but found under the market price level of the respective goods); in this case, the prejudice is found both at the level of income tax and that of the VAT (obviously, corresponding the undeclared price difference).

There have been many warning signals about the alarming dimensions of this phenomenon and, still, the effects of the measures taken to stop it are barely visible. In March 2008, a series of proposals of circumscription, if not elimination, of the phenomenon in controllable boundaries were adopted at the European Commission level. The respective measures mostly have an administrative character, made to reinforce the interstate cooperation in the field and spotting the eventual dysfunctions in due time by reducing the report period (of the economic agents) of the intra-community transactions made and the information transmission period among the member states concerning intra-community transactions.

Only time can say what will happen, but, as far as we are concerned, we believe that we should approach the cause of this phenomenon, which means radically changing the current taxing system by changing the system of taxation at destination with the system of taxation at origin. Nevertheless, in order to implement this desideratum, it is necessary to have the unanimous assent of the member states, and from this point the discussion gets more ample, if some member states are reluctant to go in this direction.

The operations in the VAT range that fall into article 143 are recognized by the legislator as being exempt operations with right to deduction. Hence, the VAT is to be paid for them, but the deduction of the due or paid tax for purchases is allowed.

3. Conclusions

We notice that the fiscal regulations do not necessarily link the site of the intra-community purchase to the delivery term, so that according to the provision of the article 132, paragraph (1) in the Fiscal Code the site of the intra-community purchase will be considered the place where the goods are at the moment of accomplishment of the transport or conveyance of the goods, without discerning who is obligated to make the transport or conveyance according to the contract delivery term.

We make this assignation because there might be a confusion generated by the provisions of article 132, paragraph (1), letter c) in the Fiscal Code that settles the site of the delivery as being the location where the goods are placed at the customer's disposal, supposing they are not transported or shipped (FOB or EXW deliveries). However, the legislator established a clear fiscal system by article 126, paragraph (9), letter b) verifiable with article 143, paragraph (2), letter a) in the Fiscal Code, namely the operations will be treated as exempt with the right of deduction if the two conditions are met.

We estimate that in this situation, the delivery term is useful in order to establish, in the accountancy of the Romanian supplier, the correctness of the registration on transportation exploiting expenses, the insurance of goods and other expenses related to the intra-community delivery.

Article 134 in the Fiscal Code establishes the moment of the VAT exigibility for the intra-community delivery of goods exempt from VAT according to article 143, paragraph (2), letter A), on the 15th day of the month subsequent to the one in which the generating factor (the delivery) happened or at the date of issue of the invoice if the issue happens before the 15th day of the month subsequent to the one in which the delivery took place. The supplier will issue the invoice where is the mention "exempt from VAT with the right of deduction" and that must encompass the information mentioned in art 155, paragraph (5) in the Fiscal Code.

The invoice is written in Romanian or any other official language of the European Union member states, and at the demand of the control bodies it will be translated into Romanian. In order to be registered in the sales papers, the taxable basis will be converted to lei according to the exchange rate given by the R.N.B. in the date of issue of the invoice or the exchange rate given by the bank through which the transaction is performed, article 139, paragraph (2) in the Fiscal Code³.

The intra-community deliveries made by Romanian suppliers are mandatorily declared in:

- The recapitulative declaration (390 VIES) that is presented at the fiscal bodies by the 15th day of the month subsequent to the one when the trimester, in which the deliveries were made, comes to a close, according to the MEF Order no. 537/2007;
- The Vat expense account (form 300) that is presented at the fiscal bodies by the 25th day of the month subsequent to the one when the reporting period comes to a close (the month or calendar

³ According to article 139, paragraph (2) in the Fiscal Code

trimester or any other fiscal period approved by the fiscal bodies) according to the MEF Order no. 94/2008;

- The Intrastate declaration (only if the volume of the intra-community deliveries made by the Romanian supplier overcomes the declaration limit of 900.000 lei). The declaration will be presented by the 15th day of the month subsequent to the one when the deliveries were made.

The ways of grating the VAT exempt are the following:

- By invoicing without the VAT by the goods suppliers or service performers, by virtue of the VAT exempt certificate released by the General Management of Public Finance of the municipality of Bucharest or, according to the case, by the general managements of public finance of the counties in whose territorial range the respective persons are located.
- By invoicing without the VAT by the goods suppliers or service performers, in virtue of the acceptance sent by the Ministry of Foreign Affairs for the persons with a diplomatic status;
- By invoicing the rent without the value added tax by taxable individuals who rent spaces as: -
- headquarters for diplomatic missions, consular offices, accommodations/residences for the personnel/their superiors and for any other foreign citizen having diplomatic or consular status in Romania or any other member state, including parking places and/or afferent garages;
- headquarters for international and intergovernmental organizations representations accredited in Romania or in other member states, residencies of the head representatives of international and intergovernmental organizations accredited in Romania, and also accommodations for the representation members, including parking places and/or afferent garages;
- By returning the VAT afferent to the purchased goods and services (including car fuel) in Romania by these individuals. The reimbursement is done by the General Management of Public Finance of the municipality of Bucharest or, as the case may be, by the local general managements of public finance.

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