

SELECTED LEGAL ASPECTS REGARDING THE TAX CLAUSE

dr hab. Mirosław Cienkowski

Uczelnia Medyczna im. Marii Skłodowskiej-Curie w Warszawie
e-mail: miroslaw.cienkowski@uwmsc.pl

Abstract: A layman's understanding of the essence of what is commonly known as carousel fraud requires a brief introduction to VAT rules. Value Added Tax (VAT) covers, as a rule, activities carried out by a taxpayer as part of his business activity. The economic activity defined for VAT purposes (Article 15(2) of the VAT Act) is wide in scope and covers any activity of a producer, trader or service provider, including the activities of natural resources acquisition entities, farmers, and entities performing liberal professions. In other words, professional turnover is subject to VAT. VAT is a turnover tax, which means that it taxes every sale (turnover) in the supply chain. The scheme of deducting input tax in the previous trading phase from output tax, as shown in the next phase, results in the taxpayer being obliged to actually account for “value-added tax” at a given trading phase. Consequently, although the tax is payable on each transaction, the principle of neutrality allows the economic burden of the tax to be passed on to the consumer.

Keywords: VAT, tax, taxpayer, broker, transaction, purpose, turnover, taxation.

Introduction

In a situation where the value of the input tax in the previous trading phase exceeds the value of the output tax in the next phase, the taxpayer shows a surplus which may be carried over to the settlement in the next settlement period or returned to its bank account. This situation is the rule in transactions of purchasing goods on the domestic market (which, for example, in Poland is subject to 23% taxation) and then selling them as part of intra-Community supplies.

The introduction into the VAT system of the concept of intra-Community supply of goods is the result of the assumption that transactions involving goods should in principle be taxed in the country of destination, using the rates of taxation and under the rules of that country. However, in view of the onerous nature of this system, it was decided to introduce a transitional system in practice, pending a definitive solution. In simplified terms, the cross-border

transaction resulting in the dispatch of goods is subject to 0% VAT as an intra-Community supply of goods for the taxable person of the seller. On the other hand, the purchaser (VAT payer) is obliged to settle the VAT on a given transaction, showing both input and output tax, using the rates applicable in the country to which the goods were supplied. The purchaser then realises the intra-Community acquisition of goods.

In practice, the above-mentioned settlement scheme proved to be susceptible to VAT fraud through the use of so-called carousel transactions.

1. Tax carousel - characteristic features

A “tax carousel” is a concept which in practice and doctrine of taxation describes a certain type of tax fraud usually associated with the trading of goods. This is a fraud using the cross-border trading schemes indicated above. There are differences in the doctrine of tax law in determining the characteristics of a carousel transaction (depending on the degree of sophistication of the structure concerned), but in principle, a carousel consists of a sale of goods using the institution of an intra-Community supply and an intra-Community acquisition, with the supply chain being closed in such a way that the goods are ultimately sold to a purchaser in the Member State from which they were acquired (usually to the person who was at the beginning of the chain). This enables the transaction scheme to be realised again. A characteristic feature of these transactions is, therefore, the closed circulation of goods, which means that they actually or only circulate on paper in the supply chain between successive trading participants.

The absence of the need to show the output VAT on intra-Community supplies and the absence of customs or border controls in the common market of the Member States creates an opportunity for fraudulent trading participants. Usually, the taxpayer's declaration of excess input tax in his tax return attracts the attention of the tax authorities. On the other hand, in the scheme of domestic acquisitions and sales of goods for intra-Community supplies, the successive recording of an excess of input VAT over output VAT (or lack of output VAT) is generally less suspicious [Wolfrhd, 2011, p. 389].

An illustrative example of a tax carousel can be found in the opinion of Advocate General M. Madura in joined cases C-354/03, C-355/03 and C-484/03, *Optigen Ltd, Fulcrum Electronics and Bond House*: “In its simplest form, carousel-type fraud works as follows. A VAT taxable person (A) registered in one Member State sells the taxed goods to a VAT taxable person (B) registered in another Member State. Sales by A to B are taxed at 0% in A Member State. B should submit a tax return and pay the tax on the acquisition in his Member State in order to subsequently deduct this tax as input VAT to the extent that he intends to use these goods for a further taxed supply. Usually, if a taxpayer is involved in a carousel-type fraud, he

does not perform any of these activities. B then sells the goods to another VAT registered person (C) in his Member State, charging and receiving the tax due. However, he does not declare the tax to the tax authorities and actually disappears; he becomes (...) a “missing entity”. Nevertheless, at the time of the sale to C, while still registered for VAT, and before [the tax authorities - W.K.] suspect that he is or may be a "missing entity" and before reacting accordingly (for example by deregistering B), he issues a VAT invoice to C, which in turn declares B as input tax. C (...) then sells the goods to a taxable person registered in another Member State; in the simplest form of fraud, the purchaser is A, and it is this cyclicity that underlies the concept of “carousel” fraud. C has the right to claim a refund of input tax, but since his sale to A is taxed at a rate of 0% in Member State C, he does not have to pay input tax on his sale”. [W.K. distinctions].

The purpose of the tax carousel is, therefore, to gain an undue tax advantage. It may be carried out in two forms: by non-payment of the output tax by an unreliable taxable person (“missing taxpayer”) and/or unauthorised deduction of input tax by other parties in the transaction, in particular by the entity making the intra-Community supply.

As a whole, it is a structure detached from the actual business activity (the sum of transactions is deprived of its economic purpose, although individual transactions may have economic justification). There is no final consumer of the goods that circulate between the traders. This feature confirms the purpose of the organiser of the transaction to carry out transactions in which a profit occurs exclusively due to the non-payment of the output VAT or the fraudulent recovery of the amount of excess of the input VAT declared over the output VAT. This is a feature that distinguishes a carousel transaction from other evasion events in business activity. From the point of view of the organiser of a carousel transaction, business activity is only a sham both to the tax administration and to other entities (including those participating in the transactions and acting in good faith). It is therefore essential to assess separately the state of knowledge and commercial integrity of each participant in order to effectively identify those responsible for organising the fraud and those unwittingly involved in it.

The lack of economic justification also means that a good which is the subject of supplies is treated exclusively as a VAT carrier and is therefore primarily chosen because of its suitability to generate a high volume of turnover or high input VAT in a short period of time.

In conclusion, the following features of a typical tax carousel should be noted:

- is a multi-stage and structured activity involving a minimum of three entities, each with a different role,
- the existence of tax fraud does not mean that all participants in the transactions constituting the fraud have equal knowledge of the nature of the transaction,
- the goods are only relevant as a VAT carrier,
- the execution of the transaction in the carousel scheme from the point of view of the total turnover has no economic justification.

It is worth noting that a tax carousel based on the scheme described above is one of many examples of organised criminal activity using VAT mechanisms and structure. A scheme analogous to the classic tax carousel is often used for this purpose (with its extension to entities outside the European Union and the use of customs law institutions). The increased efficiency of the tax administration at the local level of a country and in international cooperation also makes fraudsters look for increasingly sophisticated schemes [Kotowski, Bolesław, 2007, p. 71].

2. Participants in the tax carousel and their responsibility

As carousel fraud requires the participation of many entities, their involvement in the fraud scheme or even awareness of the purpose of the transaction scheme varies. In the basic scheme of fraud, described in the opinion of Advocate General M. Madura, quoted earlier, in which there are three entities, the scope of knowledge (and as will be indicated later in the responsibility) can be formed as follows: “The result, if the fraud is successful, is that B has received but not declared the amount of tax that the tax authorities must pay to C. In this situation, the scam is certainly done by B and probably also A. C may be quite unaware of what is going on and how his share of the turnover is used [W.K. distinction]. (...) The purpose of B (...) is not to acquire and sell in the ordinary course of trade, but to obtain VAT (...). Similarly, there is no real commercial reason for A (at least if he is involved in fraud) to buy back what he has just sold. Although it is possible that A is also involved in the fraud without his knowledge if the goods are sold to him by C for a price lower than that at which he sold them to B (or lower than the price at which he could have sold them in the future, considering the changes in the market), the position [of the tax authorities - W.K.] assumes that A and B are acting in concert and that it is necessary for A to buy back the goods, partly because of the need to control the situation and partly because it is simpler and cheaper to use a limited amount of the goods several times than to buy new goods on the free market each cycle of carousels. (...) B, knowing that he will benefit from not declaring the output tax shown in the VAT invoice, can afford to sell the goods to C for a lower price than A paid, and will do so if necessary to accomplish the sale”.

In other words, the participants described below can be distinguished in the case of carousel-type tax fraud.

3. Missing taxpayer

A “missing taxpayer” is a pictorial expression of an entity as defined in Article 2 of Commission Regulation (EC) No 1925/2004 of 29.10.2004 laying down provisions for implementing Council Regulation (EC) No 1798/2003 on administrative cooperation in the field of value-added tax. This is also the shortest term used to describe the entity. According to the legal definition, a “defaulting taxpayer” is an economic operator registered as a taxable person for VAT purposes who, with the potential intention of fraud, acquires goods and services or simulates their acquisition without paying VAT and disposes of them including VAT without remitting the output VAT to the competent State authorities.

Thus, the missing taxpayer carries out the proper activities of a VAT taxpayer (makes purchases, makes sales, accepts and issues VAT invoices), but does not settle the tax on the transactions made. Lack of settlement can vary from not submitting tax returns or zero returns to submitting returns with properly declared tax but without paying the amount of the liability to a tax authority. In the event of an attempt by the tax administration to verify the correctness of settlements, such an entity disappears according to its name, making it impossible to verify its transactions. This is part of the essence of the entity's business, so it usually has no assets and no actual operating activities. Many times, the persons representing the disappearing taxpayer do not know about his business activity; they are the persons substituted by the organiser of the transaction, the so-called straw persons, performing only specific activities (e.g. issuing invoices, making bank transfers). Practice shows that these people are often homeless or from the so-called social marginality.

The classic goal of a disappearing taxpayer is to achieve the highest possible turnover in a short time. For this reason, carousel transactions are characterised by very short payment terms (there are usually prepayments for delivery). The risk of verification of transactions made by tax authorities is usually dismissed by choosing a quarterly form of declaring turnover. By disappearing, the entity realises profits resulting from non-payment of the tax liability to the tax administration. Naturally, these profits are not retained by the straw person, whose remuneration for the activities is often symbolic.

The purpose of the disappearing taxpayer's action is not to pay the output tax, so there is no doubt about tax liability. The issue of assessing good faith or due diligence does not apply in this case. In the simplest scheme of transactions, a missing taxpayer is a taxpayer who makes a domestic sale to an entity which then makes an intra-Community supply (a broker). However, the disappearing taxpayer and broker are usually separated in practice by a system of buffers to make the transaction more credible.

4. Buffer entity

A buffer is an entity whose role is to mediate sales between a disappearing taxpayer and a broker. This entity was not mentioned in the early definition of a tax carousel in the opinion of the Advocate General in Case C-354/03, but its existence is nevertheless important for organising more sophisticated forms of fraud. As a rule, the buffer entity carries out actual business activities and settles taxes due. The introduction of buffers is intended to lengthen the transaction chain, make it more difficult to detect the fraudulent scheme and verify the origin of traded goods. It is also indicated in practice that the placement of buffers allows for blurring the links between participants in a carousel transaction.

The buffer may be aware of the criminal nature of the transactions, but this is not the rule. However, it should be borne in mind that the optimum form of the transaction from the point of view of the organisation of fraud is for the organiser to maintain control over the flow of goods and payments at the various stages of the transaction. The introduction of entities carrying out actual business activities as buffers may, therefore, carry the risk of identifying illegal activities for the organiser of the fraud. In less sophisticated transactions, there may be little difference between a disappearing taxpayer and a buffer, but they are usually formally active, often without any real impact on the way the transaction is executed, controlled by third parties.

5. Broker

A broker is usually treated by the tax administration as an entity which realises profits in the form of a deduction of input tax on the purchase of goods in a domestic transaction and an intra-Community supply taxed at a 0% VAT rate. When making a deduction, it applies to the tax administration for a refund of the excess of input VAT over output VAT.

The previously quoted position of Attorney General M. Madura indicates that this entity may be completely unaware of participating in a fraudulent transaction. It could be argued that depending on the existence or lack of awareness of the nature of the transactions in which the taxpayer is involved (possibly in case of his recklessness), he is either an accomplice to the fraud or a fraudulent entity used by the organisers of the fraud to finance the transactions.

Practice shows that the success of a carousel transaction often depends on the inclusion in the trading scheme of an entity unaware of the actual purpose of the transaction. A participant with a specific reputation, position on the market, known to the tax administration and reliably declaring and settling VAT, has a much better chance of achieving a high volume of intra-Community trade and multiple, effective claims for the refund of excess input tax over output tax to the tax authorities without raising their doubts.

From the broker's point of view, the recovery of the excess input tax over output tax is not a profit, as the amount of input tax shown on the purchase invoices was paid to the supplier (usually a buffer). Thus, the broker in fact finances the tax carousel, whether intentionally or unintentionally, and then applies to the tax authorities for a refund of the part corresponding to VAT. Therefore, while from the point of view of the whole carousel, all stages of trading can be rightly claimed by the tax authorities to consider the broker as a profit maker, this claim is more questionable only from the point of view of the stage of trading in which the broker is present. For this reason, it is of particular importance for this entity to assess its awareness of participation in fraudulent transactions or to take due diligence in this respect. Too hasty to consider such an entity as a taxpayer who is an aware participant in a tax fraudulent transaction means that responsibility for the fraud of which he may be the victim is concentrated on him [6].

6. Leading company - organiser

The leading company is a participant in a carousel transaction. It is an entity which starts another turnover of the carousel, selling to a consignee in a given EU country once again goods previously acquired under intra-Community acquisition from that country. Awareness of the purpose of delivery is obvious in this situation.

As a rule, the leading company can be considered as the organiser of the transaction in the simplest carousel scheme. On the other hand, in more advanced fraud schemes, establishing the identity of the entity responsible for forming the transaction scheme, recruiting participants and supervising the transaction is one of the main challenges facing the tax administration or law enforcement authorities.

7. Goods as VAT carrier

Due to the nature of carousel fraud and the disappearing taxpayer's desire to quickly realise the profits resulting from the fraud, the most important feature of the goods which are the subject of the transaction is their unit value or the value and volume of supplies that can be realised (in the case of low unit value). For this reason, any goods may be the subject of transactions aimed at tax evasion, marked both in terms of their nature and identity. In the practice of Polish tax authorities, frauds were most often identified in trading, e.g.:

- fuels and components for fuel production,
- construction steel, scrap metal, non-ferrous metals,

- gold, precious metals,
- consumer electronics (computers, computer components, mobile phones, smartphones, tablets).

However, tax fraud is constantly changing, also from the point of view of the subject of the transaction. If the tax administration effectively reduces the scope for fraud in a given industry, the activity of fraudsters intensifies in subsequent areas (e.g. trading in cereals, electricity, food or chemical products). The choice of the subject of the transaction may depend on the accepted scheme of fraud.

This can be illustrated by the following example. A mechanism of using a car or a specialised vehicle as a VAT carrier in a sham transaction of the intra-Community delivery of goods was presented in the National Action Plan of the Tax Administration for 2016, in Annex 1 Description of risks related to sub-areas of risk [Babiarz a.o.,2015, p. 52]. „Often the subject of such apparent supplies is used cars, e.g. lorries and buses or specialised vehicles of considerable value, from which the input VAT is fully deductible (e.g. a Ferrari car with banking status or a roadside assistance car). The fictitious buyers of these vehicles are entities registered in other EU countries, owned by Polish citizens or persons from non-EU countries (e.g. citizens of Ukraine, Russia). These entities often do not settle their intra-Community acquisition of goods transactions in the country where they are registered. At the same time, these vehicles are the subject of intra-Community acquisitions by Polish companies, with which most often there is no contact or this contact is very difficult, and which do not have the intra-Community acquisition of goods in the country. The final purchasers of these cars are the leasing companies. Entities making fictitious intra-Community supplies use only sales invoices, do not have documents proving that the goods have been transferred to another EU country, and they claim a tax refund using the 0% preferential rate applicable to intra-Community delivery of goods [6]. The above-mentioned example is interesting as it shows that carousel fraud (or a similar structure and fraud scheme) does not have to focus on the commercial sector, but can occur in any business where input VAT can be deducted.

8. Economic justification for the transaction

An important characteristic of the tax carousel is the lack of economic justification for the transaction as a whole. However, it should be noted that an objective and economic sense may arise at the various marketing stages, in particular, if the supply is made by entities unaware of the actual purpose of the structure. However, there is no doubt that the lack of economic sense at a given stage is an important premise for assessing the awareness of a given entity's involvement in the fraud. Entities aware of and benefiting from fraud may only pretend to be

actual economic activities, either in their entirety or in specific transactions. Their purpose is not to profit from the sale of certain goods.

This is also confirmed by the opinion of Advocate General M. Maruso in the joined cases of *Optigen, Fulcrum and Bond House*: "The aim of B (...) is not to acquire and sell in the ordinary course of trade, but an action aimed at obtaining VAT [W.K. distinction]. (...) Similarly, there is no real commercial reason for A (at least if he is involved in fraud) to buy back what he has just sold".

And Advocate General D. Ruiz-Rabar stated in his opinion in Case C-440/04, *Axel Kittel*, when considering the conditions for excluding the right to deduct in the event of abuse of the right: "It is clear, first of all, that the freedom of a taxpayer to choose his organisational form is subject to the advantages of his legal status. In other words, it is necessary to act in accordance with the will of the legislator, which does not happen if the obvious fulfilment of the conditions set out in the provision in question is aimed at finding and achieving an effect contrary to that provision. The second indication concerns the purpose of the activity in question, which can only be seen as an attempt to create an enforceable right in order to obtain an unfair advantage. In addition to the need for the beneficiary of the right of deduction to be aware of the fraudulent conduct, it seems necessary for him to act in agreement with the other participants in such a way that the contract, deprived of its autonomous economic value, was merely a cover for benefits. (...)

In a given case, the national courts have jurisdiction to determine whether the above conditions are met, applying the evidentiary criteria provided for by national law, insofar as this does not affect the effectiveness of the Community legal order. In their examination, the national courts must take account of the legal, economic and personal ties existing between the entities; and here two indications are particularly relevant: one is the unlawful advantage of the party invoking the right to deduct, and the other is its position in the mechanism, the closer it is to the position of a fictitious operator, the stronger the suspicion that it was involved in the fraud [W.K. distinctions]".

The above quotation indicates that carousel transactions are characterised by a certain degree of an organisation whose primary objective is to achieve a tax advantage. It stands out in this respect from other types of behaviour aimed at tax evasion. The "criminal" nature of such a transaction scheme is also clearly indicated, as these are actions against State Treasury property, as well as honest participants in economic transactions [Wilk, 2009, p. 218].

Conclusion

The adopted legal solutions, which were supposed to stop the unfavourable practice, not only were taken too late but also proved to be ineffective. They are not systemic solutions but attempts to control the situation in specific sectors of the economy on an interim basis. In addition, the institution of joint and several liability of purchasers has become a tool to pass on to taxpayers the responsibility for the indolence and incompetence of tax authorities, revealed in a report of the Supreme Audit Office. As a result, small and medium-sized enterprises have lost the most, for which meeting the new requirements is a greater burden than for large entities. Therefore, it is necessary to try to find solutions to combat fraudsters effectively.

References

1. Babiaryz S., Dauter B., Gruszczyński B., Hauser R., Kabat A., Niezgódka-Medek M., (2015). *Ordynacja podatkowa. Komentarz*, Warszawa: Wolters Kluwer.
2. Kotowski W., Bolesław K. (2007). *Kodeks karny skarbowy. Komentarz*. Warszawa: C.H Beck.
3. Wilk L. (2011). Archiwum Kryminologii. *Kryminalne aspekty przestępczości podatkowej*, Vol. XXI.
4. Wolfahrd B. (2011). International VAT Monitor. *The future of the Euroepan VAT system*, Vol. 6.
5. IV KK 222/12, LEX nr 1226744.
6. http://ww.mf.gov.pl/documents/764034/3365128/ZAl_nr_1_Opis_ryzyk.pdf [9.03.2020].