

Paper: Dissertation

Style: Harvard

Pages: 48

Sources: 41

Level: Bachelor

Value Added Tax (VAT) Frauds

[Name of Customer]

[Name of Institute]

[Name of Supervisor]

### **Acknowledgement**

I am very thankful to my supervisor for his complete guidance in order to complete my dissertation; I was unable to accomplish my research without his practical advices. I have been really inspired by him because of his deep insight and experience which made me to perform at my best for my research.

I am also thankful to my friends who supported me throughout the course and guided me for the completion of this research.

Finally, I am really thankful to my parents for their ongoing support, and always giving me the strength, courage and determination to face various challenges and for believing in my ability and trust.

### **Abstract**

Frauds in Value Added Tax (VAT) are a common practice. Although governments and tax authorities like Her Majesty Revenues and Customs (HMRC) are continuously trying to prevent Carousel and other VAT frauds but there are several flaws in the system which provides an opportunity to fraudsters to play their fraudulent activities safely.

This research study examines different types of VAT frauds and then tries to find the best strategy to prevent these carousel and other VAT frauds.

## Contents

<b>Chapter 1: Introduction .....</b>	<b>6</b>
<i>1.1 Background of the Problem.....</i>	6
<i>1.2 Statement of the Problem.....</i>	8
<i>1.3 Aim of the Study.....</i>	9
<i>1.4 Objectives.....</i>	9
<i>1.5 Research Questions.....</i>	9
<b>Chapter 2: Literature Review .....</b>	<b>10</b>
<i>2.1 Carousel Fraud.....</i>	17
<i>2.2 Weaknesses in Her Majesty Revenues and Customs (HMRC).....</i>	21
<i>2.3 Prevention Strategy.....</i>	23
<b>Chapter 3: Methodology.....</b>	<b>25</b>
<i>3.1 Introduction.....</i>	25
<i>3.2 Research Philosophy.....</i>	25
<i>3.2.1 Positivism.....</i>	26
<i>3.3 Research Approach.....</i>	27
<i>3.4 Research Strategy.....</i>	27
<i>3.4.1 Primary Data Collection.....</i>	28
<i>3.4.2 Research Method.....</i>	28
<i>3.4.3 Sample.....</i>	29
<i>3.5 Time Horizon.....</i>	29
<i>3.6 Research Designing.....</i>	30
<i>3.7 Data analysis method.....</i>	30
<i>3.8 Ethical Measures.....</i>	31
<i>3.9 Limitation of the Study.....</i>	31
<b>Chapter 4: Results and Discussion .....</b>	<b>32</b>

<i>4.1 Results</i> .....	32
<i>4.1.1 Weaknesses in HMRC</i> .....	32
<i>4.1.2 Performance of HMRC</i> .....	33
<i>4.1.3 Preventions to improve overall situation</i> .....	33
<i>4.2 Discussion</i> .....	34
<b>Chapter 5: Recommendations</b> .....	<b>41</b>
<b>Conclusion</b> .....	<b>44</b>
<b>Bibliography</b> .....	<b>46</b>

### List of Figures

Figure 1: Carousel Fraud .....	18
Figure 2: An example of Carousel Fraud.....	19
Figure 3: Complex Form of Carousel Fraud.....	20

## Chapter 1: Introduction

### *1.1 Background of the Problem*

The corporate income tax is levied on the profits of global corporations, public enterprises and unincorporated resident in the United Kingdom associations (Loretz, 2008). Non-resident companies, in turn, will pay the income tax on the profits they have made in the UK. Taxable income includes operating income, investment income and capital gains, less various deductions. Operating losses may be carried forward and deducted from the previous profits during this period or carried forward indefinitely to future fiscal years.

The standard rate of corporation tax is 30%, with a reduced rate of 19% applies to less than £300,000 profit (small business rate) (Crawford & Freedman, 2010). Companies whose earnings are between £ 300,000 and £ 1.5 million benefit from a reduction in the standard rate system, under which a 32.75% effective tax rate is applied to marginal profits beyond £ 300,000. This results in a gradual increase in the average tax rate to 30%.

Deductions for depreciation allow companies to deduct from their taxes an amount equal to the consumption of fixed capital (i.e. depreciation of fixed assets) resulting from their operations. Depreciation allowances can be made during the year of maturity subtracted from future profits, or carried up to three years back. The applicable depreciation rates differ depending on the type of asset:

- Investment in equipment can be depreciated on a declining balance rate of 25%. The goods to long life can be depreciated at a rate of 6%. A higher rate of 40% is applicable for the first year investment medium-sized enterprises and 50% for small businesses.
- Investment in industrial buildings and hotels are subject to straight-line depreciation rate of 4% per year.
- Investments in commercial buildings can be depreciated.
- Investments in intangible assets are amortized on a straight line, for which the Company may at its discretion apply the depreciation rate or a rate of 4%.
- Investments in equipment and buildings for research and development (R & D) have a more generous, since under treatment amortization of R & D plan, they can all be deducted from taxable income immediately

VAT stands for Value Added Tax. It is primarily a tax on sales, specifically a tax on the value added by the company, i.e. the difference between the amount of goods and services and the amount of goods and services purchased by enterprise (Cnossen, 1990). It is an indirect tax as it is for the company to collect the VAT it should be remitted to the state. Finally, it is a tax on consumption, since striking individual spending. In 1954, France was the first country to introduce VAT in its tax system, although the original idea of the VAT scheme had been invented in the 1920s by a German businessman, Wilhelm von Siemens, the concept was subsequently picked up and implemented by a French, Maurice Lauré. This is indeed the inventor of the VAT as a general consumption tax mechanism.

Despite its imperfections, the VAT tax is reliable, and takes a leading role in the state budget. That is why this tax was shortly after its invention becomes a success. In 1989, forty-eight countries, particularly in Western Europe and South America have adopted TVA25. On the

one hand the development of the European Union has encouraged the expansion of VAT in Europe since the introduction of a VAT system was a condition of membership in the European Economic Community. On the other hand the support of the International Monetary Fund, in the years following, has spread the VAT in more than 140 countries. The only notable exception being the United States which is insensitive to the charms of this tax, preferring the "Sales-Tax" system.

### ***1.2 Statement of the Problem***

While it is true that the inherent characteristics that limit opportunities for tax evasion and fraud, VAT is not, however, at present, a tax that remains flawless. Attempts to avoid paying this tax or obtain payment of false tax credits are also as old as the VAT itself (Smith, 2007) and illegal profits in this way are sometimes very important. It is also remarkable that these scams are becoming more sophisticated and ingenious, constantly adapting to changes in VAT. Therefore, there is no doubt that the development of VAT fraud is a tangible problem.

There are many ways to defraud the VAT. In most cases the fraud is only to evade the payment of tax. But weaknesses specific to this indirect tax also allow the development of a fraud with far more important consequences. Then it is creating a false tax credit on the Treasury, and thus achieves illegal profits at the expense of the state. Fraudsters, thus, enrich themselves at the expense of the company. These frauds are often the work of true crime networks mastering perfectly the tax rules, and the money raised can help the financing of criminal activities.

The current VAT systems suffer from many flaws that allow a chance for the fraudsters. In a society where tax evasion is sometimes due to "competition" it is not surprising that at the



birth of this new tax, ingenious minds have tried to use the mechanisms of VAT to make fraudulent profits. The tax administration has always fought against VAT fraud with more or less success. But since 1993 and the establishment of a single market within the European Union, the VAT fraud took a novella extent with the development of carousel fraud. For if the VAT fraud has always existed, Carousel fraud is recent and has catastrophic consequences for state budgets.

### ***1.3 Aim of the Study***

The purpose of this paper is to explain the vulnerabilities of UK's law which makes fraud in VAT and Carousal fraud possible. This research study also discusses the present weaknesses in Her Majesty Revenues and Customs (HMRC) due to which fraudsters can easily manipulate the law. This study also suggests the prevention strategies for Carousal fraud and how they can be implemented into HMRC to improve the situation.

### ***1.4 Objectives***

- To discuss the nature of VAT frauds, especially the Carousal Fraud
- To identify the weaknesses in the system of Her Majesty Revenues and Customs (HMRC) which make the VAT fraud possible
- To describe and explain the prevention strategy to avoid fraudulent practices in VAT

### ***1.5 Research Questions***

- What is Value Added Tax (VAT) and why fraudulent practices are so common in VAT?
- What is Carousal Fraud?
- What are the weaknesses in HMRC which makes Carousal Fraud possible?
- What is the best prevention strategy to improve the situation?

## Chapter 2: Literature Review

Fraud is a dishonest act done with intent to deceive in contravention of the law or regulations. As for tax evasion, it is done to escape the tax by improper means, i.e. by processes or manipulations that the law will suppress (Alm & McCallin, 1990). It is then possible to propose the following definition: VAT fraud is an intentional act that can be characterized by the use of this specific tax mechanism to avoid paying tax or benefit a false claim against the tax authorities (Her Majesty Customs and Excise, 2004). It is to divert the tax rules by immoral methods to evade tax or to make illegal profits.

The VAT fraud is a breach of the social contract because it is defrauded by some is paid by others. Therefore, taxpayers no longer participate in fair expenses of the company way: it is a violation of the principle of fair taxation. It is also quite ironic that that tax fraud is definitely an offender which receives the greatest indulgence from the general public. However, the VAT fraud, or more broadly tax evasion is a scourge for all society. By reducing state revenues it diminished the funding of public service, so important for the development of the community. Each fraudulent profit is thus achieved at the expense of the state. Every citizen is then direct victim of tax fraud. This is why the issue of the fight against VAT fraud is crucial. For all these reasons, the VAT fraud is now a fascinating question that it seems essential to provide solutions.

The VAT fraud is the fraudulent use of the VAT rules so as not to repay the tax due to the State or to receive a fictitious claim against the State. Therefore, in order to understand the

mechanism of VAT fraud, it is necessary to expose the schemes of such tax. The rules may vary depending on the nature of the operation performed by the subject, it is necessary to distinguish whether the operation is not an international character. It is therefore necessary to introduce rules for internal operations, and those applicable to intra-Community supplies and acquisitions (Bird & Gendron, 2007). Fraudsters take advantage of weaknesses in fact the mechanism of VAT both internally and within the framework of intra-Community trade in goods level. Although the VAT frauds are more "classic" and the most common but are mainly implemented in operations taking place exclusively in the country since 1993.

The establishment of the single market paved the way for developing more complex fraud, i.e. the "Carousel" fraud. Carousel fraud is taking advantage of the principle of exemption for supplies in the state of the seller, it allows fraudsters to make very large profits and is still very difficult to detect. Carousel fraud is a real problem for the state, as its effectiveness is formidable (Keen & Smith, 2006). Since fraud diverts VAT rules, we must discuss the VAT regimes applicable to internal operations and community activities before continuing on the analysis of the development of various forms of fraud.

Knowing the tax regime is essential to understand the mechanisms of fraudulent schemes. The scope of VAT is very wide, although some operations are, however, exempt from tax. When the mechanism of tax law, it is partly based on the system of payment by instalments. The subject and have a right to deduct. They attributed the VAT paid on the tax collected. Therefore, the tax is not a burden for businesses subject to VAT. The difference between the tax collected and input tax is in turn, donated to the state (Schenk & Oldman, 2007).

For a transaction to be taxable, it must have been made by a taxable person acting as such. The economic activities covered by the provisions relating to the tax on value added are defined very broadly as comprising all activities of producers, traders or service providers, agricultural and mining activities and those of liberal or similar professions. In fact, the condition for the exercise of an economic activity is most often filled in the presence of a business professional, so that excludes private transactions and those in which the subject will not be as such (Terra, 2007).

VAT is a tax on instalments; it is calculated on the selling price of the good or service while the taxpayer may deduct the tax charged by the person who preceded the circuit of production or distribution (Williams, 1996). Thus the calculation of the VAT payable by the company during a period, usually a month, is in two parts: one must calculate the gross tax payable before determining the deductible VAT. But the VAT scheme, simple in theory, suffers from several weaknesses. It was on the basis of the inherent mechanism of VAT law that different VAT fraud weaknesses are built. The VAT liability is the tax that is collected by a taxable person from his clients. So we must distinguish the VAT payable by the deductible VAT: the first is the tax collected downstream by a business subject, the amount is repaid to the Treasury. The second is the input tax paid by a taxable entity on its suppliers or providers (Cnossen, 2010). This is being attributed to the amount of VAT paid to the state to be reimbursed by the Treasury. The calculation of VAT payable is a very simple operation as it is to apply a VAT rate of the tax base (B). But it should be determined before the event and the chargeability of VAT (A).

For deliveries of goods made and chargeability coincide, it is the date of transfer of ownership of the property. No matter if the property is not yet paid, in which case the provider is

ahead of VAT. Indeed, the fact is the generator run time of service, while the due date is the day of receipt of the price of services rendered (Crawford et al, 2010). The amount of tax payable resulting from the application of specific tax rate for the operation of the tax base. The tax base is made for the supply of goods, services and intra-Community acquisitions, all monies, securities, goods or services received or receivable by the supplier or service in exchange for these operations from the purchaser, the customer or a third party, including subsidies directly linked to the price of these operations (Crawford et al, 2010).

VAT, like all other taxes, is territorial application, i.e. the tax is payable only when the operation is performed on the national territory. These rules essentially the result of territoriality Community provisions harmonized national legislation. It is therefore in the study of territoriality of VAT to determine attachment of various operations to territory. It should be noted the VAT rules applicable to intra-Community trade because it is within this framework that many frauds emerged. This is particularly the case of carousel fraud, which takes advantage of flaws in the current EU system of taxation for the purchase of goods and services in cross-border exemption (Balcerowicz, 2007).

Since the birth of the European Single Market on 1 January 1993, the rules applicable to transactions between member states of the European Union is no longer in the rules applicable to transactions made with a state located off the European Union (Gebauer et al, 2003). Currently, the transitional arrangements for the taxation of intra-Community transactions subject provides for the payment of tax in the country of the buyer. On services performed between taxable, taxation takes place in principle in the State of the lessee (Crawford et al, 2010). The system of intra-Community transactions of goods depends on whether the delivery is made to an identified

subject or individual. However, it is more useful to focus on the regime applicable to taxable because it is in the context of cross-border transactions subject that fraud has grown.

It is remarkable that the VAT fraud takes advantage of weaknesses in the tax system, especially in the VAT regime applicable to domestic transactions subject to tax, but also on the intra-Community transactions as fraudsters do not fail to exploit the weaknesses inherent in each of these two regimes. It must be borne in mind that VAT fraud is not only a national problem. Indeed, the creation of the single European market in 1993 abolishing tax frontiers opened up new opportunities for fraud. For the method of taxing intra-Community trade today based on a transient and incomplete system for the implementation of large scale fraud where fraudsters and accomplices share huge profits circuits. Deliveries of goods between Member States are exempted from tax effect in the State of departure, and give rise to reverse in the country of the purchaser. Therefore, in parallel with VAT fraud taking advantage of weaknesses in the VAT rules governing purely internal operations, it has developed a more complex form of fraud exploiting the weaknesses of the transitional arrangements for the taxation of intra-Community transactions.

This fraud is appointed by the specialists of "carousel fraud". It is to divert the VAT rules applicable to Community trade, making intra-Community acquisitions tax exemption without paying VAT to the Treasury (Ainsworth, 2006). This tax is very effective because it requires no claim to the state. Indeed the operator resells, charging VAT, the goods acquired tax exemption. Fraudulent gain is the difference between the cost of assets acquired and their tax exemption for re-sales price including tax. It is clear from this analysis that fraudsters adapt constantly to changing the tax system, and exploit the smallest flaws.

Since 2005, there is a Community trade of emission allowances that allows businesses to make "rights to pollute" transactions. But in recent years, several cases of Carousels fraud were found in this market. It turns out very attractive to fraudsters, since traded goods are intangible and therefore taxable in the State of the lessee to the reverse charge mechanism. Fraudsters then benefit from reverse to make illegal profits at the expense of the state. But the main interest of this fraud is the nature of good support fraud. Indeed, it is immaterial; it requires no transport logistics which optimizes performance. The recent development of carousel fraud in the European market for pollution rights perfectly expresses the extraordinary inventiveness sometimes shown in fraud crimes. The ingenuity of fraudsters is very profitable here, as it would have reported to date more than 5 billion Euros (Caridi & Passerini, 2001).

There are different forms of VAT fraud that can be grouped into three categories: Classic VAT frauds, frauds consist of circuits of false invoices and finally Carousel fraud (Pashev, 2007). VAT Classical Fraud is called so because it has been the creation of the VAT, and is found in all countries using this type of tax. The objective is to evade paying what is owed to the state. It relates generally to small amounts, and the result of "failure" to report certain business transactions; however, it represents only a small proportion of the total amount of VAT fraud. The largest part of this amount is made up of fewer but more profitable forms of fraud.

Classical VAT frauds are characterized by their simplicity, and thus remain very accessible to a wide audience. Most of the time they are to disregard the rules of taxation to reduce the total amount of VAT due to the Treasury. Such frauds may also include the use of the existence of multiple VAT rates, underestimating the rate shown on the sales invoices to underestimate the VAT payable to the Treasury. Indeed companies conducting transactions subject to different rates should report the revenues they realize by category of tax rates. The

game of fraud is to use the existence of these different VAT rates so that a transaction is taxed at a lower rate than that normally applicable (Crocker & Slemrod, 2005).

The provisions of deduction allow taxable persons to deduct the input tax credit received on the downstream. This deduction is materialized by a tax credit of the company in the state. The objective of fraudsters is to use the rules of right of deduction in order to increase the existing tax credit or create an amount of VAT credit illegally (Das-Gupta & Gang, 2003). For this, they sometimes produce bogus invoices or bills. Assuming the fictitious invoice, delivery of a good or the service has never occurred. The invoice is false because it mentions a non-existent transaction (Das-Gupta & Gang, 2003). In the second case, the bill of convenience, the reality of the transaction is not disputed, but the actual service provider is a third party, i.e. a person other than the issuer of the invoice. In these cases, the fraud is more to just evade taxes voluntarily. According to Das-Gupta & Gang (2003), it is for fraudsters to get rich by creating a notional input tax credit at the expense of the state. This is the nature of VAT that allows the diversion of tax.

The pattern of these frauds is very simple. Since the invoice is the basic document to qualify for the right to deduct input VAT, simply make a false invoice to create in favour of the purchaser a tax credit against the State equivalent to the amount of VAT on the invoice. In fact, the mention of VAT on an invoice entitles in principle in the latter to a deduction of the same amount. As for the fictional claim, the provider then charges the amount of tax he owes the Treasury or requests the State reimbursement. False invoices that do not match any execution of service delivery or deliveries of goods take the name of factious bills. The interest of these false invoices is to enjoy the deduction system to create a false VAT credit on the state that can be liquidated either by charging the VAT due or requesting a refund. Slemrod & Yitzhaki (2000)



are of the opinion that the mechanism of VAT fraud with fictitious invoice exploits vulnerabilities specific to this tax. These produce a VAT invoice but has no counterpart in term supply of goods or provision of services actually performed. Its mechanism is to divert the system of payment by instalments of the VAT is the establishment by the taxable invoice indicating the amount of tax for which it is liable. These bills when they are legal justify the existence of the VAT receivable available to the purchaser due to the payment of input tax. The purchaser may then deduct the amount of the input tax amount of the tax imposed by the state. This technique creates an imaginary VAT credit resulting in the deduction or refund of VAT shown on the false invoice. There are several types of frauds resulting in the provision of a bill that is a benefit or deliveries actually made. In all these cases of fraud, it is issuing a VAT invoice so that it is not legally authorized to be included. Thus, the assumption that the operator provides a VAT invoice when there is not liable because it was not legally opted for payment of VAT.

### ***2.1 Carousel Fraud***

The "carousel" fraud is a mechanism for VAT fraud that can take many forms, more or less complex. It involves at least two member countries of the European Union and often a third located outside the Community. One of the simplest schemes requires three actors. Company book and goods to Company B moved to UK from France. It is an intra-Community supply of goods is exempt from VAT in the country of departure. Once the goods arrived in UK, Company B sells to firm C. Company B UK VAT invoice to C, while C gets deducted or repayment of VAT that was charged by B. It then disappears without paying the UK the VAT it has charged. The loop closes when the firm sells the goods to C A and ships the goods from UK to France. Company C in turn generates an intra-Community supply of goods is exempt from VAT in UK.

There is thus a double loss for the state, which not only does not collect the tax charged by B, but reimburses C (Grandcolas, 2008). This type of fraud has a limited lifespan, usually about 2 years. It often involves the area of telephony and electronic components. These are highly demanded goods represent important amounts. These frauds are committed by organized networks with connections abroad.

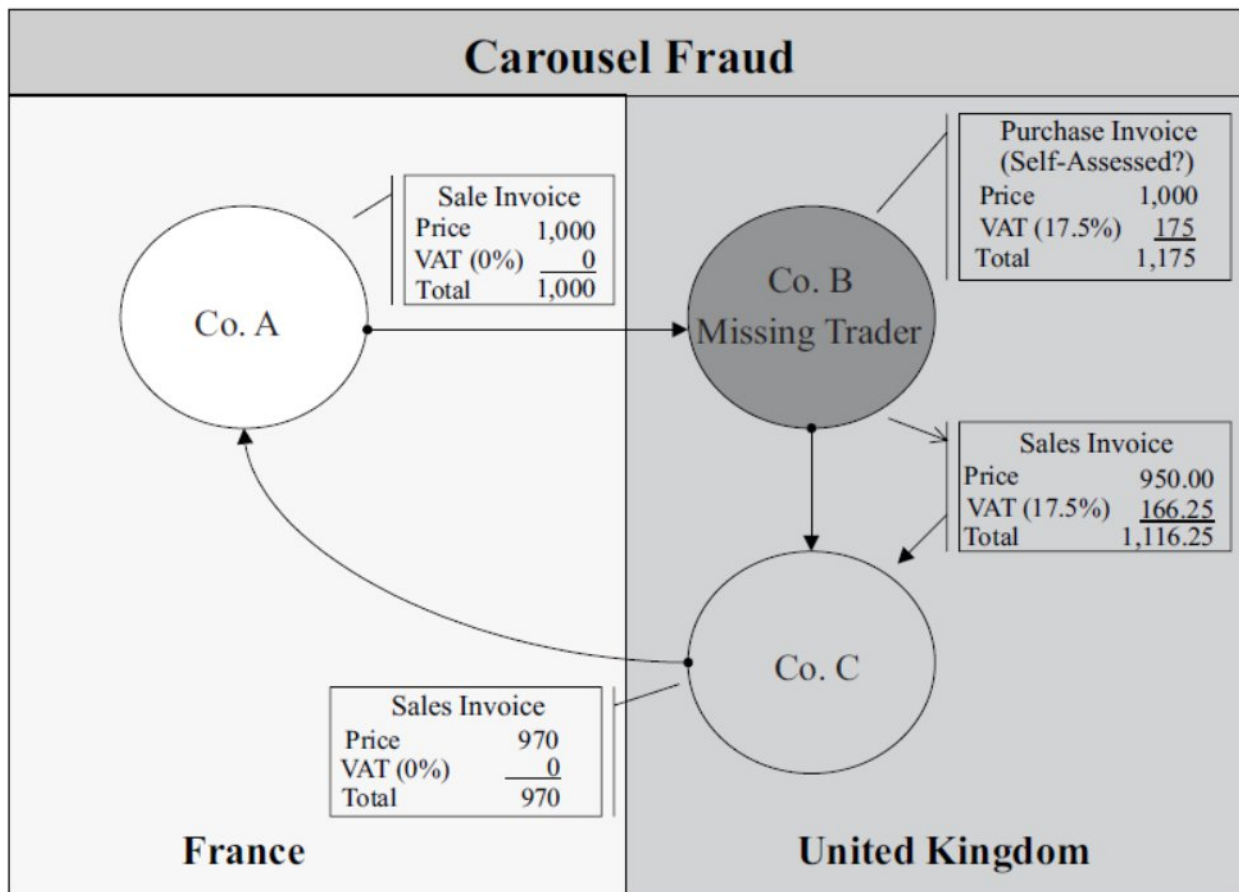


Figure 1: Carousel Fraud

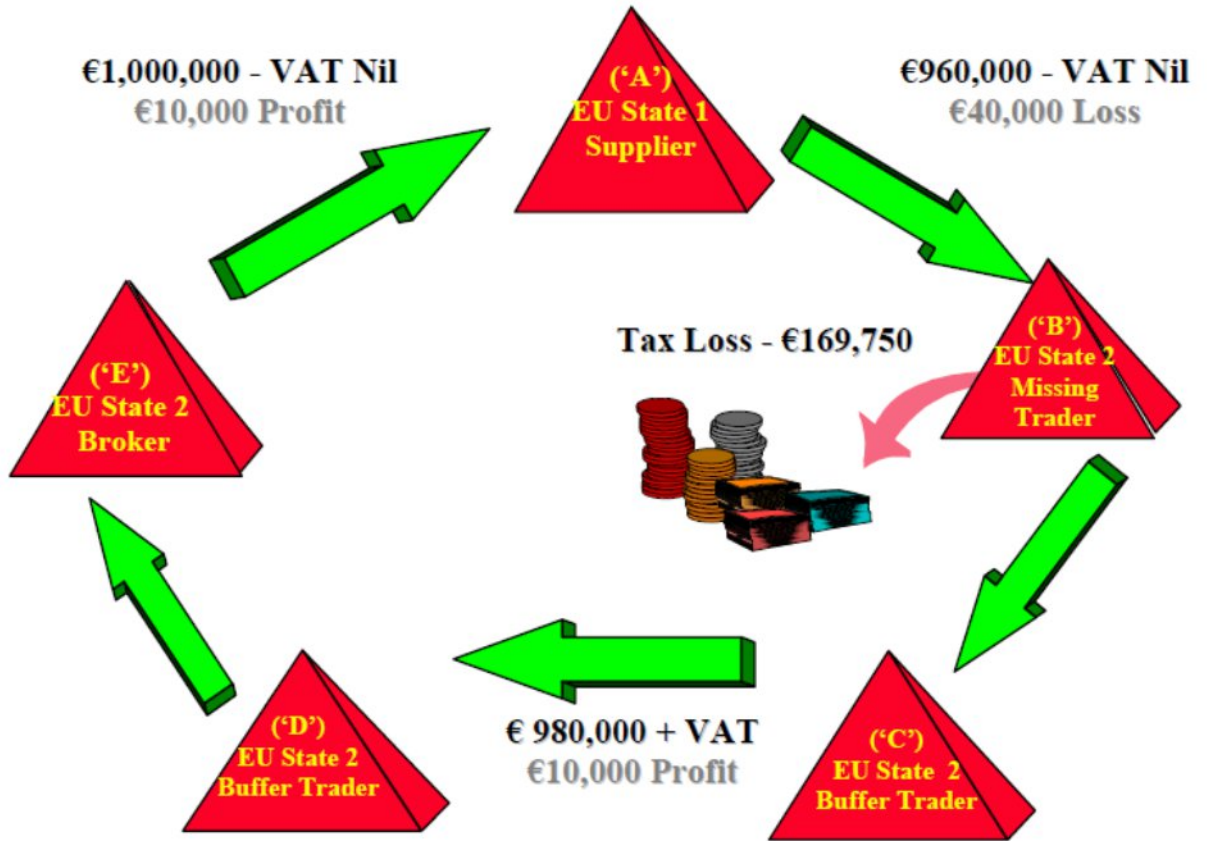


Figure 2: An example of Carousel Fraud



Figure 3: Complex Form of Carousel Fraud

Carousel fraud is primarily the goods with high value. Fraudsters prefer either the expensive products of small sizes or sectors to achieve great turnover. Therefore, it mainly concerned the fields of IT and electronics in general, that of mobile phones, luxury products like perfume, as well as automotive, oil and to a lesser extent textile (Gabriel, 2003). Carousel fraud has also been found in recent years in trade of emission allowances in greenhouse gas emissions in many Member States. The recent development of carousel fraud in the European market for pollution rights perfectly expresses the extraordinary inventiveness sometimes shown Fraud

crime. The ingenuity of fraudsters is very profitable here, as it would have reported to date more than 5 billion Euros (Plager, 2007).

## ***2.2 Weaknesses in Her Majesty Revenues and Customs (HMRC)***

Her Majesty Revenues and Customs (HMRC) is a kind of tax police of UK. Although HMRC is one of the largest organizations of UK, but it has several weaknesses which reflects in the ever increasing number of VAT fraudsters and Government's inability to collect taxes. Carousel fraud has grown with the introduction of transient system. This system of taxing intra-Community trade in goods between Member States was introduced by Directive of 16 December 1991, entered into force on 1 January 1993. However the transitional tax value is designed so that intra-Community supplies of goods between taxable persons are exempt in the Member seller taxed in the Member State destination. It should be noted that each year, the value of goods circulating in the Community and VAT exemption amounts to more than 1500 billion each year (Swinkels, 2008). This represents nearly 200 billion Euros in revenue. However, this tax system suffers from a weakness that can be exploited by fraudsters: goods can indeed move without being taxed. Thus, the exemption mechanism exposes the VAT system to fraud, particularly in the carousel fraud.

It has been observed that the standard rate of corporation tax have evolved the remarkable decline, which went from 50% in the early 80s to almost 30% today. According to Devereux et al. (2004) and de Mooij & Nicodemus (2007), this decrease in rates is more than offset by the expansion of the tax base as well as by other factors.

In the Carousel fraud system, the supplier sells goods to a taxable. This is done by tax exemption for intra-Community supplies and leads to reverse. That is to say that it is the buyer to

declare and pay the tax due itself because of the operation. However, the acquirer does not bother to meet its tax obligations and the operation does not inform the tax authorities of the existence of the operation. Failing company sells its goods to another company also located in the same country. The company charges the tax due in respect of this transaction but does not declare and does not pay the Treasury. And his client may deduct or claim a refund of the tax that was charged by the failing firm while the latter has not been paid to the state. The company can then sell its goods to another customer in UK or possibly a company located in another Member State tax exemption.

If HMRC becomes aware of the existence of the scheme to defraud it will try to recover the tax that is due to it. However, it is often impossible to recover the VAT from the "failed" operator, since it has mostly disappeared when the administration is aware of the existence of fraud. Recovery procedures are then often ineffective. There is also a "small number of complaints filed by the administration of the Head of tax fraud in contrast to the broad scope; the sanctions against the main beneficiary of the fraud, alone are ineffective in the fight against fraud. The new strategy for 2007 is to suppress such provider behavior or purchaser. This consolidation of the anti against fraud, including carousel, is primarily the result of a long evolution of jurisprudence. The new provisions relate so one side provider who participates in a VAT fraud and the other, the buyer involved in a VAT fraud.

However, the idea that tax competition leads to a loss of well-being depends crucially on the assumption that governments are benevolent, and use accordingly to maximize the welfare of all economic agents. However, the state can also act as a "Leviathan" for its own sake and trying to maximize its size, which results in excessively high tax rates. In this case, tax competition has positive effects in terms of welfare, since a decrease in tax rates leads to efficiency gains by

reducing the tendency of the authorities to engage in excessive and unproductive expenditures (Krogstrup, 2004 ).

### ***2.3 Prevention Strategy***

To cope with different types of fraud that have been developed by diverting the principles specific to VAT, a comprehensive strategy is required. However, HMRC fight against VAT fraud shows its limits when it comes to combat against illegal assemblies of larger scales. These frauds are often organized across borders. Carousel fraud is indeed very difficult to detect with HMRC administration alone. The threat of cross-border fraud must logically be considered at European level. The establishment of a common and coordinated EU strategy thus appears as the most appropriate solution to complement and support the device fight against fraud. Well advanced by the European Union and the measures put in place by the HMRC administration recent proposals "are intended to take the next step (Warren, 2007) and want to make the device and the fight against VAT fraud most effective. Therefore it should be noted that the internal device fight against fraud still seems insufficient today, given the magnitude and complexity of some circuits VAT fraud. In order to work faster and more efficiently, the establishment of a common European strategy against fraud seems necessary.

Tax penalties imposed on taxpayers who voluntarily seek to avoid paying tax in violation of tax rules. These tax penalties are fines. They may consist of fee increases or default interest. These increases are increases of 40% in cases of wilful misconduct, 80% in the presence of abuse of rights and fraudulent and 100% in case of opposition to a tax audit. These are directly applied by the tax authorities under the law and under the control of the tax judge (Lasok, 2004).

The parties involved in the Carousel fraud are most likely to be sanctioned the criminal offense of tax evasion (Collins & Gore, 2007). The facts constituting a carousel fraud may be the double qualification of tax evasion and fraud within the meaning of criminal law, and separate prosecution. This is why the prosecution is admissible for tax evasion.



## **Chapter 3: Methodology**

### ***3.1 Introduction***

In this chapter we will be looking at the ways through the help of which the different steps involved in the research can be streamlined and can be put effectively into practice. At the same time it also helps in understanding and applying of different methodological principles through the help of which research can be conducted and the steps that are necessary for it. With the help of all these salient features and steps and their subsequent implementation substantial credibility is added to the research on the whole.

It is important to mention here that the nature of methodology applied and used is dependent upon the kind of research that is conducted. The nature of methodological principles applied varies in terms from usage whether it is quantitative or qualitative and changes in methodology are incorporated accordingly. (Bryman, 2008)

### ***3.2 Research Philosophy***

The term 'research philosophy' is used as a collective term that denotes to all different research methodologies and belief systems that can be used and implemented when conducting the research and resolving the different questions that comprise the integral part of research. The different dimensions of research that are actually applied when conducting and fulfilling the different stages of research include axiology, epistemology and ontology (Malhotra & Burks, 2007). During the course of the different stages of research methodological principles related to the fundamentals of research will be complied and under the light of these research features the different stages of methodology will be conducted.

### ***3.2.1 Positivism***

There are different research approaches that are used and derived when conducting a methodology in research. In this context the most prominent approach that is applied is in the form of positivism. This approach and its use in methodology basically accentuate upon the fact that data from social and natural sciences is derived on the basis of sensory information and observation. In addition to this, the data derived from these branches is also based on the logical and mathematical treatment of such data. The positivist school of thought holds the view that the society is operated on the basis of laws that are governed by the physical world (Malhotra & Burks, 2007).

One way through which this relationship is determined is with the help of the correlation that exists between the variables being investigated the deductive processes either conforms to or reject the assumptions. This can be done in the form of preparing research questions or survey forms which can be circulated among the professionals that are related to the nature of the research statement which is being investigated. On the basis of the results and the responses that are obtained with the help of these research questions the validity or the authenticity of the formulated hypothesis is determined. In addition to this, another way through which this process is conducted is with the help of devising certain research questions that form the crux of the research statement or the possible outcomes that the research intends to develop. During the course of entire research the primary aim of the researcher is to find answers of the devised research questions which in turn determine the reliability and validity of a research (Bryman, 2008)

### ***3.3 Research Approach***

The approach towards this research will be the one that is applied to all different kind of researches. The researcher will focus upon the ways and procedures that are applied in research to study the behavioural responses and along with all other different phenomenon that continually confront and conform to the theoretical model that has been crafted for the conduction of the research. Validity in any research must be of constant concern to the research since it plays an important role in establishing credibility of a research but also in the reproduction of results that form the basis of research. However, in this context it is also important to understand and apply the research approach which is applied (Cooper & Schindler, 2003).

The nature of approach that will be applied for this research is in the form of inductive approach. Inductive approach is the assessment applied based on the individual instances of life that respondents had experienced in the different phases of their life. On the other hand deductive approach used which is based on general statements and the logical conclusion derived on the basis of these statements (Eisehartdt, 2008).

### ***3.4 Research Strategy***

Strategy employed for the conduction of research is mainly influenced and dependent on the type of research which is being conducted, whether it is qualitative or quantitative. This particular research, however, will be based on the qualitative nature of methodology which will be conducted on the basis of the questions that have been formed. Since the nature of research statement being dealt is pre-dominantly financial, it is important that people either to this field and those who have closely been observing VAT issues and weaknesses within HMRC for some time are chosen as the population to present their views and perspectives on the questions.

Hence, sample chosen for this particular research are people from the financial sector who have been dealing with tax issues and carousel frauds and related to academia, regulatory bodies or audit firms (Miles & Huberman, 2006).

### ***3.4.1 Primary Data Collection***

Since the nature of research is completely qualitative, it is important to state here that the method of data collection that will be employed for the purpose of this research is based on the utilization and processing of results that will be obtained from the responses of the research questions that were formed in the research process.

The questions that comprise the research process encompass all necessary dimensions and aspects that cover all necessary dimensions of the research statement which is being analyzed. It is on the basis of the responses obtained for these questions that analytic strategies will be employed in the different stages of the research for obtaining clear results (Patton, 1980). The nature of research does advocate the use of questionnaire. With the help of the research question will be utilized for the subsequent phases of discussion.

### ***3.4.2 Research Method***

This chapter aims to describe the implementation of research and try to answer the research questions. The data is collected through secondary sources like books, journals, articles, and Internet. Apart from these sources, data is also collected through a survey questionnaire. The questionnaire survey is a tool that allows observation to quantify and compare the information. This information is collected from a representative sample of the population under evaluation. A questionnaire is a set of questions built to obtain information relevant to the issues of the

evaluation. Respondents are not required to meet directly to them: a good questionnaire comes in the fact basic problem in which the basic questions meeting will meet perfectly.

### ***3.4.3 Sample***

The survey questionnaire collects the views of the participants regarding use of derivatives and company's profitability. This questionnaire was distributed among all the participants. The methodology to analyze the data collected is a type of Probability Sampling, i.e. Purposive Sampling because the sample size is not very large. After getting the response the answer of each question is calculated and then the analysis was done. Purposive Sampling method of analysis helped the researcher to deduce the correct judgment and enable the researcher to answer the research question of this study.

### ***3.5 Time Horizon***

With the help and application of cross-sectional nature of research the researcher is provided with the convenience of exploring more than one frontier for the researcher through which he can easily collect and explore multiple areas of information regarding the research. With the help and use of cross-sectional strategy in the research process the researcher gets ample time so that it can go through with each of the stages of research with complete detail effectively filling each of the loopholes that might be present in the work (Saunders et al., 2007).

However, apart from the time saving feature of cross-sectional research, a major setback of this application is in the form of its scope. It cannot be applied to researches or areas of research that involve the usage or application of information that is personalized in nature (Yin, 2003). Even though time horizon and cross-sectional nature of research might come in very handy for different type of researches, it might not prove very helpful in the kind of research that is under discussion.

### ***3.6 Research Designing***

The segment of research designing particularly focuses upon the ways through the help and application of which data can easily be collected during the course of research conduction. As mentioned earlier in the initial phase of our research, for the purpose of accomplishing our research objectives we have formed a questionnaire.

It is on the basis of this questionnaire that data will be collected from the target population that has been chosen for the research. This will include people from the corporate sector. Once their feedback and responses are obtained regarding the research questions, the research design will definitely prove helpful in the streamlining of other related processes. However, a major limitation that is associated with the use of questionnaire is that the information used in the preparation of research questions is already utilized in some form or the other in secondary research.

### ***3.7 Data analysis method***

In a sociological research or for that matter a research statement which is subjected to the fundamentals and pre-requisites of research conduction it is important that the data obtained from research findings is properly analyzed with the help of properly analyzed tools. An important function that this intends to do is to basically verify the authenticity or nullify the credibility of the hypothesis which is being researched.

Under the light of this context the study that has been conducted will examine and analyze the findings made in the form of responses made under the light of the research questions that were formed for the research.

For this study, based on the nature of responses that will be obtained regarding different research questions, answers will be written based on the feedback and the answer that has been provided by the members of the target population that has been selected for the purpose.

### ***3.8 Ethical Measures***

In the process of conducting any research it is important that some fundamental ethical considerations and measures are kept in mind. Firstly, the identity of all respondents involved in the research was kept confidential. Secondly the motive and objective of the research was informed prior to dispatching of questionnaires to all respondents. Thirdly, no inquiry about any personal information was asked about the respondent and lastly, all measures were employed to ensure that the research work is credible and completely transparent.

### **3.9 Limitation of the Study**

The most important limitation of this research is to get the data regarding VAT frauds because the companies which are involved in such practices do not reveal this information. This study is limited to using pre existing (secondary) data. It is limited in that it is student level research and the most preferred method as access to required data can be obtained at little or no cost to the researcher. Journal, periodicals, newspaper articles and internet were the sources used to prepare this research paper. Thus, for student level research it is the most preferred method because it is not possible for students to perform expensive research.

## **Chapter 4: Results and Discussion**

### ***4.1 Results***

The use of carousel frauds by companies has become commonplace. These are large companies who use the weaknesses of the tax system of European Union in general, and UK in particular, for their fraudulent practices. Use of Carousel frauds is one of the most common and widely used forms of VAT frauds. We have conducted a survey on the use of VAT frauds by UK companies. The main objectives of this survey are to determine the weaknesses in HMRC system and the preventions implemented which may help in improving the overall situation.

The first question posed to companies is whether there are weaknesses in HMRC or not? 68% of respondents answered in the affirmative. The results of the survey showed that despite several preventions regarding improper use of VAT laws, the number of firms using fraudulent practices has increased in the recent years as compared to the decades of 80s and 90s.

#### ***4.1.1 Weaknesses in HMRC***

Flaws and weaknesses in the present system of HMRC is the most common motivation for the companies to use fraudulent practices in VAT, especially carousel frauds. We sought to determine the objectives of the respondents in this field. The respondents were asked to indicate how they identify frauds in VAT. In addition, they had asked for each type of fraud, whether the laws or current legislation of HMRC covers the active management of that particular risk. 76% of the respondents say that they frequently identify VAT frauds but the fraudulent party cannot be caught because of the gaps and flaws present in HMRC.



#### ***4.1.2 Performance of HMRC***

The use of control in the current context by HMRC raises questions like the legal aspects, information requirements, the cost of operations, lack of knowledge of the business, the difficulty in quantifying the exposure to risk underlying public's image of products etc. Participants had to indicate for each of these points, if it was for them a matter of great concern, moderate concern, some concern or raising any particular concern.

Performance of HMRC is the number one concern of the respondents. It is indeed a matter of great concern for 73% of persons surveyed and medium concern for 20% of them. Perhaps because major losses suffered by the UK government, persons associated with regulatory bodies or academia have expressed their deep concern about their ability to identify and control carousel frauds. In this regard, 59% of respondents consider this concern as very important and 36% as an average.

The next question, in descending order of concern, is about the uncertainty concerning the risk of fraud and prevention through control procedures. This is not surprising, given the absence of specific rules in this area and the importance of these rules to the presentation of the results of these operations. 77% of the respondents say they are very concerned about this issue, 20% moderately concerned. Also accounting, tax and legal aspects are also important concerns for corporations.

#### ***4.1.3 Preventions to improve overall situation***

The implementation of preventive measures is widespread; the survey questionnaire is very detailed on this point. For 6 reasons most frequently cited as justification for the use of preventive measures respondents had to indicate how often they feel the requirement of

preventive measures. The most frequently cited motivations for the use of such measures is prevention against fraud and financial malpractices and the existence of operations less than one year horizon.

#### ***4.2 Discussion***

The history teaches us that tax evasion was present at all times, in all countries, by thwarting various events abstractions for finance the state. The aim of the fraudster is to evade taxes, there is a link of close relationship between the nature of the collection and strategy to evade it. Therefore, the tax evasion is imbued with polymorphism and quickly becomes a complex subject. However, the practice of fraud, causing a decrease in tax revenues and reflecting the imperfection of control exercised by the public authority individual actions, was at all times subject to repression. If the terms of the enforcement and punitive action followed the evolution of society, not giving rise to performance as could be the case in the eighteenth century, they still hold under exemplary of deterrence and for this punishment.

Fraud is a reaction to the mandatory nature of the tax. This study implies to provide answers to several questions. At first, it seems necessary to clarify the nature of this reaction defining the phenomenon and behaviours associated with it. Secondly, it seems necessary to understand the fiscal environment in which it manifest. The causes of tax evasion are indeed presented as multiple and many of them are the subject of controversy. However, whatever the motivations of fraud they cannot lead to concrete action in case of the existence of opportunities. Finally, fraud constitutes a breach of social ethics and undermining the fairness of the tax system, it seems necessary to assess its magnitude.

Corruption and fraud in VAT appears to be an obstacle that the governments must fight to achieve effective competition, maximizing assistance and funding international growth and faster development (Gordon & Maiko, 2001). However, all the solutions are not good and some may have perverse effects. The increase in complexity of standards and rules is a breeding ground for corruption. It is therefore necessary to consider the effectiveness of existing standards, the issue of monitoring and control and the possible solutions for the future, and to search for new tools and to improve existing ones. To effectively fight against carousel and other VAT frauds, the first step is to attempt to define the boundaries and limits (Punch, 1996).

To do this, including developing risk maps based on their impact and their occurrence. Accountability and control then helps them provide answers in the form of procedures and best practices, while internal audit examines the effectiveness of internal control. Accountability is the process by which the UK government regulates its activities to accomplish its mission of preventing VAT and Carousel frauds. Accountability should not be considered as a separate system; instead, it should be recognized as an integral part of any system used by HMRC to guide their operations.

Having control and implementing preventive measures for VAT frauds is not necessarily needs big, heavy and costly bureaucracy because more the procedures are simple, known and accepted, more it is effective. Stack layers of control or have cumbersome procedures are inherently antithetical to the purpose of internal control, which is a matter of efficiency and performance. Thus, the recipe lies in the right dosage but that is not always easy to achieve. It is to believe that there are good practices everywhere. But this is far from proven. Moreover, the requirements of preventive control aimed at the sincerity of the image performance than the latter. The coordination between different agencies to prevent VAT frauds is necessary to meet

multiple needs, including the legitimacy and legality. The nature of the associations created by the administration itself is variable.

The research has proved that VAT fraud and especially carousel fraud is a common practice in UK because of the flaws present in the HMRC. In order to improve the situation, we need a comprehensive and common strategy. The internal device fight against VAT fraud quickly shows its limits when it comes to combat against illegal assemblies of larger scales. These frauds are often organized across borders. Carousel fraud is indeed very difficult to detect if the British tax administration (HMRC) works in isolation. The establishment of a common and coordinated EU strategy thus appears as the most appropriate solution to complement and support the device fight against fraud. This European strategy should involve strengthening administrative cooperation in the various Member States.

There is a debate going on the appropriateness of measures to fight against fraud and to adopt a more "conventional" policy of improving the current system of VAT or adopting an ambitious solution and accept change and the principles of current system, which could lead to the adoption of the final plan. Each of the two hypotheses offers interesting solutions. Currently, it seems that both the legal and economic context is a major obstacle to the adoption of measures described as "ambitious". It seems that improving the transitional regime is the most likely short-term outcome. But some more ambitious proposal to amend some existing principles can be interesting and effective. The objective is to gradually strengthen the capacity of tax administrations to detect and prevent VAT fraud by use of mutual assistance. However, the task may seem daunting because fraud is not perceived or defined differently in different Member States. Furthermore, are not harmonized by anti-fraud laws.

It appears that the fight against VAT fraud is possible through the government of each Member State. Administrative cooperation in the field of value added tax is an indispensable tool for States in order to detect and thwart the VAT fraud. The Action Plan puts forward the interests of effective administrative cooperation to prevent and detect VAT fraud. Administrative cooperation is now an essential tool in the fight against VAT fraud. Member States cannot combat cross-border fraud alone. The expansion and consolidation of the existing legal framework for information and cooperation between tax authorities exchange is the result of a settlement entered into force on 1 January 2004. It is part of a common European strategy to address the challenge of carousel fraud. It is basically to strengthen cooperation between Member States for the automatic exchange of essential information by reducing delays in the transmission of information between tax administrations. Strengthening administrative cooperation between Member States led to the creation of a European network "Eurofisc". It provides a multilateral early warning mechanism in the fight against VAT fraud including strategic analysis of common risks. Finally, a number of European measures aimed at improving the collection and recovery of tax.

Strengthening the capacity of tax administrations in different Member States to detect illegal assemblies requires information relating to community exchange transactions system. This system to be effective must allow states to detect fraud as soon as possible. The abolition of border controls in 1993 requires perfect cooperation between Member States. Since this event, it is become impossible for a country to act alone to collect the information necessary to monitor the flow of goods into its territory. In order to be able to effectively control the carousel fraud, it appears necessary for the tax authorities to obtain the relevant information from other Member States. That is why there was a set up of a community of information exchange transactions

system. Member States collect and exchange relevant information on cross-border transactions. This system thus making it more effective to control VAT frauds in intra-Community supplies of goods.

However, in 2008, the Commission stressed that the information on intra-Community supplies of goods existing exchange system was insufficient. Thus, since 1 January 2010, it is expected that Member States collect and exchange information on EU operations in the period of one month after the completion of the transaction. Previously, the time between when a transaction took place and when the information was made available to the Member State of the purchaser was between three and six months. The proposed measure is balanced since it saves on average three months for the availability of data and imposes a minimal burden on businesses. The objective is to speed up the collection and exchange of information on intra-Community transactions to allow Member States to quickly detect fraud and to implement measures in a very short time, all without imposing too heavy administrative burdens to economies of different operators.

One of the most innovative measures is the creation of Eurofisc. It was established to strengthen the detection instruments of VAT fraud. Eurofisc is a European network to develop the use of mutual assistance between states in order to better detect fraud. This should allow Member States to exchange relevant information concerning the fight against fraud. The main advantage of this data exchange is the establishment of a common strategy based on the analysis of joint risks. The aim is to act quickly and effectively. Creating Eurofisc has been raised by the European Commission in a communication dated 1 December 2008. Subsequently, the Commission adopted a proposal for a recast of the Regulation on administrative cooperation which envisaged the creation of Eurofisc structure. Eurofisc was finally established on 7 October

2010 with the adoption of a new European Regulation on "redesigning administrative cooperation and the fight against fraud in the field of VAT. In February 2011, experts from the 27 EU member states met for the first time in Paris in the first working Eurofisc.

A number of measures are intended to enhance the capacity of tax administration to collect and cover the VAT. They consist in part to encourage states to make every effort to maintain an adequate level of protection to ensure tax revenue from other Member States. A number of measures have been put in place at EU level to strengthen tax systems of the Member States in order to prevent carousel and other VAT fraud. The Fiscalis program has been established to allow members to better detect fraud states. More control methods are gradually modernized. The Fiscalis 2013 program is established by a decision of the European Parliament and of the Council of 11 December 2007. It is unsaturated for the period 1 January 2008 to 31 December 2013 and follows the Fiscalis 2007. It concerns all Member States of the European Union and the candidate countries for accession. It provides financial support to the development of common European strategy as a result has a budget of about 160 million Euros. Its aim is to increase the daily cooperation of experts and tax officials. It provides for concrete measures, such as funding seminars for administrative control officers of VAT or exchange of expertise in the fight against fraud in the Member States. There are also group projects so that governments can work together more closely. In addition, the Fiscalis enforces the EU tax legislation uniformly in all Member States.

The establishment of the VAT Community seems to evolve the idea that modernization and strengthening the transitional regime, appears to be a more attractive alternative than the adoption of the definitive VAT system. Europe needs to provide its Member States with the necessary tools to work more closely and exchange information faster. Thus, even if the principle

of fractionated payments under the internal system is an essential rule of tax value, it can be questioned by the development of reverse as a solution to fraud. Similarly, the idea of linking the deduction of VAT to pay the tax or its payment to the tax authorities by the supplier is a possible solution. Moreover, the simplification of the tax is likely to begin to answer to fraud.

Although some countries of European Union insist on implementation of reverse charge mechanism to reduce the chances of VAT and carousel frauds; but such a solution suffers from several drawbacks because the principle of fractionated payments is itself a guarantee against fraud. Thus, the introduction of the reverse charge mechanism would necessarily be accompanied by a process of enhanced control and more costly for states. This is why the idea of a compromise now seems the most suitable if you want to improve the current solution. It is to stop the payment of VAT for only certain targeted operations. This proposal has also received several accolades by the Commission, and applies in some Member States for certain fraud-sensitive goods.

Thus, the challenge of carousel fraud, the internal device, in part ineffective because of the trans-boundary nature of the fraud, will rely on a common European strategy. The European Union has quickly shown its commitment to improve the transient and therefore not considered to present the adoption of definitive arrangements provided for in the Treaties. Therefore, the development of cooperation between the various tax authorities, materialized through the exchange of vital information between Member States. To such an extent that the use of mutual assistance is an essential tool for states to combat fraud. Modernization of control methods and the creation of Eurofisc is a continuation of this will improve the regime.



## Chapter 5: Recommendations

Since the benefit of Carousel fraud is the non-payment by the missing trader, VAT has been deducted in full by the client and accomplice, the suspension of payment of VAT for all internal transactions subject is a possible outcome to improve the current VAT system. This suggestion appears indeed as a solution to fraud, since it signals the end of the deduction mechanism. It necessarily entails the establishment of a system of exemption from internal transactions between taxable persons, or by the application of a reverse charge mechanism. In the latter case, the idea is that the purchaser declares and pays the tax himself, while deducting the VAT burdened purchases simultaneously.

However, this proposal is far from ideal due to the principle of payment by instalments. Indeed, the challenge of the principle of payment by instalments is paradoxical because it limits the possibilities of fraud. In fact, it encourages taxpayers to monitor each other to keep the benefit of the right to deduction. It thus acts as a guarantee of the VAT system since it ensures partly self sounds. Moreover, the mechanism of fractionated payments moderates the impact of possible fraud since the responsibility of collecting the tax is spread over all the operators involved in the sales channel.

Another solution could be to limit the suspension of payment of VAT to certain targeted domestic operations. This issue is therefore accompanied by the introduction of the reverse charge mechanism for only a few categories of goods or companies. But applying this approach means using two VAT systems at a time. Nevertheless, this solution is already partially adopted by the commission in setting up an optional and temporary application of the reverse charge. It applies particularly to areas susceptible to fraud. This is particularly the case for computer chips, perfumes, precious metals and some mobile phones. In addition, due to a number of suspected

cases of carousel fraud in the scheme of emission quotas system, the Commission extended the reverse charge system in Inner transfer quotas issue between operators.

The complexity of a tax system may lead to weaken the tax compliance. That is why countries are encouraged to simplify the VAT system. A possible solution to the fraud may be the removal of some reduced rates established by the members within their borders; the standard VAT rate now covers only two-thirds of the total consumption. Indeed, experience shows that the existence of many reduced VAT rate often has a negative effect on compliance by taxpayers of their fiscal obligations. This is explained by the fact that multiple rate system and charged several exemptions is more difficult to administer for the state than a single-rate with only few exemptions. However, the question of the abolition of reduced rates could raise differences of opinion between Member States, since, if some want the introduction of a single rate for all goods and services, others prefer keep them in the areas of health, culture and the environment.

Therefore, in order to preserve the mechanism of fractionated payments guaranteeing self VAT system, other solutions are possible. These proposals are more ambitious than those of improving the transient, since they go against the principles of the VAT system in force. Thus, in response to issues raised by the treatment of cross-border transactions, one method is to retain taxation in the Member States. The Commission also argues that the adoption of the final plan would be likely to provide answers to some of the weaknesses of actual system. However, this solution suffers from a major drawback because the rate differences among member states may influence the choice of place of purchase. Companies then fear diversion of consumption in favour of states whose rates are the lowest. Thus, the adoption of definitive arrangements under the Maastricht Treaty must necessarily be accompanied by a harmonization of all tax rates.

Finally, the adoption of the final tax VAT regime should be accompanied by a system of reallocation of revenue from the country of origin to the country of the recipient. This system provides for the payment of the fee must be accompanied by a supplement or a repayment of tax by the rate is lower or higher in the Member States.

## Conclusion

It appears from this study that the VAT fraud takes advantage of weaknesses inherent in the principles of VAT to grow. The ingenuity and imagination of fraudsters have therefore allowed the flowering of many forms of fraud which the most successful and most lucrative is without context carousel fraud. The VAT fraud is a real problem for the economy and the national budget as the loss of tax revenue it generates is important. It is also synonymous with tax injustice. It is true that internal device to fight against fraud is relatively effective to detect and punish fraud in domestic operations, it quickly reaches its limits when it comes to dealing with fraudulent international stature as carousel fraud.

As part of the prevention of VAT fraud, states have realized the benefit of upgrading control procedures. The first solution is to target companies and sectors likely to be monitored enjoying the potential risk of fraud. This method is based on an analysis of risk system. Various obstacles, especially legislative, hinder the effective cooperation between Member States. Thus, some laws prohibit access tax authorities of other countries to certain information that could be useful. Moreover, the lack of financial resources is a barrier to cooperation and mutual administrative assistance.

However, these measures strengthening the cooperation between Member States appear to have a limited impact because the Carousel fraud continues to plague. And if at the moment, continue to strengthen the current VAT system seems the only possible solution, it appears that long-term modification of the principles of current systems is the most effective outcome in the fight against fraud to VAT. Because even though almost 60 years VAT is still relatively young, the tax system must now adapt or be transformed to cope with their environment and remain

effective tax. VAT and come to a crossroads in its life. This is why the radical change in the principles of VAT appears as a possible response to fight effectively against fraud. Therefore, two solutions seem to offer states to cope with the Carousel fraud: modify certain strategic points in particular developing the reverse or consider a complete overhaul of the current VAT system, and consider the final arrangements under treaties.

However, other solutions are also possible. Indeed, it has been speculated that the questioning of certain principles inherent in the VAT seems a coherent response to fraud. It is especially to develop the mechanism of reverse charge at the expense of the domestic payments system split. This mechanism to suspend the payment of VAT on domestic transactions subject is now applied to certain targeted areas such as the trading market of emission allowances. But after leading the generalized reverse was not explored enough and deserves a little more consideration. The lack of empirical data to analyze the consequences of such an ambitious reform seems to be a barrier to its adoption. The implementation for a given period in a defined territory of this mechanism is apparently a proposal that deserves some consideration.

Thus, the solutions against VAT fraud exist but their implementation is sometimes challenging, and requires a bit of courage and a lot of sacrifice on the part of States. The fight against fraud appears as a test of the ability of European countries to act together to protect their savings and their interests.

## Bibliography

- Ainsworth, Richard T. (2006). Carousel Fraud in the EU: A Digital VAT Solution. *Tax Notes International*, pp. 443–48.
- Alm, J. & McCallin, N. (1990). Tax avoidance and tax evasion as a joint portfolio choice. *Public Finance*, vol.45, n°2, pp.191-200.
- Balcerowicz, W. (2007). *How to Stop the Carousel? Methods of Combating the Missing Trader Intra-community Fraud in the European VAT System*. Thesis for the degree of Master of European Studies. Bruges: College of Europe.
- Bird, R.M. & Gendron, P. P. (2007). *The VAT in Developing and Transitional Economies*. Cambridge, UK and New York: Cambridge University Press.
- Bryman, A. (2008). *Social Research Methods*. 3<sup>rd</sup> Edition. Oxford: Oxford University Press.
- Caridi, P. & Passerini, P. (2001). The underground economy, the demand for currency approach and the analysis of discrepancies: some recent European experience. *Review of Income and Wealth*, 47 (2), pp 239-250.
- Cnossen, Sijbren (1990). Taxing Value Added: The OECD Experience. *International VAT Monitor*, 5 (May), pp. 2–16.
- Cnossen, S. (2010). VAT Coordination in Common Markets and Federations: Lessons from the European Experience. *Tax Law Review*, vol. 63(3).
- Collins, Jason & Gore Phil (2007). Stopping the Carousel. *Tax Journal*, Issue 889.
- Cooper, D. R. & Schindler, P. S. (2003). *Business research methods*. 8<sup>th</sup> Edition, New York: Pearson Publishing.
- Crawford, I., Keen, M. & Smith, S. (2010). Value Added Tax and Excises. In Stuart Adam et al. *Dimensions of Tax Design: The Mirrlees Report*. Oxford: Oxford University Press.
- Crawford, C. & Freedman, J. (2010). Small Business Taxation. In Mirrlees, J. et al. *Dimensions of Tax Design: the Mirrlees Review*. Oxford, Oxford University Press.
- Crocker, K. J. & Slemrod, J. (2005). Corporate tax evasion with agency costs. *Journal of Public Economics*, 89, 1593–1610.
- Das-Gupta, A. & Gang, I. (2003). Value added tax evasion: Auditing and transaction matching. In McLaren, J. *Institutional elements of tax design and reform*. World Bank Publications, pp. 25–48.
- de Mooij, R.A. & Nicodème, G. (2007). Corporate Tax Policy, Entrepreneurship and Incorporation in the EU. *European Economy – Economic Papers*, n° 269, European Commission, Brussels.
- Devereux, M., Griffith, R. & Klemm, A. (2004). How has the UK Corporation Tax Raised so

- much Revenue. *IFS Working Paper*, n° W04/04, Institute for Fiscal Studies, London.
- Eisenhardt, K. M. (2008). Building theories from case study research. *Academy of Management Review*, 14(4), 352-550.
- Gabriel, Sarah (2003). Carousel Fraud. *Taxation*, Volume 151, Issue 3907
- Gebauer, A. C., Nam, W. & Parsche, R. (2003). *Is the Completion of EU Single Market Hindered by VAT Evasion?* CESifo Working Paper No. 974, June
- Gordon, Kathryn & Maiko, Miyake (2001). Business approaches to combating bribery: A Study of Codes of conduct. *Journal of Business Ethics*, 34: 161-173.
- Grandcolas, Christophe (2008). Managing VAT in a Borderless World of Global Trade: VAT Trends in the European Union - Lessons for the Asia-Pacific Countries. *Bulletin for International Taxation*, April, p. 137.
- Her Majesty Customs and Excise (2004). *Tackling VAT Fraud*. Report by the Comptroller and Auditor General, HC 357 Session 2003-2004.
- Keen, M. & Smith, S. (2006). VAT Fraud and Evasion: What Do We Know and What Can Be Done? *National Tax Journal*, vol. 59(4).
- Krogstrup, S. (2004). A Synthesis of Recent Development in the Theory of Capital Tax Competition. *EPRU Working Paper Series*, n° 04-02. Economic Policy Research Unit. University of Copenhagen.
- Lasok, Paul (2004). Joint and Several Liability: the Answer to VAT Fraud. *Indirect Tax Voice*, Volume 66
- Loretz, S. (2008). Corporate taxation in the OECD in a wider context. *Oxford Review of Economic Policy*, 24 (4), 639-660.
- Malhotra, N. K. & Burks, D. F. (2007). *Marketing research – An applied approach*. 3<sup>rd</sup> European edition.
- Miles, W. (2002). Financial deregulation and volatility in emerging equity markets. *Journal of Economic Development*, Vol. 27(2), pp. 113-126.
- Pashev, Konstantin, V. (2007). Countering Cross-Border VAT Fraud: The Bulgarian Experience. *Journal of Financial Crime*, Vol. 14, No. 4
- Patton, M. Q. (1980). *Qualitative evaluation methods*. Beverly Hills, CA: Sage.

- Plager Allison (2007). Stop the carousel!. *Taxation*, Volume 159, Issue 4110.
- Punch, M. (2010). *Dirty Business: Exploring Corporate Misconduct*. Sage Publications, Londres, Thousand Oaks and New Delhi.
- Saunders, M., Lewis, P. & Thornhill, A. (2007). *Research Methods for Business Students*. 4<sup>th</sup> Edition. Prentice Hall.
- Schenk, A. & Oldman, O. (2007). *Value Added Tax: A Comparative Approach*. Cambridge and New York: Cambridge University Press.
- Slemrod, J. & Yitzhaki, S. (2000). *Tax avoidance, evasion, and administration*. NBER working paper, no. 7473.
- Smith, S. (2007). *VAT Fraud and Evasion. The IFS Green Budget*. Institute for Fiscal Studies & Stanley Morgan. London
- Swinkels, Joep (2008). Carousel Fraud in the European Union. *International VAT Monitor*, IBFD, March/April, p. 103.
- Terra, B. (2007). European Proposals for New Rules Regarding the Place of Supply of Services. In Krever, R. & White, D. *GST in Retrospect and Prospect*. Wellington, NZ: Thomson/Brookers.
- Warren, Neil (2007). Beating the carousel. *Taxation*, Volume 159, Issue 4108
- Williams, D. (1996). Value-Added Tax. In Thuronyi V. *Tax Law Design and Drafting*. Washington, DC: International Monetary Fund.
- Yin, R. (2003). *Applications of case study research*. Beverly Hills, CA: Sage.