

# VAT FRAUD A GLOBAL CHALLENGE

INSIGHTS INTO THE EU RESPONSE  
TO THIS GROWING PROBLEM



# VAT FRAUD

## A GROWING PROBLEM

VAT fraud is on the rise across the European Union. While enforcement of VAT laws has become a priority for the EU, the scope and prevalence of VAT-related fraud both saps enforcement resources and lowers overall VAT revenues. In fact, the European Parliamentary Research Service has concluded that tax fraud costs the EU anywhere from \$55 to \$75 billion dollars per year.

This amount is known as the VAT Gap or the difference between expected VAT revenues and VAT actually collected. The gap represents an estimated loss of revenue due to tax fraud, tax evasion and tax avoidance, as well as bankruptcies, financial insolvencies or miscalculations.

Considering that VAT is a major source of tax revenue in the EU, currently at a staggering 21.5% average, the widening gap translates into considerable losses for EU Member States. In 2015, the EU VAT Gap amounted to €151.5 billion, representing a significant total revenue loss of 12.77% across the EU.



The European Commission differentiates three major avenues available to tax evaders:

Tax fraud and evasion, such as not reporting certain income, particularly cash, which illegally deprives public budgets of money.

Tax havens, which facilitate tax evaders and avoiders by storing money offshore, where it is unreported and untaxed.

Tax dodging, often by aggressive tax planning by big businesses or individuals, which exploits the limits of the law with the aim of minimizing taxes paid.

Some of the most prominent types of VAT fraud include:



**Cash Transactions** – the off-book cash-only transaction, the oldest method of VAT avoidance, is still one of the most effective. So effective, in fact, that some EU members have considered legally limiting cash transactions.



**Phoenix Fraud** – Named after the mythological bird that arises from the ashes of its predecessor, a “phoenix company” emerges from the collapse of another company into insolvency. Following the stripping of whatever assets possible, the new company is able to continue trading, presenting an external appearance of “business as usual,” while relieved of the burden of VAT from the original entity’s transactions.



**MTIC** - Missing Trader Intra-Community, also called “carousel fraud,” exploits multi-jurisdictional transactions, wherein the movement of goods between jurisdictions is VAT-free. In an MTIC scenario, the fraudster in “Country A” originally buys goods from a seller in “Country B” VAT and then makes a local sale in “Country A”, but then absconds with the VAT instead of paying it to the government of “Country A”.

It is important to note that in any VAT fraud, it is not only the tax authority which loses; honest businesses lose out as well.

# THE IMPORTANCE OF T&E COMPLIANCE

While reliant on employee data, businesses are ultimately responsible for the VAT claims they submit. One key area that must be monitored closely is employee T&E costs. Every year, companies file incorrect VAT claims, reporting T&E data that is inaccurate or not properly backed by evidence. This puts them at serious risk for audits and non-compliance with domestic and international regulations. Valid claims may also be rejected due to incorrect filing, leaving significant sums of VAT unrecovered.

Incorrect VAT claims can be the result of many factors, including:

**Improper system configuration:** It is not uncommon for companies to discover that the initial system setup was not configured properly. Some issues that cause improper handling of VAT include erroneous configuration of VAT rates, lack of consideration for various jurisdictions and their varying use of expense categories, expense categories with unclear nomenclature, and failure to properly incorporate updates to VAT rules, a process that often requires VAT-specific experts and procedures.

**Faulty invoice data:** Employee invoice submissions often contain missing or incorrect data. If there are multiple receipts submitted in bulk, missing invoice details such as supplier ID, duplicate submissions or lack of a proper invoice altogether, the (valid) VAT claim will be rejected. There are also instances where employee submissions will be acceptable for expense claims, but not for VAT claims, such as using credit card slips or booking confirmation emails instead of proper invoices.

**VAT calculation errors:** T&E systems are programmed to make assumptions that may cause erroneous calculation of recoverable / deductible VAT. For example, accommodation expenses automatically assume VAT is included, while that may not actually be the case.



**Special VAT rules:** Certain expense categories have very specific VAT rules that may vary from location to location. These include Meals, Entertainment, Fuel & Mileage, and Gifts. For example, in the UK, VAT can be recovered only for meals that do not include third party attendees, and this must be specified by the employees in the submitted documentation.

**Currency inconsistencies:** Inconsistent usage of currencies can easily lead to processing errors. These errors are often not detected until they are uncovered during an audit.

# EMPLOYEE EXPENSE FRAUD

One of the easiest ways to defraud a company is through expense reimbursements. According to a 2016 survey of over 1,000 business travelers by Chrome River, expense reporting fraud currently costs U.S. businesses almost \$3 billion per year. The study effectively shows that despite available fraud detection technologies, expense reporting fraud is a current issue, and is causing many companies significant revenue losses.

There are many ways that employees can commit expense reporting fraud. The Association of Certified Fraud Examiners ([ACFE](#)) highlights four categories of fraud:

**Multiple reimbursement schemes** – When an employee requests to be reimbursed multiple times (likely from different individuals) for the same expense. This ‘double-dipping’ is most common when the employee has multiple forms of documentation that serve as proof of purchase.

**Fictitious expense schemes** – When an employee fabricates a purchase and requests to be reimbursed for that expense.

**Overstated expense schemes** – When an employee inflates the actual cost of a business expense prior to requesting reimbursement.

**Mischaracterized expense schemes** – When an employee attempts to receive reimbursement for a personal expense by characterizing it as a business expense.

According to a 2016 Oversight Systems study, 10% of travelers have submitted at least one duplicate expense, and that error averages more than \$50. Another 20% of employees were found to have at least one, non-compliant purchase per report. Bear in mind that intentions are often not malicious. However, with the continuing globalization of business, and the corresponding increase in T&E to facilitate this growth, the risk of fraud and abuse in these areas must be monitored and addressed. Ensuring that the company's expense policy is clearly stated, and management retains full visibility into all T&E spend is critical for control over out-of-compliance expenses.

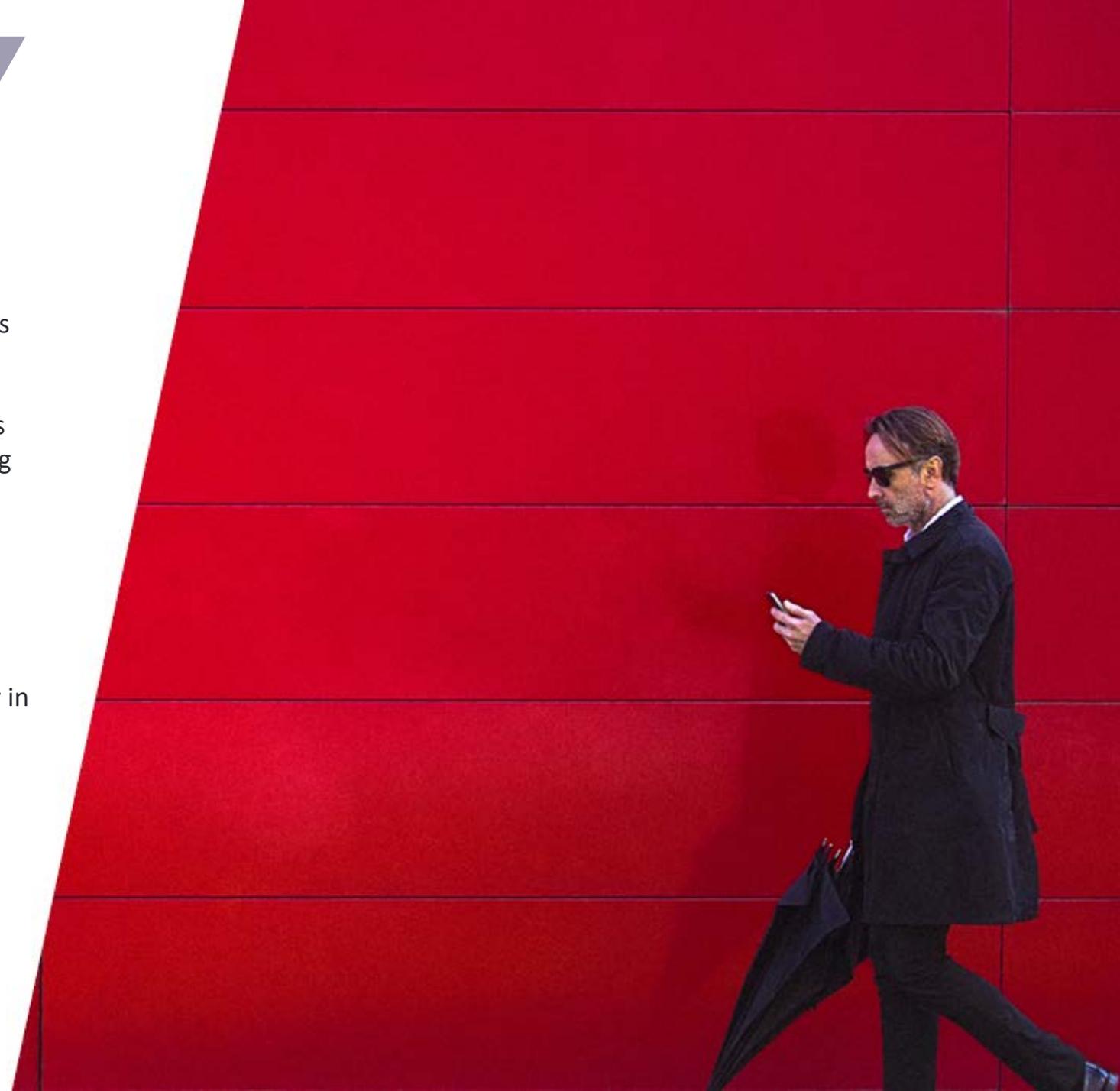
### **Other common methods of VAT Fraud**

- Failing to use the local entity to contract for products or services
- Reality not aligned with head office/ finance/ contractual terms
- Mistakenly billing the wrong entity or billing the incorrect entity in the wrong country
- The Triangular processing; i.e. the tooling issue
- The involvement of third countries and/or third parties
- DDP issues, or simple mistakes, such as, for example, mistaking Northern Ireland for the Republic of Ireland; as a result, goods are sent to the wrong

## VAT REFORMS ARE UNDERWAY

The EU has embarked an ambitious effort to effect change within their tax systems. The EU's relatively narrow tax base, complex array of exemptions, and low tax rates on basic goods and services such as food, rent, healthcare, and more, have constrained VAT revenue. The need for an updated VAT code, coupled with the scandalous revelation of the Paradise Papers in November 2017, has spurred the EU into action – the rolling out of a package of VAT reforms. The first phase of these reforms began in 2010, and since then the EU has introduced more than **100 measures**, widened the taxable base, and completed the EU's move to the destination system.

The VAT destination principle means that the consumer who buys the goods will pay VAT to the government of the country in which he or she lives. For example, if “Company X” in France sells goods to “Company Y” in Belgium. VAT is due in Belgium, not in France. To make this happen, the transaction between France and Belgium is exempt from VAT, however, this even further increases the risk of tax fraud.



Some specific steps the EU has taken to combat VAT fraud include:

### **Information Exchange**

The EU Commission has begun to implement measures that will stop criminal tax fraud from taking place across the EU. A current proposal recommends an increased level of cooperation between EU member states, especially in the area of information exchange. As part of this effort, on 1 January 2018, the EU Tax Info Exchange Rules went into effect. National tax authorities can now obtain direct access to information on the beneficial owners of companies, trusts, and other entities, along with information on bank account balances, interest income, and dividends. They also have access to the customer due diligence records kept by companies.

### **Exposure of non-compliant countries**

In addition, the EU Commission is in the initial phases of creating the first common EU list of non-cooperative tax jurisdictions. A pre-assessment scoreboard of countries has been determined by key indicators, and these countries will be subject to further screening in order to pinpoint those countries that refuse to comply with international tax governance standards. This list is also aimed at preventing aggressive tax planners from abusing discrepancies between the different national systems.

### **Enhanced collaboration**

The Commission has also published a report recommending ways for Member States to collaborate towards better direct tax and VAT collection. The report's results indicate that implementation of digital and IT systems, as well as investment in human resources, are required for EU countries to improve their national budgets. Member States must deploy more resources to improve tax collection – a benefit that can increase national budgets by €150 billion a year in VAT alone.

## MOVE TO THE DIGITAL AGE

The increased use of electronic systems by tax authorities and taxpayers can make it easier to collect, transfer, store and analyze large amounts of data without significantly increasing the time spent by companies on compliance. According to E&Y's 2016 TaxTech Survey , 84% of participants voted that technology is the most important factor in improving the effectiveness of the tax function. Tax authorities are increasingly implementing electronic reporting systems, including real-time transaction reporting systems, in the hope that increased collection and evaluation of data on a real time basis will help to reduce the levels of VAT fraud while increasing the efficiency of VAT compliance and the reclaim processes.

The OECD's Guidance on Tax Compliance for Business and Accounting Software aims to simplify tax compliance and reduce risk of tax audits by encouraging better internal control procedures. The guidelines incorporates best practices in areas such as systems documentation, internal controls, audit trails, reliable records, compliance and usage of the Standard Audit File for Tax Purposes (SAF-T).

SAF-T is a file that contains reliable accounting data, exported from an original file system, for a specific period of time, and easily readable due to a standardized format. It provides an international standard for the electronic exchange of tax data, along with standard tests to be performed during a tax audit. SAF-T was designed to provide easy access to auditors, and to reduce compliance costs for businesses that would otherwise be required to devote additional resources to provide the data. To date, SAF-T has only been fully adopted in Luxembourg, though Portugal, Austria, Germany, Poland, Norway and France all use a version that is more limited in scope. The OECD is expected to launch a study on the application of the SAF-T in different countries in 2017/18.

Other countries have introduced real-time and/or daily invoice level reporting requirements, such as China, India, Spain and Italy.

The move to digital has delivered results. According to PwC Paying Taxes 2018 , it takes 27% less time on average to comply with VAT obligations in countries where businesses pay and file VAT online. Since 2008, 26 more economies have adopted electronic filing and payment systems to make VAT compliance more efficient and to help reduce fraud and evasion.



## OTHER REFORMS

Additional tax reform recommendations include:

- Guidelines to better define transfer pricing
- Better protection for whistle-blowers
- An EU-wide withholding tax to ensure that profits made in the EU are taxed at least once
- A code of conduct for banks, tax advisors, law and accounting firms
- Full access to a global register of all assets held by individuals, companies and entities

## THE BOTTOM LINE

Combating the wide-scale prevalence of VAT fraud requires resources and time. While authorities are investigating mega corporations – such as Google, Apple, Ikea, Amazon and Microsoft – in an effort to recover billions of dollars in owed taxes, at the same time they are also scrutinizing smaller businesses to recover any losses due to VAT fraud. With electronic data capture becoming more widespread, it is easier than ever for tax authorities to exploit the data afforded by these systems. It is for this reason that today's companies are placing increased emphasis on being proactive in avoiding VAT fraud.

# AUTOMATED VAT RECOVERY

## AND HOW DOES IT WORK?

Financial technology firms, or FinTech, apply technological innovations – such as software, mobile devices, data networks and accurate analytics – to reduce fraud, improve compliance and speed up the process of obtaining a VAT refund. Automation in particular is transforming the tax function by delivering much added value in the avoidance of fraud. Detecting errors such as duplicate invoices, inconsistencies or wrongly-charged VAT ensures improved transparency, controls and efficiencies, while mitigating risks, reducing costs and delivering more accurate results.

While many established companies already have VAT recovery processes for T&E, shipping, tooling and other services, they are usually managed internally or by external service providers. However, existing VAT recovery processes for non-standard or unusual transactions are often manual, paper-based, time-consuming and resource-intensive. They are also not always effective at actually recovering VAT. For example, many VAT recovery providers simply choose to ignore the reams of smaller invoices that could be submitted, due to the high overhead of processing. Simply put, this represents money left on the table.

To streamline the VAT recovery process, markedly raise the amount of VAT recovered, and gain new levels of visibility and transparency over all enterprise-wide VAT spend, many companies are turning to automated VAT recovery systems.

Advanced, automated VAT recovery systems seamlessly access standard data and scanned invoices from ERP, TES and other internal systems. This is data that already exists – but often remains unexploited for the purpose of VAT recovery.

These systems minutely examine travel expense data and employee travel expense reports. Automatically eliminating errors, duplications, disqualified evidence, and incomplete data – they find disparities between actual expenses and documented expenses, between real costs and considered costs. They also illuminate data leakage - the significant gaps between data and evidence.

The result is complete data visibility, sound governance and maximum VAT recovery, combined with VAT insights and expertise.

VATBox is a global cloud-based technology company focused on simplifying the laborious VAT recovery process through intelligent knowledge-based automation. VATBox's state-of-the-art patented technology puts companies in control, providing total transparency and insight into all VAT spent.

### **Unprecedented data integrity and validation**

Truly automatic data processing seamlessly manages the details of every single invoice or receipt – no matter how small – and reconciles this data to the customer's total spend. VATBox integrates smoothly with all ERP and expense management applications, ensuring a rapid setup, flawless data consolidation and mapping.

### **Tight governance and compliance**

VATBox maintains a database of all current and historical VAT rates, application rules and reclamation procedures across all international and domestic jurisdictions – updated in real-time – ensuring the highest levels of data security and compliance. Sophisticated tools greatly enhance the transparency of a company's tax policies, leading to stricter internal and external compliance, and reduced exposure and risk.

### **360-degree VAT visibility insights**

VATBox provides its clients with full insight with unprecedented analytics, segmentation, instant record retrieval, useful reports, detailed audit trails, and visibility, and ultimately – higher returns. A sophisticated dashboard and drill-down analytics provides detailed visibility into the status of every invoice, resulting in a materially improved VAT recovery process for the customer.

### **Wide areas of expertise**

VATBox's areas of expertise include Foreign VAT, Domestic VAT, Accounts Payable (identifying, validating and claiming back all foreign AP VAT), Inter-Company VAT, Conventions and event-related transactions (abroad and domestic), Shipping - Delivered Duty Paid and Tooling (ensuring that all tools and equipment were properly charged and correctly identified).



VATBox is a global cloud-based technology company focused on simplifying the laborious VAT recovery process through intelligent knowledge-based automation. VATBox gives businesses full visibility, full international compliance and data integrity. Using intelligent automation and keeping all data entirely in the cloud, VATBox gives you full control of your VAT spending, making the VAT recovery accurate, productive and increases returns. VATBox effectively utilizes the partnership and easy integration with SAP to recover 4x more while providing full transparency on any VAT spend.

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