

# VAT fraud: my presentation to the EU parliament this mo...

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*I have [already noted](#) the information I supplied on VAT fraud in advance of the hearing of the Tax3 Committee of the EU Parliament that I am submitting evidence to this morning. For the benefit of the translators the Committee asks that oral evidence be supplied in advance. This is something like what I will be saying:*

I thank you for the invitation to attend today.

I have noted the questions that the Committee asked in advance of my appearance, and I would draw your attention to the written answers that I have already supplied, including some additional data with regard to the scale of potential unpaid VAT in the European Union, which I estimate may exceed €125 billion per annum.

If I interpret the questions raised correctly, VAT fraud is your primary concern, and you are most exercised with regard to the international dimensions of this issue. However, my suggestion, based upon the data in the answers already supplied and upon information included in the VAT gap analysis prepared by the UK's HM Revenue & Customs (which is generally considered to be the most comprehensive annual assessment of any such gap prepared anywhere in the world, and which is, with regard to VAT, technically sound in my opinion) is that by far the largest losses arising to that tax authority result from likely fraudulent activity in the domestic shadow economy. Approximately 62% of losses may arise for this reason in the UK<sup>[\[1\]](#)</sup>, with approximately 10% being due to abuse of international distance selling trading rules; 10% being due to errors and mistakes; 13% being due to bad debt, just 4% being due to criminal attacks on the system and only 1% being attributable to tax avoidance.

*I would stress that this is the likely apportionment, in my opinion, within the UK. But as my evidence also suggests, the overall shadow economy in that country is approximately 10% at present. In those countries where the shadow economy is proportionately somewhat larger, and this is true for the vast majority of EU member states, so too might the proportion of VAT loss attributable to activity in the domestic shadow economy also be higher, in my opinion. I stress then that in my opinion when it comes to VAT fraud, important as international issues are, domestic tax gaps are now*

by far the most important issue of concern.

*I would add that my research with Dr Hannah Petersen at City, University of London, suggests that only 14 of the 28 EU member states have, at present, undertaken any work at all on estimating their own tax gaps. Admittedly, the EU Director General for Taxation makes good this deficit with regard to VAT, but without a domestic focus on this issue which seeks to understand the cause and effect of the VAT gap within the local economy I find it very hard to understand how any tax authority can have an effective policy to appropriately direct their resources to address the issues that such a substantial losses of revenue gives rise to.*

*If I was to make a first recommendation to this committee it would, then, be that you should recommend that every EU member state should prepare comprehensive tax gap estimates that should be published annually, together with a plan for addressing the issues that arise. I would stress, if the estimates are to be useful they should also be prepared on what is technically described as a 'top-down' basis and not the more commonplace 'bottom-up' approach usually used with regard to almost all taxes barring VAT.*

*My second recommendation based upon this evidence is that as important as international measures are when it comes to preventing criminal VAT fraud it is the taking of appropriate measures to tackle the domestic shadow economy to ensure that it is brought within the scope of not just VAT but all other taxes that is fundamental to the collection of all taxes now owing and to beating the consequences of tax fraud. I would stress the importance of VAT when considering this issue. VAT is, of course, a tax on turnover i.e. on sales. Those familiar with accounting, as many on the Committee no doubt will be, will realise that if the tax due on the sales of the business are excluded from its declared accounting information then it will necessarily follow that every other tax liability that it is likely to owe will also, and inevitably, be understated because the cash not recorded will also, necessarily, not be declared for the purposes of income tax, or social security contributions, or corporation tax. Making sure that sales are recorded is, then, the fundamental objective of every domestic tax authority, I would suggest.*

*There are, thirdly, mechanisms that can be adopted to assist this process. Of these, that used in Portugal in recent years, where all sales records of a business are automatically notified to the tax authority, with the receipts that they issue being automatically entered into a national lottery to encourage those making payment to request such evidence, seems to me to be quite fundamental to the creation of a modern online tax record-keeping system. The Committee needs to explore such measures.*

*This does not, however, prevent there being businesses that entirely avoid the process of recording their very existence. In other words, the problem in these cases is not that the top part of turnover is not declared, with all other businesses tax liabilities being under declared as a consequence, but that the business as a whole entirely misses the*

registration process. My fourth recommendation does, then, address this issue, which has long vexed me within a UK context.

Approximately 10% of all UK limited companies that are in existence at any point of time do not file their accounts and corporation tax returns as required of them by HM Revenue & Customs. That is approximately 400,000 companies a year, of which maybe a half will never do so during their entire life-cycle.

In addition, whilst there are supposedly 5 million self-employed people in the United Kingdom, their average earnings are now so low that collectively they all earn less than our national minimum wage if they work on a full-time basis. Systemic under-declaration of income is, therefore, very likely.

My solution to both problems is to be found in a mechanism that the tax justice movement has for some time promoted for the purpose of tackling offshore tax abuse. Many of the committee members will, I am sure, be familiar with the idea of automatic information exchange, which is now coming into operation, where banks and other financial institutions in tax havens and other locations are duty bound to share information with the tax authority of another jurisdiction if they identify that the beneficial owner of an account in their jurisdiction is tax resident in that other place. As a consequence it is now very likely that information on a bank account held in, for example, the Cayman Islands, will be correctly notified to the beneficial owner's tax authority if they are, for example, located in Slovenia.

However, similar arrangements do not exist in all EU member states. So, for example, in the UK, there is no obligation for a bank in Cardiff, Belfast, Edinburgh or London to notify HM Revenue & Customs of who the beneficial owner of a company for whom they operate an account might be to our tax authority, or to disclose the level of deposits going through that account. The consequence is that if that company trades but never makes a declaration to that tax authority then they are blissfully unaware of the fact, and allow the company in question to be dissolved without ever raising a challenge.

It is, therefore, my last recommendation to the committee that such automatic information exchange should become a standard requirement with regard to every company that maintains a bank account in every EU member state, whether the owners be within, or beyond, that state's borders. In addition every bank which operates an account where erratic deposits of funds occur, suggesting that trading is taking place, should also be required to notify that account to a tax authority, and every online trading platform and card processing agency should likewise be required to make disclosure of the beneficial recipient of the funds that they handle to the relevant domestic tax authority so that trading can be identified.

Since the procedures to do this are already in place to meet international regulations, the costs will be minimal. The behavioural change amongst taxpayers when they realise that their trading will be identified will, I suggest, be substantial, and significant, and

*fundamentally change the rates of recovery of tax from what are now quite substantial shadow economies that exist in far too many member states. This will deliver enormous benefit not just to the national exchequer but also to fair competition in the places in question because those honest businesses that have always underpinned national prosperity deserve this protection from every state in which they operate.*

*I shall be pleased to answer your questions.*

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[ii](#) *My basis for calculation is noted in the answers already supplied.*