

## **ACTIVITY REPORT 2004 OF THE WORKING GROUP ON VALUE ADDED TAX**

### **A Background and History**

On the occasion of the first Contact Committee meeting of the now 25 Supreme Audit Institutions of the EU Member States (SAIs) and the European Court of Auditors (ECA), the VAT Working Group considers it appropriate to provide a briefing on the working group's background and past activities.

#### **I. The precursor of the current working group**

Up to mid-1999, the SAIs of some EU Member States, e.g. Belgium, Germany, Italy, the Netherlands and the United Kingdom as well as the European Court of Auditors cooperated in a working group on VAT which had formerly been established by the Contact Committee. That working group was chaired by the European Court of Auditors that hosted all sessions and meetings.

After six years of activity by the working group and the submission of its fourth progress report, the Contact Committee terminated the mandate for the working group at its Dublin meeting in October 1999.

However, the Contact Committee reached an agreement to the effect that the exchange of information on VAT issues should be continued informally.

#### **II. The launching of the current working group in 2002**

In response to an initiative of the UK NAO and Germany's Bundesrechnungshof, the UK informally revived the working group in May 2002 without a mandate of the Contact Committee. This re-launching of the working group was to allow the exchange of experiences about tackling intra-Community VAT fraud.

At the first conference in London a number of topics were discussed such as:

- Definition of the problem of intra EU VAT fraud
- What are the customs functions of Member States doing to tackle this type of fraud?
- What are the auditors doing?
- View from the ECA on how this problem is being tackled centrally
- Future ideas for the role and activity of the working group.

The UK NAO drew up an agenda for the first working session of the experts of the participating SAIs. It also organised that session and drafted its minutes. The findings generated in London were considered extremely valuable by the participants. As a result, the group agreed to continue its work informally and to confer the role of host for the meetings to a volunteering member.

### **III. Further activities of the working group in 2003**

In May 2003, the working group held its second meeting in Brussels, where it discussed the involvement of the European Anti-Fraud Office (OLAF). The meeting focused on OLAF's ability to assist Member States in the struggle against VAT fraud.

The group discussed:

- OLAF's legal authority in combating fraud
- OLAF's staff and technical resources for VAT fraud control
- OLAF's operations and the co-operation with SAIs
- Desirable legal or administrative provision to enhance co-operation with SAIs.

On the basis of the geographical proximity, the Belgian SAI offered to host the meeting. Its technical implementation (agenda, chair, minutes) was assumed by the Bundesrechnungshof.

In September 2003 the Bundesrechnungshof hosted the third working session in Bonn. For the first time, the SAIs of the EU Accession Countries were also invited to attend this meeting. A total of 21 SAIs followed the invitation.

The discussion in Bonn focused on the following matters.

- Exchange of current information about new developments in the anti-fraud policies of the SAIs
- New regulations and systems for the Acceding Countries; status of the preparations for the accession
- New developments in OLAF
- Fraud in context with subcontractors and illegal labour in the construction business
- Design of possible guidelines on tax management system auditing.

To continue work on the last mentioned issue, the formation of a core group was decided under the lead responsibility of the Spanish representative.

## **B Activities of the Working Group in 2004**

Based on the resolution made by the Contact Committee in 2003 the Working Group was asked to submit an activity report to the Committee for its 2004 meeting in Luxemburg.

### **I Questionnaire “Legal authority providing for the efficient performance of intra-Community external audit in the field of tax fraud control”**

In accordance with the conclusion of the 2003 meeting in Bonn, in February 2004 the Bundesrechnungshof, acting as rapporteur, launched a survey among the ECA and all SAIs of the EU-Member States and of the ten Acceding States.

The purpose of the survey was to

- find out the current legal situation concerning options for cooperation among the SAIs on one hand and among the SAIs and the European Union authorities, and
- to explore the SAI's vision (concerning the legal and factual circumstances) of their future cooperation.

### **Background and problem**

In each EU Member State, several branches of the public administration (e.g. Inland Revenue/customs and excise, public prosecution service, police) are responsible for fighting VAT fraud, and that these agencies are subordinate to different departments or ministries (e.g. Finance, Justice, Interior or Home Office).

In addition, apart from the EU Commission, the following authorities may be responsible at the supranational level: European Office for Fighting Fraud (OLAF), the European Police Office (EUROPOL) and the EU Agency for the coordination of the fight against serious crime (EUROJUST).

National agencies must (be able to) cooperate not only within each member state but also with the relevant agencies of the other member states and the supranational agencies mentioned above. The supranational agencies also must (be able to) cooperate efficiently, subject to clear definition of their respective remits.

External audit involves verifying the efficient and effective implementation of such cooperation. All efforts need to be made to avoid gaps in the audit of these issues, which are of major social and economic importance.

Based on the experience gathered so far, an efficient implementation of such audits appears possible only if SAIs (are able to) cooperate on the basis of the legal and factual situation.

The SAIs and the ECA should thoroughly examine whether the circumstances required for such cooperation are already met. Where additional legal bases are needed, the question is whether they will have to be created at the national or Community level.

## **The replies and their analysis**

22 SAIs and the ECA participated in the Bundesrechnungshof's survey.

To analyse the replies received the topics addressed by the questionnaire have been divided into the following three groups:

1. SAIs' national audit mandates
2. Supranational cooperation of SAIs
3. Exchange of information among the SAIs and the ECA as well as other supranational agencies

The reply of the ECA to a question exclusively addressed to is stated separately in the analysis.

After the presentation of the survey's first analysis to the Paris Liaison Officers meeting from 24 and 25 May 2004 several participating SAIs took the opportunity to communicate to the Bundesrechnungshof any requests they had as to the updating, specification or amendment of their answers and/or their interpretation.

Based on this review process, the Bundesrechnungshof drew up an updated report (dated 15 September 2004) on the results of the survey and suggested for further action that the following two steps be taken:

### Step 1

At the Rome meeting on 18/19 October 2004, the VAT Working Group should discuss

- The potential options for joint action arising from the validated results of the survey and the basics of the resolution to be submitted for approval by the Contact Committee 2004.

- The basics of the activity report of the VAT Working Group which the Presidents of the SAIs of the EU Member States, the Acceding States and of the ECA had requested in their pertinent resolution dated 9 December 2003.

Based on this discussion the Bundesrechnungshof would draw up a draft activity report and a draft resolution by 10 November 2004 and would forward them for comments before 25 November 2004 to all Liaison Officers and to the members of the VAT Working Group.

### Step 2

The final report on the survey results should be submitted to the Contact Committee 2004 as part of the activity report of the VAT Working Group.

The draft resolution to be submitted for approval by the Contact Committee 2004 should also foresee that the Working Group, its informal status being recognised, considers, in the course of its activities, the necessary scope and the existing options (including the necessary requirements) for the creation of legal bases for the efficient intra-Community external audit of the efforts to fight VAT fraud and to report to the Contact Committee about the progress made by the working group in this area.

The Liaison Officers, during their meeting in Luxembourg on 4 – 5 October 2004, agreed to this procedure, only amending the deadlines for the transmission of the above mentioned documents (thus receiving the opportunity twice to comment on the draft resolution).

During its meeting in Rome (see below) the VAT Working Group has adopted the attached final report on the results of the survey. It should be noted that some members of the Working Group made use of the opportunity to modify their answers and that the Working Group did neither discuss nor decide about its status.

## Major results of the survey

The major results of the questionnaire as laid down in the final report and especially in its annexes are as follows:

### Access to bodies involved in combating VAT fraud<sup>1</sup>

A few SAIs do not have – full – access to the bodies involved in combating VAT fraud and do not sometimes (or cannot at all) conduct field work at local tax offices to look at how individual tax cases are processed.

### ECA's audit mandate regarding EUROPOL and local tax offices<sup>2</sup>

The European Court of Auditors (ECA) may not carry out audit work at Europol and its competence to do so at local tax offices is doubtful.

### Authority for co-operation with other SAI's or the ECA<sup>3</sup>

18 SAIs replied that they were authorised to audit the efficiency of intra-Community tax fraud control measures together with other SAIs or the ECA. But only 9 of them may examine individual cases (of fraud) and exchange data subject to tax secrecy provisions with other SAIs.

### Value of joint audit work<sup>4</sup>

14 SAIs regard the joint audit work with other SAIs as (very) useful. Depending on the specific theme and scope of the audit, 11 SAIs would carry out such cooperation.

### Access to or Exchange of individual relevant data<sup>5</sup>

11 SAIs confirmed the possibility that joint audit missions may also look at individual cases of tax fraud; 4 SAIs reported certain restrictions. 10 SAIs confirmed the possibility of exchanging relevant data directly.

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<sup>1</sup> See Annexes A – 1 / B – 1, second and third question.

<sup>2</sup> See Annex C and Annexes A – 2 / B - 2, first question.

<sup>3</sup> See Annexes A – 2 / B - 2, second and third question.

<sup>4</sup> See Annexes A – 2 / B - 2, sixth and seventh question.

<sup>5</sup> See Annexes A – 2 / B - 2, fourth and fifth question.

Tax secrecy provisions<sup>6</sup>

7 SAIs cannot exchange information about individual cases which is subject to tax secrecy provisions. The cases have to be anonymised beforehand or the tax administrations, mainly their central liaison offices, have to carry out the transfer.

Exchange of audit findings among SAIs<sup>7</sup>

19 SAIs consider it useful to have a targeted exchange of audit findings/information relevant to topical issues within the community. For 9 SAIs the absence of legal bases leads to the consequence that only the exchange of published information would be possible.

Communication of audit findings to EU bodies<sup>8</sup>

7 SAIs replied that they were not authorised to communicate unpublished audit findings to the EU bodies involved in fraud control such as EUROPOL, EUROJUST, OLAF and the Commission.

**Working Group decisions**

At its meeting in Rome on 18 and 19 October 2004 the VAT Working Group decided to propose to the Contact Committee (Attachment no. 4) to call upon all SAIs and the ECA to examine their legal authority and where necessary make recommendations for it to be amended on a national and/or EU level to facilitate enhanced cooperation with other SAIs and the ECA in accordance with the eight principles approved by the Contact Committee on 9 December 2003.

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<sup>6</sup> See Annexes A – 2 / B - 2, fifth question.

<sup>7</sup> See Annexes A – 2 / B - 2, eighth and ninth question.

<sup>8</sup> See Annexes A – 3 / B - 3, third question.

## **II Activities of the Core Group for the preparation of Guidelines for VAT management systems audit**

### **Background**

Following the conclusion of the 2003 meeting in Bonn, a core group was established and began with a discussion and analysis of the different management and audit approaches to the systems of tax management in the diverse community countries. The core group also examined common problems that arise in the audit of tax management (VAT) systems, as well as fraudulent practices and corruption caused by the means for payment and collection of tax which can take place in different countries.

At the meeting of the Working Group held in Bonn on 29 and 30 September 2003, members stated the importance of the existence of good audit systems, and the desirability that SAIs become as co-ordinated as possible to limit the negative effects of fraud and corruption. A paper on the convenience of having guidelines (of common use) for auditing the tax management systems was presented.

Those guidelines could constitute a useful tool for promoting and ensuring reasonable expectations of detecting irregularities, material fraud and bad practices; to inform the Parliaments (or other entities) on it; to advise them (or other entities) on improvements to tax management systems and to obtain more efficient results; to assist in the fight against fraudulent and corruptive practices; to promote “good practice”; and to promote guidance and good governance.

The paper included some considerations about the role of SAIs concerning public income, with special attention to procedures to help safeguard public funds from frauds or irregularities, developing an important function for preventing, detecting and deterring fraud and corruption while carrying out their mandates (auditing, jurisdictional and advising competences). Some ideas on common risks that could be identified on the tax management systems and on the performance of its audit and on the importance of a good checking of the internal controls; and some indications for financial, regularity and performance audit, were also provided in the paper.

Taking into account the complexity of the topic, the VAT Working Group decided to create a reduced core group to focus on the study of the initiative proposed and the content of the paper presented, to advise and to present proposals to the Working Group on the issue.

Representatives of the SAIs of Belgium, Germany, Hungary, the Netherlands, Slovenia, Spain and United Kingdom initially formed the core group. The SAI of Austria joined later.

### **Work developed by the core group**

The core group created met in Brussels on 24 and 25 June 2004 in order to fulfil the tasks entrusted to it by the VAT Working Group. As a preliminary issue, some discussions about the objective of the meeting, the convenience of collecting and exchanging existing materials for auditing tax management systems and what to produce took place.

The core group analysed particular aspects of the tax management systems audit, like the role of the SAIs, the common risks (legal risks, audit risks, tax processing risks, VAT specific risks, risk connected with international co-operation), the general principles to be taken into account.

In drafting guidelines, the group proposed to focus only on Value Added Tax management systems, as it is a tax with Community scope, making them easily applicable for all the SAIs in the European Union.

The group agreed the guidelines to be drafted, their object and purpose and possible content and structure. These included the need for the guidelines to be practical, comprehensive (containing as many options as possible), focussed on systems (avoiding mentions to specific national cases relative to tax management or audit systems) and on the specificities for the tax management systems audit (not including general audit principles). The independence of SAIs requires that the guidelines provide guidance for all the SAIs in the European Union Member States taking into account the respective mandates and national legislation.

Each member of the core group agreed to draft sections of the guidelines and agreed to provide the final draft for presentation to the VAT Working Group, at its meeting in Rome on 18 and 19 October 2004.

### **Draft guidelines for auditing VAT management systems**

The draft guidelines prepared by the core group have tried to follow a comprehensive structure in order to include as many aspects as possible to be taken into account while auditing the VAT management systems. They go down from general to particular aspects.

The first Section is dedicated to explain the purpose and the scope of the guidelines. The second section details the competence and mandates of the SAIs in auditing public revenues and, in particular, VAT (analysing the main steps of the audit work up the final reports are produced)..

Three Sections are dedicated, respectively, to the general principles for Tax Auditors (code of ethics, confidentiality and tax secrecy, and special professional competence); the common risks detected in the VAT management systems, and control requirements and internal control.

Two Sections cover financial, regularity and performance audit, detailing objectives outputs in each case, and to the audit techniques that could be used to obtain best results in achieving these objectives.

International co-operation in this field is encouraged.

### **Adoption by the Working Group**

As more extensively explained in the following section, at its meeting in Rome on 18 and 19 October 2004 the VAT Working Group agreed a final version of the report as guidance for auditing VAT management systems (Attachment no. 2), and proposing to the Contact Committee (Attachment no. 4) that SAIs and the ECA take note of and use, whenever appropriate, the guidance.

### **III Meeting and decisions made in Rome (18 – 19 October 2004)**

In Bonn in September 2003 the Italian SAI announced that it would host the 2004 meeting of the Working Group.

The representative of the Italian SAI arranged and chaired the meeting which considered the following matters (Attachment :no. 1):

- Exchange of updated information about the functioning of the single market and fraud possibilities related to different VAT systems, the prospects for the introduction of a definitive VAT system, the progress towards an improved and more uniform application of current rules both at E.U. and Member States level and the problems encountered by the new Member States
- Need for international cooperation between the SAIs and with E.U.-bodies: discussion of results of the survey on the topic by the Bundesrechnungshof and potential options for further joint action
- Design of possible general guidelines on tax management system auditing: discussion and adoption of the report by the core group established on the subject at the Bonn meeting of the VAT Working Group
- Decisions about future work by the Working Group.

After the closing of the official part of the meeting, an informal session was held where representatives of the Italian fiscal and financial Police (Guardia di finanza) illustrated and discussed their strategies, actions and experiences in combating VAT fraud and in integrating criminal investigation and administrative VAT audit.

#### **Agenda item 1: Carousel Fraud and Transitional VAT System**

The Working Group has shared the opinion that, for the foreseeable future, a radical change of the present VAT system cannot be reasonably considered to be a realistic prospect, or even a practicable option. As a consequence, attention has to be focused on how to improve the functioning of the present transitional system by trying to overcome its inherent weaknesses by adopting the best practices emerging from E.U. Member States.

A number of issues emerged as critical for combating VAT fraud:

- 1) monitoring and analysing VAT revenue on internal trade and on imports in respect to GDP growth;
- 2) applying and improving methods of estimating revenue losses as a consequence of VAT fraud: agreeing on best practice based on previous analysis, studies and reports;
- 3) implications of external trade and of strong commercial ties with third countries for VAT tax management audit;
- 4) how to minimise fraud possibilities depending on simplified customs procedures for import and export transactions;
- 5) how to integrate criminal investigation in VAT fraud audit;
- 6) measures to enhance administrative cooperation among E.U. Member States: training multilingual staff and elaborating a multilingual technical glossary;
- 7) improving quality and reliability of statistics on exchange of information on request between Member States;
- 8) extending tax liability to traders asking for refunds or deducting VAT on sales on the grounds of illegal tax avoidance practices;
- 9) detecting and overcoming legal restrictions to more effective anti-VAT fraud action;
- 10) identifying best practices recommended by the Group: carrying out coordinated audit work by SAI's.

**Agenda item 2: Discussion of the Draft provisional Guidelines for VAT management systems audit**

The paper drafted by the core group containing the guidelines for VAT management systems audit was submitted to the VAT Working Group.

The VAT Working Group had to review and comment on the guidance and decide on the future of the core group to see if it should be dissolved, having completed its assigned tasks, or if it should have a further role.

The VAT Working Group had to decide on the time schedule of submitting the results (report, draft guidelines, proposals), through the Liaison Officers, to the next meeting of the Contact Committee of Presidents of the SAIs and the ECA that will take place in Luxembourg next 6 and 7 December 2004.

The Group adopted the draft report (with some minor changes), as a common understanding on the main principles for auditing VAT systems and decided to propose it to the Contact Committee as a guidance in all Member States and European bodies (Attachment no. 2).

**Agenda item 3: Finalisation of the Report on Legal Authority**

The VAT Working Group meeting finalised the draft report on the survey among all SAIs on the current legal situation concerning options for cooperation among the SAIs and with E.U. authorities and on the SAIs vision of their future cooperation (Attachment no. 3).

The Group conclusions (Attachment no. 4):

- claim a strong need for permanent cooperation between SAIs and with ECA in performing audits of the Value Added Tax collection process and related issues
- express the expectation that all SAIs and the ECA will establish and encourage such a permanent international cooperation
- highlight some legal weaknesses and loopholes for the efficient performance of intra Community external audit in the field of tax fraud control

- call upon all SAIs and the ECA to examine their legal authority and where necessary make recommendations for it to be amended on a national and/or E.U. level to facilitate enhanced cooperation with other SAIs and the ECA in accordance with the eight principles approved by the Contact Committee on 9 December 2003.

### **Draft Resolution and Adoption of the 2004 Activity Report**

The VAT Working Group meeting discussed and adopted a draft Contact Committee resolution on promoting activities in the field of VAT to be submitted for Liaison Officers approval by written procedure in November 2004 (Attachment no. 4), embodying conclusions previously summarised.

The Working Group meeting also discussed and adopted the present 2004 Activity Report calling on the Bundesrechnungshof<sup>7</sup> and on the Corte dei conti who have been in charge of the technical implementation of the third and of the fourth meetings to provide a final version of the report according to the guidelines set forth by the Working Group.

### **Agenda item 4: Planned activities for 2005**

The Working Group identified two major work priorities for 2005:

- 1) Review methods of estimating revenue losses as a consequence of VAT fraud
- 2) Carrying out more coordinated audit work by SAIs to induce more effective follow up by tax administrations on applying best practices to combat VAT fraud suggested by the E.U. bodies and by the SAIs and the ECA.

The work will be conducted by two different core groups.

For theme 1 will participate SAIs of Belgium, Italy, Netherlands, Poland and U.K.. Slovenia has to confirm its preliminary intention to participate. The U.K. National Audit Office will act as spokesman.

As theme 2 is concerned, Germany will be spokesman; Lithuania and Sweden will participate; Austria and Spain have to confirm their preliminary intention to be part of the Group. ECA and other SAIs will as soon as possible inform the chairman of Rome meeting about their interest in joining one of the two core groups. In the meantime Austria has confirmed its participation and the Czech Republic has declared its interest to be part of the first core group.

The two core groups will submit progress reports to the Working Group meeting that will take place in autumn 2005 in a location to be agreed with the Chairman of the Rome meeting.

The agenda of the 2005 Autumn meeting will also include the activity report 2005, to be jointly drafted by the two SAIs responsible for organising the fourth (Rome) and fifth meeting of the VAT Working Group.