VALUE-ADDED TAX FRAUD IN THE EUROPEAN UNION

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FOREWORD

This report is the result of a research project which was begun in 1994. The research was split up in two phases. A pilot/exploratory study was conducted in 1994 and at the beginning of 1995. The main research took place during the rest of 1995 and the beginning of 1996.

The pilot study, which focused on the tax control system and examined a number of VAT fraud cases in The Netherlands, resulted in an interim report being published by the Research and Documentation Centre, Ministry of Justice, The Netherlands (WODC). The main research extended the examination of control systems to the neighbouring countries of Belgium, Germany and the United Kingdom, and examined fraud cases in those countries as well. The final report is divided into two parts. This volume constitutes Part I, while a comprehensive examination of detection and settlement of VAT fraud in the aforementioned four countries can be found in Part II, published by the WODC.

The pilot project was jointly funded by the Dutch Ministry of Justice and the European Documentation and Research Network on Cross-Border Crime Foundation (EDRN). Despite EDRN's assurance to support the main research as well, the foundation was not able to keep its word. Thus, the main research was funded entirely by the Dutch Ministry of Justice. The researchers would like to extend their gratitude to the Ministry of Justice for making the entire project possible.

The following people deserve special mention for their input regarding this project. Special thanks to Hans Nelen, project supervisor, who spent countless hours supervising the research activities, supporting the researchers, and making recommendations, alterations and suggestions on ways to improve the text. Members of the Advisory Commission, ir. J.C. Plooy, from the Dutch Ministry of Finance, mr. G.H.Th. van de Bult, FIOD Haarlem, dr. P.C. van Duyne, Dutch Ministry of Justice and prof. dr. H.G. van de Bunt, WODC, provided valuable comments on the final text.

It is difficult to personally thank everyone who supported this research. Our contacts were numerous. However, the following individuals warrant a mention due to vital contributions to the course of the research:

In The Netherlands: R. Faber (FIOD), H. de Die (Central Liaison Office), R. Verbraak (Business Unit, Tax Administration), R. Tjalkens (EUROPOL), R. Emmery (Ministry of Justice).

In Belgium: M. Holsteyn and G. Vervliet (Central Service for the Fight against Organized Economic and Financial Offenses, CDGEFID),
F. Godfriaux and B. Dernicourt (BOB, State Police), Lt. De Bie and J. Stouwen (State Police, Brussels), M. van den Eede and W. Uyttersprot (BBI), P. Vermote (Central Administration VAT, Registration and Domain).


In Germany: G. Himsel (Federal Ministry of Finance, Berlin), Herr Hesse and Frau Gabe (Regional Finance Office, Düsseldorf), Herr Dörn and R. Schwab (BuStra, Berlin), Herr Lübke (Steufa, Berlin).

Thanks are also due to representatives from the Directorates General XIX and XXI who granted interviews, and to other representatives from the various tax authorities and fiscal agencies who sent copies of the questionnaires outlining their country’s tax collection and control procedures.

To all those whose names have not been mentioned, we would like to offer a special word of thanks for all the hours spent working with us on this project. Their dedication to this project greatly enhanced the researchers’ understanding of the patterns of value-added tax fraud, its investigation and control in The Netherlands, Belgium, the U.K. and Germany.
INTRODUCTION

During the last decade organized crime has attracted increased attention from governments, law enforcement agencies and social scientists all over the world. The focus of interest is the worldwide drug trafficking of international crime organizations like the Mafia, the Chinese Triads, the Colombian cocaine cartels and the huge profits these organizations allegedly launder and reinvest in legitimate industry. The strong emphasis on drug trafficking neglects the finding that organized business crime may be at least as lucrative and (from the point of view of the crime-entrepreneur) much safer (van Duyne, et al. 1990, 1995). There is also ample evidence that the distinction between crime entrepreneurs and so-called white collar criminals is fallacious. Indeed, many symbiotic relationships have been established between representatives of organized and corporate crime.

This research project, to a certain degree, aims at filling the knowledge gap concerning organized business crime by highlighting one specific phenomenon, that of European Union cross-border VAT fraud. Insight is to be provided into

(a) the effectiveness of the present VAT control system
(b) the vulnerability of legitimate trade to criminal inroads
(c) the development of organized crime in this area.

1.1 The need for research on value-added tax fraud

Value-added tax (VAT)\(^1\) is a cost price increasing tax: it creates a `wedge' between the price of the real production process and the final market price. As exportation is free of VAT (the so-called `zero tariff') and differences in VAT rates occur between the member states of the European Union (E.U.), the potential for abuse of this economic regulation is great. On 1 January 1993 a new regulation concerning VAT went into effect in the member states of the E.U.. Because import and export documents between member states are no longer required, and because customs controls at the internal borders

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\(^1\) Value-added tax will be abbreviated throughout this report as VAT. For a list of further abbreviations, see Appendix 3.
have been abandoned, criminal opportunities are likely to increase. Research on organized VAT fraud has been carried out in the Netherlands and Belgium on the basis of investigations of several large fraud schemes by customs officials and the police in the Benelux (van Duyne, et. al, 1990, 1993, 1995). The research has shown that the Benelux treaty provided ample opportunity for VAT fraud. The extensive organized crime VAT patterns which have been observed in the Benelux during the last 10 years may well spread to the whole E.U.

The cases identified by van Duyne are only a small part of the whole range of VAT fraud within the E.U. Therefore, the question to what extent the legitimate industry is affected by such crime entrepreneurs, cannot be answered. As no quantitative research data are available, statements about the impact of VAT fraud on the legitimate trade are merely speculative. Nevertheless, the damage to the member states and to society is thought to be great and such practices have a serious negative impact on the competitive relations in industry. Tax fraud's corrupting influence creates a real danger that legitimate businesses cannot compete any more with crime enterprises that sell their goods at a (fraudulently) reduced price. As a result of this unfair competition legitimate businesses may be forced into bankruptcy or induced to join the criminal VAT trade themselves. VAT fraud's further negative impact can be seen in the form of frustration from the standpoint of commercial policy or objectives and last, but not least important, in the form of direct financial disadvantage to the E.U. and its individual member states. In essence, then, VAT fraud claims numerous victims. It affects the communal budget of the E.U. as well as the tax base of the country in which the fraud is being committed. It destabilizes legitimate businesses (possibly causing some to go bankrupt and others to join in the illegal operation to avoid tremendous losses). Members of society are the final 'victims'. Their trust in commerce and industry may be shattered as a result of fraudulent business practices.

As little scientific knowledge is available on VAT fraud, it is highly relevant to gain more insight into the nature of this type of organized business crime and its perpetrators. This information may also be used in the process of developing a uniform VAT control system within the E.U.
1.2 Construction of the report

Chapter 2 of this report is designed to introduce the reader to the concept, history and purpose of VAT, as well as the concept of VAT fraud. Here we will provide a formulation of the problem. Further issues addressed in Chapter 2 define the parameters of the research, and pose questions which the research project aims to answer. The methodology and research instruments (both research instruments are included in the Appendix) will be discussed at greater length.

Chapter 3 addresses in greater detail the E.U. regulations prior to and after 1 January 1993. The reader will also become familiar with controls at the European level and intra-Community cooperation in the fight against fraud.

In Chapter 4 the research examines the practices of the auditors in the tax administration as well as investigative divisions and prosecution services in the four countries surveyed in this study: the Netherlands, Belgium, the United Kingdom (U.K.) and Germany. The question of specialization within and authority of various agencies is addressed. The investigation of VAT fraud in a number of cases is discussed. An explanation of the functioning and tasks of the Central Liaison Office (established under E.U. Council Regulation 218/92) is provided. For more details concerning the individual countries, the reader is requested to refer to Part II of this study. Chapters 5 through 7 introduce the reader to an analysis of the material obtained through interviews with investigators and in the files. It is in these chapters that the questions concerning individuals and/or the structure of the organizations, the primary function of the business, the goods and branches, secondary offenses, and the modus operandi will be addressed. Summaries of numerous cases are provided in these three chapters to exemplify certain aspects. In essence, chapter 5 examines the goods and markets which fall prey to VAT fraud as well as other offenses perpetrated alongside of VAT fraud. Chapter 6 provides insight into the modus operandi. The reader is provided with a description and diagrams of fraud patterns. This information advances a general understanding of the ways in which VAT fraud is being committed. A case study is presented in section 6.3. This illustrates the sophistication and complexity of such VAT fraud constructions. Chapter 7 answers the question “who is behind the operation?” Are VAT fraudsters more often relatively legitimate businessmen peripherally involved in the perpetration of VAT fraud or are these mainly criminals who use business constructions and the VAT system to profit? The reader will be introduced in this chapter to the concept of organized
crime. The cases in the study will be analyzed on the basis of the definition provided.

Some concluding remarks will be presented to the reader in the chapter entitled Summary and Conclusions. This chapter concludes with recommendations for the European Commission concerning the fight against VAT fraud in the European Union.
RESEARCH QUESTIONS AND METHODS

2.1 The rationale of value-added tax

In this section the rationale of value-added tax based upon the situation in the Netherlands will be examined.\(^1\) VAT laws applicable to intra-Community trade are the same within E.U. member states with possible minor differences in detail.

The history of VAT in The Netherlands dates back to 1569 (Schoenmaker, 1990) when it was first introduced by the Duke of Alva. The tax originated in Spain when, in 1342, dwindling state financial resources led to the introduction of this tax. Some years after its introduction in the Netherlands the tax was repealed. It was not until 1934 that the tax was reintroduced in The Netherlands. In that year a bill for a so-called luxury tax was introduced. It took eight years before the diminishing state finances resulted in the levying of a sales tax. In 1940 the system of levying a one-time tax was substituted by the cumulative cascade system. This resulted in a tax being levied on the supply of all goods and services at each step along the way. In other words, every time an item was sold, and the price increased between each new supplier and purchaser, a new tax was levied on the sale. Since 1969 the system of cumulative cascade has been replaced by the system of value-added tax. The trader, who must pay tax, is able, at a later point in time, to reclaim the prepaid tax on every supply or service purchased. This system results in the trader paying tax only on the value which he or she added to the item. The consumer, as the last one in the chain, pays the final tax and is not entitled to a refund. In essence then, it is the consumer who pays the tax on the value of the goods.

The principles of VAT are quite simple. Whenever Company B purchases goods, VAT is charged by Company A which supplies the goods (in the Netherlands VAT amounts to 17.5% of the value of the item).\(^2\) Com-

\(^1\) From a historical perspective, the development of a value-added tax took a different course in other countries. For more information on the history of VAT in the countries in this study, the reader should refer to the chapters on the various countries in part II of this report.

\(^2\) In The Netherlands the 17.5% rate is the standard rate. A reduced VAT rate (6%) exists for certain goods (food, books, pharmaceutical products) and exemptions exist for
Company A pays this tax to the tax authorities and Company B may request a refund from the tax authorities, of the VAT paid to Company A. This scenario is repeated if Company B sells the goods to Company C; (B charges C VAT and pays this to the tax authorities; C may request a refund of its taxes paid). Diagram 1 outlines the flow of goods and taxes between businesses and the tax administration. For the sake of simplicity, this example uses a 20% VAT rate.

The imposition of VAT, as it applies to corporate bodies or businesses, occurs in the country where the taxable item is ultimately used by the consumer. The following example illustrates this principle: a company in the Netherlands which sells and delivers a product to a company in Germany is not required to pay VAT to the Dutch government on the product. Intra-Community supply is subject to a 'zero-rating'. The German company, on the other

services (financial, medical, postal, educational and insurance services). These standard and reduced rates, and exemptions differ from one country to the next.

3 This differs depending upon whether individuals or businesses are involved. This will be spelled out in more detail in section 3.2 of this report.
hand, is required to pay VAT to the German tax authorities on the intra-community acquisition of its goods. The principle of paying VAT in the country of destination is called the 'country of destination principle'. Similar VAT laws are applicable in all E.U. countries.

VAT is the largest and most important source of income for the E.U. coffers. Member states pay 1.3% of their taxable basis (this amounts to approximately 10% of their own VAT taxes; it ranges from a low of 5% in Denmark to a high of 13% in Luxembourg) to the E.U. which amounts to approximately 53% of the Union’s budget.

2.2 Various dimensions of VAT fraud

According to Mennens (1994; 97) VAT fraud occurs thousands of times a day in Belgium and other E.U. member states. Tax inconsistencies or fraud can take on different forms. Below are some examples of fraudulent tax practices. The way in which these practices are carried out may be determined by the E.U. legislation in effect at that particular time. Chapter 3 of this report will address the specific changes in European law concerning intra-Community transactions and customs control as well as the various types of fraudulent practices which developed as a result of the introduction of the 6th Revised E.U. directive which entered into effect on 1 January 1993.

Practices which deprive the tax authorities of their proper revenue range from non-intentional omissions such as forgetting to submit a tax return or submitting one past the deadline, to filing a (non-intentional) incorrect tax return. Other practices involve criminal intent and are somewhat more sophisticated. Individuals may file false returns (failing to report and pay taxes on goods which were acquired as the result of an ICA and then later sold on the 'black' market) or may falsify an ICS – and then reclaim prepaid VAT from the authorities. Even more sophisticated fraudulent practices involve the custom of smuggling goods from E.U. and third (non-E.U.) countries into the country (to avoid paying customs and VAT and possibly excise taxes), the use of false VAT identification numbers or the (ab)use of a company’s VAT identification number without the knowledge or permission of the owner, the exchange of goods (taxes are paid on lower

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4 The terms intra-Community supply (ICS) and intra-Community acquisition (ICA) will be used to describe transactions (intra-Community transactions or ICT's) which occur between E.U. member states. The terms import and export are generally reserved for trade between E.U. member states and third or non-E.U. countries.
quality equipment or goods and more expensive goods are sold without
taxes), and the use of fraud-carousels.\textsuperscript{5} These fraudulent schemes are de-
scribed and diagrammed in Chapter 6, sections 6.2.1 through 6.2.4.\textsuperscript{6}

VAT fraud can be committed at various levels. The level at which VAT
fraud is perpetrated will most likely determine the scheme used to commit
the offence. VAT fraud can be committed within the borders of one coun-
try. This type of fraud is characterized by a failure to report certain turno-
ver (false declarations are filed failing to declare a domestic supply or
acquisition on the regular tax return). A second level of fraud, cross-border
fraud between E.U. member states, involves more than one country or the
use of E.U. regulations to create the illusion of transacting an ICS against
the `zero-tariff'. Fraud-carousels are characteristic of this type of fraud. A
third level involves fraudulent practices between E.U. member states and a
third (non-E.U.) country.

While member states are required to turn over information to the E.U. con-
cerning cases of fraud occurring within their countries, any statistics involv-
ing cases of fraud must be viewed with scepticism. There is a large `dark
number' of unidentified or unreported cases involving fraud. To further
complicate this picture, a number of other factors are at work which obscure
the true picture of fraud within the E.U.. According to Mennens, (de Smet,
1994; 301) the number of registered fraud cases reported to the European
Union is relatively small; countries are either uncovering an insufficient
number of fraud cases, or their reports to the E.U. concerning the known
cases do not accurately reflect the actual practices within their country (ie.
they simply are not reporting all of the cases uncovered). Even where cases
of fraud are discovered, member states' reporting is inaccurate which leads
to a distorted picture of the true extent of crime in the E.U.. An accurate
assessment of VAT fraud within the E.U. will probably never be known.

\textsuperscript{5} Carousel-fraud is a fraud scheme in which fictitious invoices and falsified documents
are used to create the illusion of the intra-Community transaction of goods. Typical of this
type of fraud is its repetitive nature (the goods go `round' and `round' between countries as if
on a carousel) whereby the (real or fictitious) goods are purchased and sold numerous
times between countries. VAT refunds are frequently requested on the same goods.

\textsuperscript{6} For more on VAT fraud practices also see Emmery, 1992-1993, Faber, 1993;, and
FIOD, no publication date).
2.3 Defining the research terrain

Although, originally, the focus of research was upon cross-border value-added tax fraud within the E.U., the decision was made to expand the field of study to include frauds perpetrated with non-E.U. countries by way of falsifying exports. The investigation into VAT fraud was complicated by a number of issues. Firstly, VAT fraud is rarely an isolated offense. Often times it is committed in conjunction with other tax frauds such as excise or employment tax evasion. Usually the evasion of excise tax results in larger losses to the inland revenue, thus such cases may be pursued by a different law enforcement agency or authority. This classification problem may be partially responsible for the fact that so few VAT fraud cases post-1.1.93 were available for study.

A second problem encountered in our study was the result of the fact that it may take years before large scale VAT fraud cases come to light, are investigated, and then settled. Some of the more interesting cases have not yet been fully investigated or settled, thus, little is known concerning the individuals behind the operation, the structure of the organization, and the financial impact upon the member state. As access to ongoing investigations was restricted in two countries, this reduced the pool of available cases.

This leads to a further concern. Had we restricted our research solely to post-1.1.93 fraud within the E.U. we would have had to considerably limit the number of cases under consideration. To compensate for this, Benelux fraud cases prior to 1.1.93 were included in the study. The Benelux Treaty provided for open borders between the Benelux countries and trade regulations similar to those implemented in the E.U. after 1.1.93. Additionally, we examined cases prior to, and post 1993 involving exports outside of the E.U. The decision to include these cases was based upon the following three arguments. Firstly, fraud, even with non-E.U. countries (by falsifying exports), still has financial ramifications for the E.U. member state. Secondly, we were interested in examining the backgrounds of offenders. Of additional interest was the modus operandi. Thirdly, while the formalities differ, in terms of the paperwork which must be falsified to perpetrate intra-Community VAT fraud and export fraud, the essential of fraud is basically the same: the fictitious supply of goods outside of the country (within the E.U.) or outside of the E.U. to qualify for a zero-rated transaction.

An issue of interest was the fact that three cases of fraud stopped, for example, in December of 1992. Was this a fluke or were the new E.U.
regulations directly responsible for the cessation of the fraud?

Another issue of interest was examining the modus operandi in relation to the time of the operation. Were certain types of modus operandi more successful in evading identification than others? Did the structure of the business (individual, small business, loose network or highly organized operation) influence the success of the operation and thus the time span the fraud construction was able to operate? These issues, among others, will be examined in the following chapters.

The Netherlands, Belgium, the United Kingdom (U.K.) and Germany were selected for this research project. The Netherlands and Belgium provided interesting cases both prior to and after the establishment of the interim regulations because of experience with the Benelux treaty.

The choice was made to conduct research in the U.K. It was postulated that the U.K.'s island status might provide interesting examples of VAT fraud not found in the Netherlands or Belgium. This was, in fact, the case, but it was due largely to the high excise taxes upon such items as alcohol and cigarettes and the unequal VAT rates in neighbouring countries on gold.

It was the desire of the research team to conduct research in Germany as well, due to the fact that Germany borders non-E.U. countries. It was anticipated that Germany would provide examples of various types of fraud not witnessed in the Benelux. This, also, was true, but for different reasons. A treaty between the Federal Republic of Germany and the departing Soviet troops providing for VAT-free trade, afforded a perfect example of the creativity of VAT fraudsters whenever a new opportunity presents itself. Thus, this study is limited to descriptions of the control, investigative and prosecution services and case analyses in the aforementioned countries.

2.4 Research questions

Although limited information is available concerning the control systems in member states\(^7\), one of the aims of this project was to talk with experts in

\(^7\) The questionnaire, *Questionnaire concerning VAT Collection and Control Procedures applied in Member States*, is sent by the Directorate-General (DG) XIX to VAT or fiscal offices in member states every three years to obtain information on VAT collection and control procedures. The DG then summarizes the results of this questionnaire and sends the report back to the member states.
order to establish a better understanding of how the system works in practice: the authority, working patterns, and limitations of control and investigating agencies involved in the identification and fight against VAT fraud. To fully comprehend the nature of the problem it was necessary to examine control systems on both a national and a supranational level. Questions addressed in this project include:

I. – What are the existing control mechanisms and how do they operate?
   – What public bodies are responsible for the fight against VAT fraud and what are their competencies?
   – What are the possibilities to exchange information between member states on VAT irregularities and how are these put into action?

Beyond a purely juridical approach to studying VAT fraud, this project emphasizes a sociological or criminological approach by addressing the subject of the actual operation of fraudsters. This objective was accomplished through empirical research into the structure and modus operandi of crime-enterprises involved in (organized) VAT fraud. The following questions are addressed in chapters 5 through 7:

II. – What techniques of VAT fraud are being used?
   – Which legitimate branches of industry are being affected by this fraud in the sense of (a) damage inflicted and (b) complicity of the ‘legitimate’ entrepreneurs?
   – What are the structures of the organizations or networks and what are the profiles of the crime-entrepreneurs involved?

2.5 Methodology and research instruments

To complement the literature review of the phenomenon of fraud to include the practice of fraud with VAT, a number of interviews were arranged with representatives from several institutions in all four countries. In The Netherlands contact was established with the Fiscal Intelligence and Investigation Department – FIOD, EUROPOL, the Central Liaison Office – (Centrale Eenheid) and one of the Enterprise Units (Ondernemingseenheid). Interviews were held and file analysis was conducted with representatives in Belgium from the BBI (Bijzondere Belastinginspectie), the CDGEFID, the state police (Rijkswacht) and the Administration VAT Registrations and Domain. In the U.K. the researchers met with members of the VIRT (Investigation Division) in London as well as representatives from the Central
Information concerning the functioning of the various agencies can be found in abbreviated form in chapter 4 and in more detail in chapters on the individual countries in Part II. These interviews facilitated a better understanding of the nature of the problem, and the difficulty involved in the investigation of tax fraud.

In addition to the aforementioned meetings, contact was established during the initial stages of the research with representatives from the Directorates General XIX and XXI at the European Commission in Brussels. In addition to the previously mentioned agencies involved in the audit, inspection and investigation of VAT fraud in the various countries, contact was also established with tax advisors. Further contact with experts in the area of VAT was established at conferences in The Netherlands and Germany.

Additionally, on November 20, 1995 the researchers met with Mr. Aad de Bruyn, reformed fraudster and current director of the Foundation for the Prevention for Economic Criminality (Stichting Preventie Economische Criminaliteit) in The Netherlands. Mr. de Bruyn presented valuable insight into the European VAT fraud scene as well as modus operandi.

Access was granted to review files of VAT fraud cases at various agencies in three of the four countries in which this research was conducted. File analysis began in September 1994 and ended in September 1995. In total, thirty-one cases were examined. Files from eleven cases were provided by various agencies in both The Netherlands and Belgium. Eight cases were reviewed in the U.K. Because of laws governing privacy and protection of data in Germany, it was possible to obtain access to only one case, the facts of which had been published in a tax journal. Some of the cases reviewed in The Netherlands and Belgium were still being investigated. All cases in the U.K. were completed, at least in terms of the investigation. Completed cases provide information on the administrative or penal handling of the offense; information contained in on-going cases is more limited and in more than one case the entire fraudulent operation had not been completely exposed.

This research project does not provide a complete study, but rather a
general picture of VAT fraud patterns and offenses in three of the four
countries in this study. As mentioned before, access to open cases was
restricted in Germany and the United Kingdom. It is possible that there
were current investigations into ICT frauds and that the researchers were
simply not given access to the information.9 The data were further limited
as it was sometimes difficult to obtain accurate information concerning
offender antecedents.

As this is primarily an exploratory study to identify patterns of VAT
fraud and the degree of organization, the nature of the data collected in this
research project is qualitative. The research instruments, described in more
detail in section 2.5.1, were designed for the purpose of collecting this type
of data.

2.5.1. The research instruments

Two research instruments were developed to obtain information from spe-
cialists in the field as well as to extract information from files at various
enforcement agencies. The first research instrument, developed for use with
file analysis, was designed as an outline to identify key variables.10 The
variables describe, in detail, the methods and organization of the operation,
characteristics of the offenders, the organization of the criminal enterprise
and the environmental variables, the financial overview of the operation as
well as the investigation.

The second research instrument, a questionnaire for experts, contains 39
open-ended items.11 It is divided into three major sections, the first con-
taining general questions, those which can be posed to anyone being inter-
viewed.12 The second section of the questionnaire contains questions di-
rected specifically at personnel working at the Central Liaison Offices. A
third section contains questions written specifically for individuals in-
volved in the investigation and or prosecution of offenders.

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9 This, in fact, happened in at least one case. There was a post- 1.1.1993 international
VAT fraud carousel involving three countries. The fraud was discovered by an investigative
branch in the United Kingdom. The main part of the fraud occurred in another country
which was not a participant in this research. The fiscal attaché of that country refused to
allow the British investigators to provide enough information so that the fraud could be
included in this study.
10 See Appendix 1.
11 See Appendix 2.
12 This section of the questionnaire was adapted in part from a questionnaire submitted
by Prof. Dr. Gerhard Dannecker from the University of Bayreuth, Germany.
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EUROPEAN UNION REGULATIONS

European Union regulations governing cooperation at various levels between member states is extensive, complex and confusing. It is, however, necessary to be familiar with the laws governing intra-Community trade, enforcement and cooperation, in order to understand how fraud may be perpetrated, why it is difficult to investigate, and what is being done from a domestic as well as an intra-Community standpoint.

It is not the authors' intention to provide the reader with an extensive background in E.U. law and regulations. For more detailed information the reader is encouraged to refer to the literature listed in the reference section or in the footnotes.

3.1 E.U. regulations prior to 1 January 1993

Prior to 1993 VAT had to be paid on the import of goods entering a country (whether from an E.U. or from a non-E.U. country). At the border crossings customs documents had to be presented and stamped, and at any time customs officers had the authority to check transport vehicles to verify whether the contents matched the information printed on the import documents. This worked more as a psychological than an actual physical control. In general, physical checks of the contents of transport vehicles at all border crossings occurred irregularly and with low frequency, thus there was only a slight chance of actually being caught in a fraudulent transaction.

To avoid a delay in the passage of goods within the E.U., community transportation documents were developed. Documents used for transactions between E.U. countries was the T2-document. The code T2 meant the import of goods was duty-free or free from agricultural levies but national taxes like VAT or excise still had to be levied. T1-documents were used in situations where the goods entered the E.U. from third countries. All taxes had to be levied upon import. When goods entered the E.U. and had to transit various countries before arriving at the place of destina-

1 Although no transportation document was necessary for trade between the Benelux countries, a registration document, the Benelux 50 document, was utilized. This could be used to trace the flow of goods between the Benelux countries.
tion, declaration for import had to be made in the first country. Businesses
which continually imported goods employed a customs-accountant
(douane expediteur) or a company to deal with handling the customs re-
quirements for the company.\(^2\) This individual prepared the declaration,
paid the tax owed and was responsible for the clearing of customs docu-
ments. Customs, which settled the declaration, saved a copy of the docu-
ment. When the goods arrived at the place of destination the final declara-
tion was made. The customs official receiving this final declaration sent a
copy of the document to the customs office of the country where the goods
entered the E.U. The previously issued T1- or T2-document was then
‘cleared’ which meant that proof existed that the goods had reached their
intended destination and that the taxes due were paid.

In principle then, the tax payment occurred at the point of import or
when the goods entered the country. Under certain circumstances customs
payment at the point of entering the E.U. could be postponed until a later
point in time. In The Netherlands, a company which imported goods on a
regular basis and maintained a reliable and accurate administration, was
given a VAT code number. With this, the company could import goods
without having to pay VAT at the border. The amount owed was ‘trans-
ferred’ to the person or company actually receiving the goods and, rather
than having to be paid at the border by a customs accountant, was then
submitted with the business owner’s total monthly or quarterly VAT decla-
ration.\(^3\) This transfer of payment became known as the ‘transfer rule’
(veiligheidsregeling).

Transactions at the borders between the Benelux countries were gov-
erned by the Benelux Economic Union Treaty.\(^4\) The regulations initiated in
the Benelux Economic Union Treaty and the ‘transfer rule’ set a prec-
edence for the current E.U. regulations.

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\(^2\) A customs-accountant is someone who is professionally responsible for assuring the
clearance of customs documents for client traders.

\(^3\) A regular VAT declaration is submitted by a business usually on a monthly basis.
Smaller businesses may submit a tax declaration on a quarterly or annual basis.

\(^4\) The Benelux Economic Union Treaty of 3 February 1958 governs transactions between
the Benelux countries. Legislation applicable to VAT can be found in a specific convention,
‘Convention on the Simplification of Formalities at the Benelux Inner-Borders Concerning
3.2 E.U. regulations post 1 January 1993

As of 1 January 1993 the formalities applied to the import and export of goods at the inner-borders of the E.U. were abandoned. Among these formalities was the payment of VAT upon import at the border. As a consequence of the abolition of controls at the E.U. member states’ internal borders, the E.U. Commission proposed the following options: VAT could be levied in the country of the one who performs the service or provides the goods, or in the country where the service is being performed or where the goods are being delivered. From these options, the Commission selected a system of levying taxes based upon the so-called ‘country of origin’ principle. Under the new system the ‘zero-tariff’ would disappear, thus there would be no difference between service offered to a domestic customer or to one elsewhere within the E.U. On the other hand the Commission wanted to let the receipt of taxes wind up in the country in which the goods would be used. Should the ‘country of origin’ principle be unabridgedly adopted, then the VAT income of the countries with high exports would increase, while that of importing countries would decrease. Thus, a system of compensation was suggested. This mutual settlement between the member states is supposed to occur through a ‘clearing institute’. The purpose of this clearing institute is to regulate the results of the inequalities in VAT tariffs and create a balance between importing and exporting member states. This compensation regulation is thought to be the weak link in the proposed system and the E.U. member states are sceptical about introducing it.

Given that the E.U. was intent upon opening up the borders and abolishing border control in 1993, and at the same time did not want to introduce the new tax system based upon the country of origin until 1997, it was necessary to introduce a new system of controls5 which would minimize the perpetration of fraud. In principle, these new arrangements are in force for the transitional period of four years and should remain in effect until 1 January 1997. However, “[t]he period of application of the transitional arrangements shall be extended automatically until the date of entry into force of the definitive system and in any event until the Council has decided on the definitive system” (European Commission, 1994; 1).

Title XVIa, Article 28a of the amended Sixth Council Directive of 17 May 1977 addresses the scope of taxation of trade between member states. The transitional rules have by now been incorporated into the legislation of individual member states. For individuals (and limited corporate bodies), the country of origin principle applies, so that VAT is paid in the country

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where the item was sold. For example, a person from The Netherlands who purchases a camera in Germany, pays VAT (15%) in Germany instead of the Netherlands (17.5%). The exception to this rule is VAT taxes on new motor vehicles and goods on which excise taxes are levied. For businesses, the country of destination principle remains in effect for the interim period. This requires companies to pay VAT in their own country when intra-Community acquisitions are involved. Furthermore, the ‘zero-tariff’ on ICS’s still exists.

Under the above mentioned transitional control system, companies are required to file a quarterly summary to the tax authorities concerning their supplies to businesses in other E.U. member countries. Every member state must have a Central Liaison Office Intra-Community Transaction Base, where information is collected and an overview can be provided of all intra-Community supplies (Regulation 218/92, article 2.2). At the Central Liaison Office files are established and information is compiled concerning items such as the VAT identification number of the supplier, the VAT identification number of the purchaser in the other member state, and the total amount of ICT sales per (domestic) supplier in the given quarter. The total amount of ICS’s per foreign purchaser is provided to the Central Liaison Office of the member state in which the purchaser has his seat of establishment according to the so-called listings.6 This information can then be compared to the VAT declaration on the regular tax return which the particular business has filed in its own country. In these regular tax returns the company is required to provide information concerning the value of the goods acquired from other member states.

Due to the fact that there may be differences between the listings and a business’ own tax return, questions may be posed to the purchaser by the tax authorities in that particular country: tax authorities in each member state conduct their own VAT audits. At the same time information may be sought from the member state where the supplier has his seat of establishment. Thus, the purchase (ICA) and sale (ICS) of goods are opposite elements of the same transaction.

This section has examined the E.U. regulations which govern intra-Community transactions. The following section will provide an overview of the initiatives of the E.U. to prevent fraud and the possibilities for intra-Community cooperation between member states in their fight against fraud.

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6 The quarterly ICT-listing is a compilation of intra-Community supplies to businesses in other E.U. member states. It is submitted to the Central Liaison Office. This should not be confused with a trader’s monthly or quarterly tax declaration, which is submitted to the tax authorities.
3.3 European controls and cooperation: the communal fight against fraud

Until now the implications of the Amendment to the 6th Directive on the national regulations and systems of control in the member states have been discussed. Discussion will now centre around the communal fight against fraud. Member states are primarily responsible for the fight against VAT fraud. However, as VAT is the most important source of income for the Union, the E.U. is interested in ensuring correct and consistent methods of collection and payment of VAT in the member states to the E.U. budget. Because of the multiple and complex regulations, possibilities arise which could easily lead to irregularities and fraud. Further discussion will point out the policy established by the E.U. to secure this interest and which provisions have been made to trace and prevent fraud.

In 1989 the Commission established a programme with regard to the fight against fraud. Each year the programme is reviewed to determine whether new directions should be emphasized. Although the Commission introduced a new programme in September 1992, the three main objectives of the 1989 programme still remain valid today. These objectives\(^7\) are: prevention, enforcement and cooperation.

3.3.1. Prevention

The first emphasis of the prevention policy is the application of control measures to the communal regulations. A few years ago the authority of the European Commission concerning the control of VAT collection and payment was rather limited in comparison to its authority in the area of agricultural subsidies.

In 1989, Council Regulation 1553/89, Article 12, sub 1 was adopted. It required member states to inform the Commission about their taxpayer registration procedures, their procedures for the assessment and collection of VAT and about the regulations and results of their VAT control systems. Based upon this report, the Commission consults the involved member state about possible improvements in the procedures to increase the system's effectiveness (Article 12, sub 2). Every three years the Commission writes a report concerning the member states' procedures and formulates possible improvements. The emphasis of the 1989-1991 Commission

report\textsuperscript{8} addressed the issue of voluntary compliance. In essence then, the extent of the Commission's control is a "control on control": the Commission checks the control of the competent national tax authorities. In this way the Commission contributes to the effectiveness of the national collection and control systems and attempts to introduce consistencies in the method of tax collection.

The second focal point of the prevention policy is the simplification of the regulations. EG-regulations are often complex and for that reason unclear. This has a negative impact upon the application as well as the enforcement of the regulations. Over the last few years the Commission has emphasized the simplification of regulations and has involved experts\textsuperscript{9} whose input has aided in a more efficient application and enforcement of the regulations. Another emphasis of the prevention policy is carried out by the fraud cells attached to some Directorates-General (DG's): DG VI: agriculture, DG XIX: budget, DG XX: financial control and DG XXI: customs and indirect taxation. At the other DG's one or more persons from the financial department are in charge of fraud prevention.

As a final step in the development of a formally coordinated anti-fraud policy, the Unité de Coordination de la Lutte Anti-Fraude (UCLAF) was founded in 1988.\textsuperscript{10} The UCLAF coordinates the fight against fraud between the DG's on one hand, and the Commission and the member states on the other. The UCLAF is involved in the collection and review of information concerning fraud cases reported by the DG's and the DG's handling of these fraud cases. Additionally, the UCLAF develops initiatives to fill gaps in the regulations and takes part in investigations which have been organized by the fraud prevention teams of the DG's. At the end of 1992 the Commission redefined its programme of action in the fight against fraud. As a result, the UCLAF acquired more responsibility in a number of areas. Last year the UCLAF was restructured with a new emphasis upon operational activities. The Budgetary Control Committee has proposed an amendment to further

\textsuperscript{8} Report from the Commission to the Council and the European Parliament, Value-added tax; Collection and control procedures applied in Member States, SEC(92) 280 final, 24 February 1992.

\textsuperscript{9} Other experts, to include officials and social scientists, participate in study conferences concerned with the fight against fraud. Certain of the Commission's services study the way communal fraud files are treated by the national courts (Van de Beek, 1991).

\textsuperscript{10} Unité de Coordination de la Lutte Anti-Fraude, European Commission, Doc. SEC.(89) 8211 (working programme).
strengthen the activities of the Commission to fight fraud and in particular of the UCLAF by means of a significant increase in the number of staff (Knudsen, 1993).

3.3.2 Enforcement

In addition to prevention, another emphasis of the Commission’s policy to fight fraud is enforcement. However, the E.U. institutions have neither legal authority to enforce the criminal law or to prosecute offenders, nor authority to influence the criminal law or the law of criminal procedure of any of the member states. The investigation, prosecution and punishment of fraud, even E.U. fraud, has always been, and remains a function of the individual member states. Article 5 of the E.U. Treaty (25 March 1957, Rome) dictates that the member states themselves are responsible for enforcement of the Union legislation.

There are, however, limited channels through which the E.U. can exercise its enforcement policy. The European Court has made some demands concerning the enforcement of the Union law. The court declared that the member states should enforce the Union law as if it were national law. A further option lies in Article 155 of the E.U. Treaty. Under this article the European Commission has authority to observe and intervene (in the form of making recommendations) in the way member states fulfil their obligations derived from Article 5.

Finally, the European Commission executes the budget according to Article 205 and this implies that other Union institutions, especially the Parliament, can hold the Commission accountable for losses. This leads to the conclusion that the European Commission is judicially, institutionally and politically responsible for the fight against fraud although it has no executive means to enforce this responsibility (Mennens, 1988).

One possibility, then, would be to provide the Commission with enforcement powers. Although providing the Commission with supranational authority may aid in the fight against cross-border VAT fraud, it is unlikely that in the near future member states will be receptive to forfeiting their autonomy.

3.3.3 Cooperation between member states

“The traditional international legal assistance is no longer sufficient to fight increasing cross-border crime. Member states’ suspicion towards each oth-

\[\text{11 The European Commission vs. Hellenic Republic, Case 68/88 of 21 September 1989.}\]
er's legal system must be removed. An effective measure to combat cross-border crime needs a more simple and efficient manner of international cooperation”.

These words of the former Dutch Minister of Justice, Dr. Hirsch Ballin, reflect the attempts toward international cooperation in the areas of control and mutual assistance in judicial matters. This is the third focal point of the communal policy to fight fraud. Although the fight against fraud is the primary responsibility of the member states, fraud often has a European, cross-border dimension and for that reason close cooperation between the Commission and the member states is essential. In January 1992 a regulation adopted by the European Council spelled out the VAT control arrangements for administrative cooperation between member states. Article 4 provides that each member state must maintain an electronic data base, the VAT Information Exchange System (V.I.E.S.), to store and process the information collected from the statements submitted by intra-community suppliers within its territory. Other member states must have direct and immediate access to this information. This information can be compared with the value of ICA’s declared on the VAT regular returns. Article 6 makes provision for the maintenance of an electronic database by each member state, containing the VAT identification numbers of its traders. This database provides for an immediate check on the validity of a VAT identification number in another member state. The tax administrations are able to use it as a first control check on the integrity of their traders who have made ICS’s against the VAT ‘zero-tariff’. Additionally, Article 5 provides for a follow-up request system to supply supplementary information relating to specific intra-Community transactions in cases where the computerised exchanges of information are insufficient for resolving an audit problem.

In the area of the control of, and the fight against VAT-fraud, there are other options available to exchange information between member states. Particu-

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12 Dr. Hirsch Ballin, E.M.H., 'Internationale samenwerking bij de bestrijding van grensoverschrijdende criminaliteit in Europa en het Caribisch gebied', guest lecture presented by the Minister of Justice on 13 September 1993.

13 Council Regulation 218/92 deals with administrative cooperation in the field of indirect taxation. For more information see Publikatieblad L 24 from 01 February 1992; 218/92.

14 The Convention of Napels of 7 September 1967, for instance, deals with the mutual assistance between the administrative services of the customs branch and with judicial assistance to prevent, detect and fight crimes in the field of customs.
larly in the Benelux countries the administrative cooperation is extensive and far-reaching.

In addition to administrative cooperation in the fight against fraud, cooperation can occur on two other levels:
- cooperation between law enforcement agencies of the member states, and
- judicial cooperation between member states.

A number of conventions with emphasis upon interstate cooperation in the judicial area have taken place. There is, however, no specific convention in the area concerning the fight against fraud. On the contrary, the existing conventions frequently hinder intra-Community cooperation in fraud cases because of exceptions for fiscal crimes. Even where treaties exist which provide for mutual cooperation in house-searches and seizures, governments are not obliged to, and are often prevented from cooperating in the case of fiscal offenses such as VAT fraud. These barriers to legal assistance with regard to fiscal crimes were removed for the participating

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15 The Benelux Treaty concerning the administrative and judicial cooperation (29 April 1969) provides for an intensive administrative cooperation with regard to detecting crimes. Assistance in the area of VAT fraud is possible in cases of cross-border crimes as well as crimes committed within the borders of one of the Benelux countries (Article 33 Benelux Treaty and the Additional Protocol). The legal provisions of this treaty are far-reaching and include such issues as house-search and seizure.


17 The European Treaty of 20 April 1959, for instance, makes provision for mutual legal assistance in criminal cases. Article 2a of this treaty dictates that legal assistance concerning fiscal crimes can be refused. There was, however, an Additional Protocol signed on 17 March 1978 with regard to extradition based on fiscal crimes. Extradition must be allowed for offenses similar in nature to those found in the legislation of the requesting state (Articles 1 and 2 Additional Protocol). Another example is provided by the Benelux Treaty concerning extradition and legal assistance in criminal cases of 27 June 1962. Although this treaty makes no restriction at all on the legal assistance in criminal cases, there is one exception with regard to house-search and seizure. In this case the offense must also be a crime according to the legislation of the requesting state. This means that foreign requests for legal assistance to affect a house-search or a seizure may be executed only for offenses for which extradition is possible. Because there are no special arrangements addressing this matter, basically no house-search or seizure can be executed on the basis of fiscal crimes.
members of the Schengen Treaty. Under Article 50 of the Schengen Execution Treaty it is possible to provide legal assistance in (VAT) fraud cases.

Until the 1993 Treaty of Maastricht, the international cooperation between police services was performed outside the context of the E.U. Two approaches were taken: by way of Interpol or by way of the cooperative agreement *Terrorisme, Radicalisme et Violence International* (TREVI). Interpol, founded in 1923 in Vienna, is an international organisation for cooperation between national police services. Interpol has no executive authority and the handling of requests is dependant upon the local police in the member states (Heijerman, 1993).

TREVI refers to an inter-governmental cooperation between police services of the member states within the E.U. After almost twenty years TREVI was replaced by the Treaty of Maastricht which entered into practice in November 1993 and established the European Union. The Treaty of Maastricht provided for intergovernmental judicial, police and customs cooperation and affirmed the budget control and the fight against fraud within the E.U. A new Article 209a and Title VI address the necessity for fraud prevention within the E.U. The Treaty of Maastricht also regulates different kinds of cooperation between the Ministries of Justice and Domestic Affairs between member states. Article K.1.5. of the Treaty obliges the member states to consider several issues as a matter of common

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18 The treaty, signed in Schengen on 14 June 1985, was an agreement between the governments of the Benelux countries, the Federal Republic of Germany and France to broaden the authority of law enforcement agencies in fighting cross-border crime.

19 In 1989 Interpol acquired one of the most advanced computer-systems, the Automated Search Facility (ACF), for the input and handling of data. If the requesting office is connected with the Automated Search Facility (a central data bank in Lyon where information about international criminals is stored) it has direct access to this data and questions are immediately answered.

20 *Brief van de minister van justitie en van de Staatssecretaris van Buitenlandse Zaken* (Letter from the Ministry of Justice and from the Secretary of State of Foreign Affairs), "*Misbruik en oneigenlijk gebruik op het gebied van belastingen, sociale zekerheid en subsidies*", 17 050 nr.181, 's-Gravenhage, 25 juni 1993; 7.

21 Article 209a of the European Community Treaty stipulates that "Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests" (European Commission, 1993; 6).

22 Article 209a confirms the obligation of the Member States according to Article 5 and the corresponding jurisprudence, to fight fraud and to protect the financial interests of the E.U. as well as they protect their own financial interests.
concern. Mentioned here are international fraud, judicial, customs, as well as law enforcement cooperation. Organized crime has become an issue of great concern. One of the targets is the acceleration and implementation of new ways to exchange information between the police, customs and judicial services. Priority has been given to the development of Europol. At present, only the European Drugs Unit is operational. The Europol Treaty has yet to be ratified. After its ratification, information exchanges relating to other forms of cross-border crime will also be included. Europol will complement the already existing Interpol through the exchange of intelligence ('soft information') (Verdelman, 1994). Another potential strength will be the crime analyses of Europol based on the information provided in national data bases. Finally, the extension and employment of data bases and data communication networks has accelerated and improved the exchange of information.23

International cooperation depends heavily upon member states’ political willingness and interest in cooperating with each other in order to fight international crime. This intention is expressed by several inter-governmental treaties which were discussed in this chapter. Inter-governmental meetings, however, often lead to laborious negotiations which end in compromises. Compromises often result in complex and fraud-sensitive regulations. It is clear that in practice more is needed in the effective fight against international crime in the E.U. Member states’ reservations about forfeiting sovereignty concerning the enforcement of their criminal law is perceptible in the Treaty of Maastricht where police, judicial and customs cooperation has been excluded from the context of communal decision-making (Van de Wijngaert, 1994). Until complete mutual cooperation becomes a reality, the acceleration, improvement and institution of new ways to exchange information between police, customs and judicial services is necessary for an effective fight against cross-border crime.

Member states are faced with a difficult challenge. In addition to gaining international cooperation in their struggle against VAT fraud, they must also fight the battle on the domestic front. Unlike the war on drugs, a moral offense, for which mutual cooperation is willingly provided, economic

23 Commissie van de Europese Gemeenschappen, *Jaarverslag van de Commissie over de fraudebestrijding*, COM(93) 141 def., 20 april 1993, pages 36/37. Some examples of these data bases are: IRENE (Irregularités, Enquêtes, Exploitation), DAF (Documentation Antifraude), SCENT and SCENT-FISCAL (Systems Customs Enforcement Network), CIS (Customs Information System).
offenses, such as VAT fraud, often raise little concern. This is clearly exhibited in treaties and conventions which allow countries to refuse to cooperate in cases of economic offenses (see footnote 17). Member states must recognize the danger inherent in economic crimes and their impact upon the business climate. Perhaps a willingness to recognize the problem is the first step toward gaining international mutual cooperation.

While this chapter focused on the fight against fraud from the intra-Community standpoint, the next chapter provides a summary description of the situation in The Netherlands, Belgium, the U.K. and Germany with regard to systems of detection, investigation and settlement of VAT fraud.
DETECTION AND SETTLEMENT OF VAT FRAUD IN THE EUROPEAN UNION: A SUMMARY OF 4 COUNTRIES

Chapter 2 presented a number of questions to be addressed by this research. The issues were divided into two major themes. The first deals with the control mechanisms and public bodies involved in the fight against tax fraud, as well as the possibilities to exchange information between member states. This chapter addresses those issues by examining the detection and settlement of VAT fraud by various institutions in the countries surveyed in our study. We begin by discussing the role of auditors as the first individuals who usually come into contact with traders and signs of potential fraud. A survey will be made of the tasks and functions of the investigators, special fiscal investigative divisions, and the processing of cases through the prosecutors office. In order to present the wealth of information in an ordered and coherent fashion, the major points have been summarized in table I. For more detail on the system in individual countries see part II of this report.

4.1 Control by the tax authorities

The administration and control of VAT differs between countries. This is particularly evident in Germany in which the responsibility for the assessment, control and collection of VAT occurs at the ‘Land’ or state level. In other member states the administration is central but the control rests with the local offices of the central tax administration.

In all countries the frequency of control visits is primarily determined by the size of the enterprise. Smaller businesses are audited irregularly, whereas larger companies and international concerns are audited on a regular, if not ongoing basis. Other risk factors influencing the frequency of control visits are: the perceived risk of individual traders, whether the trader is dealing in a fraud-sensitive branch or whether it is a newly-founded business. In The Netherlands automated risk analysis is conducted to determine certain risk categories for the purpose of conducting more frequent and thorough audits. While The Netherlands is concerned with identifying risk categories, the United Kingdom and Germany are inter-
### Table I

<table>
<thead>
<tr>
<th>Risk Analysis</th>
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<th>GERMANY</th>
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<tr>
<td></td>
<td>risk categories</td>
<td>Individual traders based upon “risk points”</td>
<td>individual traders</td>
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<th>CONTROL BY TAX AUTHORITIES</th>
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<th>U.K.</th>
<th>GERMANY</th>
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</thead>
<tbody>
<tr>
<td>Discretion handling case</td>
<td>limited; established by law; must go to Selection and then Tripartite councils</td>
<td>broad discretion; no directives</td>
<td>Finance Acts spell out penalties; fraud turned over to investigation unit</td>
<td>“principle of legality”; all cases must be prosecuted</td>
</tr>
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<table>
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<tr>
<th>Further processing</th>
<th>Selection and Tripartite councils</th>
<th>prosecutor</th>
<th>Tripartite body</th>
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<th>U.K.</th>
<th>GERMANY</th>
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<td>Special Criminal Investigation Agency</td>
<td>FIOD</td>
<td>CDGEFID</td>
<td>Criminal Investigation Units; Investigation Division (VIRT)</td>
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<tr>
<td>Specialization</td>
<td>Tripartite councils; special fraud units</td>
<td>Fraud units</td>
<td>Special prosecutors work directly with HM Customs and Excise</td>
<td>special economic crimes units; specialist advisors in business management or political economy</td>
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<th>GERMANY</th>
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<td>concordance between prosecution department and FIOD</td>
<td>Financial civil servants in prosecutors office</td>
<td>lay juries</td>
<td>BuStra prosecutes on behalf of fiscal administration</td>
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<th>U.K.</th>
<th>GERMANY</th>
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<tr>
<td>Tax offense: fine 100% over money owed; fraud conviction: fine and/or fine plus max. 6 years for forgery conviction</td>
<td>fine: ECU 260 to 13,000 and/or confinement from 8 days to 2 years</td>
<td>fine, community service, confiscation of property, costs; maximum 7 years imprisonment</td>
<td>daily rate fines; maximum prison sentence in serious cases is 10 years</td>
<td></td>
</tr>
</tbody>
</table>
ested in identifying individual companies which require extra attention. The U.K. performs this task by calculating the risk of the trader (based upon risk points) and the time lapsed since the last visit. Germany does this by maintaining and analysing extensive data on businesses for the purpose of identifying potential problems. Additionally, Germany conducts lottery sampling audits. Businesses, including small ones, are selected by lottery for audits even when these are not otherwise scheduled.

Auditors confronted with inconsistencies during a control visit have limited discretion in terms of handling a case. This varies from one country to the next. If the tax evaded in the Netherlands is under the threshold established by law, the controller may settle the case administratively. If more serious circumstances exist, the case will be submitted first to a Selection Council and then to a Tripartite Council. In Belgium the auditor’s discretion to handle a case administratively is broader than that of his counterpart in the Netherlands as there is no directive concerning the reporting, transaction and legal proceedings in fiscal fraud cases. The auditor, therefore, exercises broad discretion in determining whether to handle a case administratively or process it criminally.

In Germany, the “principle of legality” requires that all offenses be prosecuted so the auditor does not have the authority to handle the case administratively. In the U.K. in the 1980’s, non-fraudulent compliance problems concerning VAT and other tax offenses was decriminalized. A number of successive finance acts have spelled out the penalties and surcharges for misdeclarations of taxes. If fraud is suspected, the case will immediately be turned over to an investigative unit.

The decision to process a case through the system is a multi-tiered process in all countries. If the auditor decides against handling a case administratively (in the case of Germany such a decision is not possible) there are a number of individuals, fiscal units or bodies to which the case may be presented before a decision is made to further process the case through the system. A report is usually filed directly with the auditor’s supervisor. It may

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1 ECU 5,800 for individuals and ECU 12,100 for businesses. These figures are approximations as the guilder to ECU rate fluctuates.
2 A Selection Council (with representatives from the FIOD, the fraud coordinator from the local tax office Enterprise Unit and the official responsible for the enforcement of the General National Tax Law) meets to determine if enough evidence exists to move the case from the administrative to the criminal sphere. If the decision is made in the Selection Council to formally process a case, it then moves to the Tripartite Council.
be presented to a fiscal investigative unit (attached to the Ministry of Finance – such as the FIOD (Fiscale Inlichtingen en Opsporingsdienst) in the Netherlands, the BBI (Bijzondere Belastingsinspectie) in Belgium, the VAT Special Audit Service (Mehrwertsteuer Sonderprüfungsstelle) in Germany or one of the investigative units in the U.K. to aid in further investigation. The decision to formally process a case through the system is made by tripartite bodies (comprised of members from different departments) in the Netherlands and the U.K., by the prosecutor in Belgium, and by the Department of Fines and Criminal Proceedings (Bußgeld und Strafsachenstelle) in Germany.

Germany and Belgium have special fiscal branches which perform audit services and operate under the Ministry of Finance. Their task is to assess fraud for the purpose of establishing the correct taxable base. Germany is the only country which has a special unit dealing solely with the control and investigation into VAT inconsistencies. Both the BBI in Belgium and the VAT Special Audit Service in Germany are the recipients of cases forwarded from the auditors. These agencies also work in a preventive fashion, although the orientation is somewhat different. While the BBI conducts proactive searches in fraud-sensitive branches, the VAT Special Audit Service engages in proactively auditing individual businesses which may present a potential problem.

4.2 Investigation and settlement

Investigation of VAT, E.U. subsidy fraud and other tax offenses is often complex and requires special skills not often developed within regular police departments. The task, therefore, is often handed over to specialist investigative branches within the Ministry of Finance. What differentiates these investigative units from Belgium’s BBI or Germany’s VAT Special Audit Service is that these divisions or units conduct audits and investigations with the intent of collecting criminal evidence, possibly for the purpose of a formal prosecution in criminal court. Their law enforcement powers of search and seizure are greater than those of fiscal control agencies, and the role of the individual changes from taxpayer to criminal suspect.

4.2.1 Investigation of VAT fraud by the special fiscal investigative agencies

All four countries have special fiscal law enforcement agencies with expertise in investigating complex VAT fraud cases. In the United Kingdom, all
local finance offices have investigative units (the Local VAT Office Investigation Unit or LVOIC) which investigates fraud under civil procedures. Within the region there is also an investigative unit (Collection Investigation Unit or CIU), which, on the collection level, examines fraud according to criminal procedure within the collection. When cases take on a national or international aspect, they are handed over to the VAT Intelligence and Research Team (VIRT), part of the Investigation Division located in London. Within this division there are separate units which deal only with VAT offenses. Proactive investigations take place on local and regional levels, as well as at the investigation division which provides intelligence to both local and collection investigation offices.

Expertise in fiscal offenses is concentrated in the Fiscal Intelligence and Investigation Department (FIOD) in the Netherlands. Assisting the national office are eleven regional offices. Within the national office a VAT division has been established for the purpose of conducting analysis (but has no investigatory authority). Only special officers granted authority to conduct criminal investigation may do so.

In addition to receiving cases sent to it by the various Enterprise Units, the FIOD also conducts proactive investigations. It links and compares several data bases examining tax data for inconsistencies, particularly within fraud-sensitive branches. If suspicions arise indicating the possibility of tax fraud, the case can be handled by the national office or turned over to one of the regional FIOD offices.

Belgium is the only country in which VAT fraud cases are investigated by fiscal fraud divisions within the judicial (*Gerechtelijke politie*) and state police (*Rijkswacht*). While a special unit, the Central Administration for the fight against Organized Economic and Financial Offenses (or CDGEFID) was created to handle the investigation into VAT offenses, some cases are still siphoned off to the aforementioned police departments. Expertise in the state police can be found within the "Criminal Organizations and Proceeds Unit". Expertise within the judicial police was transferred to the CDGEFID. The prosecutor determines whether a case will be investigated by the state police, the judicial police or the CDGEFID.

The CDGEFID in Belgium is a relatively new organization, established in 1994. This organization was created to provide assistance to all police services but is also capable of conducting independent investigations.

Unlike the free flow of information between control and investigation agencies in the United Kingdom and the Netherlands, more formalities are necessary in Belgium. If the CDGEFID needs written information from the
BBI, a formal, written application (kantschrift) to the magistrate who is directing the investigation is necessary to allow this exchange of information. If the BBI needs written information from the CDGEFID, permission from the investigating magistrate is required.

All of the aforementioned organizations also serve as international points of contact for the exchange of information. The situation in Germany is somewhat different. Because VAT taxes are a “Land” or state matter, there is no national fiscal law enforcement agency to coordinate investigations. The agency tasked with carrying out investigations (within each “Land”) for the purpose of establishing tax evasion in criminal proceedings is the Steuerfahndung or the Steufa. It may be established as an independent agency within a regular finance office responsible for servicing more than one finance office in the area or is established as an external, independent finance office for the sole purpose of auditing, investigation and settlement of tax fraud. In addition to its role as an investigative organization, the Steufa also provides advice to the prosecution in technical tax matters.

Because there is no centralized point (in terms of an enforcement agency) for the coordination of investigations and exchange of information, foreign services seeking cooperation from their German counterparts must first make an application to the Federal Ministry of Finance which then passes requests through the chain of command down to the appropriate office.

Officers within the FIOD (Netherlands), the Steufa (Germany) and the Investigation Division (United Kingdom) have the same powers as commissioned police3 and may conduct searches, seize evidence, interrogate and arrest suspects. Their counterparts in the CDGEFID (Belgium) are somewhat more restricted. In Belgium, CDGEFID officers may make unannounced visits to suspected businesses, but may only examine the books and make copies of the materials. In response to what is uncovered during that audit, an official report will be written and sent to the prosecutor. This may result in the administration being seized, but only if so ordered by an investigating magistrate.

In addition to the previously mentioned proactive work conducted by control agencies in Belgium and Germany, proactive investigations by investigative

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3 In the Netherlands fiscal law enforcement officers have, in some respects, more power than commissioned police in terms of searching and seizing evidence in fiscal fraud cases.
agencies take place in all countries. In the Netherlands this task is conducted by the Enterprise Units (of the Dutch tax administration) and the FIOD. This proactive "investigation" takes place on another level in the U.K.. The VAT Registration Unit, known as NEWRY, is the central registration point for businesses in commercial London and Northern Ireland. If a VAT registration application appears suspicious it is "tagged" by specialist teams and a "repayment inhibit" is placed upon it to prevent a possible repayment fraud. This "prevention" occurs at an early stage in the process. Further proactive investigation is conducted by the (regional) Collection Investigation Divisions and the Investigation Division national office in London.

4.2.2 Investigation of Cases

Half of the thirty-one cases investigated began as the result of a regular administrative investigation or control visit. These control visits are part of the regular activities of the tax administration or are based upon proactive investigations, thus, there was no suspicion of a criminal offense at the time of the audit.

One way to differentiate investigations is to classify them as either proactive or reactive. Proactive investigations occur in all four countries. Proactive investigations are those investigations which are initiated by the agency or based upon internal information. Agencies do not wait for a fraud report or complaint, but actively look for cases of fraud using available means. In nine of the cases in this study a proactive investigation lead to the disclosure of fraud.

The majority of the cases, however, were initiated as a result of fraud signals provided by other agencies or informants, thus, the investigation was reactive. The investigation was conducted to collect evidence to substantiate these suspicions. The fraud signals in the cases varied; sometimes they were the result of control visits, a search of the premises was con-

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4 Based upon a profile, certain criteria are identified: the applicant is a known tax fraudster, the business is registered to an accommodation address, the business has no telephone or bank account, or the owner has registered the business from a foreign country, etc..

5 The information provided in this section as well as in chapters five through seven was obtained from both case material as well as interviews. It was not always possible to talk with the investigating officer and often times crucial information was not present in the files.

6 In the U.K. and Germany, repayment declarations are regularly checked.
ducted and suspicion arose. Other control activities such as verification of a repayment claim often led to the fraud signal. In other cases, information resulting from the investigation of other offenses or offenders was the impetus to initiate a VAT fraud investigation.

Despite the fact that VAT-free goods may undermine competition and destroy honest trade in a market, not all traders are eager or able to take advantage of this illegal and profitable practice. In 8 cases (3, 6, 7, 8, 9, 11, 27 and 30) fraud signals were derived from complaints by informants, usually businesses in the same branch.  

Eighteen of the cases began as VAT fraud investigations focused on the main suspects. In the remaining 13 cases the investigation was the result of an investigation either into other offenders (cases 18, 20, 21, 30, 31), which ultimately led to the discovery of this case, or of investigations into other types of offenses such as customs and excise fraud involving petroleum, alcohol or tobacco, or luxury automobiles (cases 8, 11, 15, 16, 27, 28, 29) or fraud with gold (cases 20 and 26).

To support an investigation, officers often obtained information and evidence from several domestic agencies, such as import/export figures from the Central Bureau of Statistics (CBS) in the Netherlands, the chambers of commerce, witnesses, the tax administration itself and the evidence found in the administration of the businesses in question. In approximately half of the cases there was international cooperation which included the use of rogatory commissions, exchange of information concerning invoices, use of the data from the Central Liaison Office to verify questionable declarations (3 cases), the use of Interpol and fiscal attachés at the embassies.

In 70% of the cases several coercive measures were used to obtain evidence. Surveillance was used to observe suspects or buildings, items were seized and confiscated and the fraudsters involved were arrested. In a few cases wire taps were used.

7 In cases 3, 7, 8 and 27 the complaint came from competitors in the market. In case 6 the tip came from the shipping company, responsible for paying VAT. In cases 9 and 11 the informant is unknown, but suspected to be a competitor. Investigators in all countries reported that complaints also often come from former employees or ex-girlfriends or ex-wives, although this was not the case in any of the files reviewed for this study.

8 It is possible that the VIES system was used to verify intra-Community transactions when fraud was suspected in other cases. The researchers were able to find this information or verify it with investigators in only three cases.

9 Wire taps in the U.K. are used only for the purpose of gathering intelligence, and information thus obtained may not be used as evidence.
With the exception of four relatively lengthy investigations (of which one lasted almost 3 years), most of the investigations were completed within 3 to 9 months (from the moment of the control visit until the end of the investigation resulting in a fiscal settlement or the charging of the involved suspects).

Due to the lack of capacity at the investigating agencies, the inquest is still in progress in a few cases. In one case, after a substantial period of time, the decision was made to turn the investigation over to a foreign investigative agency because the main part of the fraud was perpetrated there.

4.3 The public prosecutor and cases involving serious fraud

There is little variance between the countries concerned in terms of the role of the public prosecutor. The level of involvement and the point in the process in which the prosecutor becomes involved, differs. In this section, more information will be provided on the specialization within the department of the public prosecution and the differences between the countries in this research.

Because of the complex nature of tax fraud cases, specialization had to be developed not only in the area of investigation, but also in the prosecution department. All four countries have introduced specialization either in the form of fraud or economic crime units within the prosecution department (The Netherlands, Belgium and Germany) or by housing prosecutors (solicitors) directly within HM Customs and Excise (in the United Kingdom). In addition to the department of public prosecution in Germany, another special external division, the BuStro, exists for the criminal prosecution of fraud cases on behalf of the fiscal administration.

In The Netherlands, when a case moves from the administrative to the penal sphere, the case is turned over to a tripartite council. Members of this tripartite council are representatives from the tax administration, the FIOD and the public prosecutors office. Here the decision will be made in terms of whether further investigation is needed and desirable. Based upon certain criteria, the decision will be made to settle the case administratively by imposing a penalty or to initiate a criminal investigation for the purpose of prosecuting a case in court. The prosecutor may further decide to waive prosecution in lieu of payment (transaction).
The department of public prosecution in most jurisdictions in the Netherlands now has special fiscal fraud units. Generally, two officers serve on this unit for a period of at least four years. Ideally, they rotate out at different times so, in theory, expertise to prosecute special fraud cases exists in most jurisdictions. The department of public prosecution in the Netherlands has entered into a concordance with the FIOD. This agreement stipulated that the FIOD would present a certain number of cases each year for prosecution and that all of them would be prosecuted.

Similar to the procedures in the Netherlands, VAT fraud cases in the United Kingdom are also subject to a tripartite body, in which the representatives from the solicitors (prosecutors) office, the investigation division and the administrative branch participate. Serious criminal cases are either compounded\(^{10}\) or sent to court. For tax or duty offenses in the U.K., HM Customs and Excise remains a prosecuting authority in its own right. Therefore, solicitors work directly for Customs and Excise and become specialists in the prosecution of complex tax fraud cases.

Unique to the United Kingdom is the use of lay juries when serious cases come before the criminal courts. The challenge of presenting difficult cases to lay juries is discussed in more detail in chapter 3, Part II, on the United Kingdom.

Prosecutors in Belgium enter the process relatively early. Based upon notification by the BBI or an independent official report submitted by an investigative agency (usually the judicial police), the prosecutor determines whether further investigation is necessary and whether the investigation will be turned over to the judicial police, the state police or the CDGEFID. Unlike the situation in the Netherlands or the U.K., no tripartite body is used. The prosecutor has sole discretion in whether or not to prosecute a case.

To provide fiscal expertise to the department of public prosecution in complex fraud cases in Belgium, a majority of district courts have introduced fiscal civil servants to assist prosecutors. They bring expertise from various tax authorities (customs, VAT, Registrations and Domains, Direct Taxes). They remain with the prosecutors office, on average, for a period of six years. Additionally, fiscal Substitutes-Procurator of the King (prosecutors) have either three years work experience within the Ministry of Finance or have obtained an additional university diploma in fiscal matters.

\(^{10}\) A financial settlement is agreed upon in lieu of criminal prosecution. The compounded settlement is a sum based upon the arrears plus interest plus a penalty.
In larger districts, as is also the case in Germany, there are prosecutors assigned to financial sections.

In Germany there are two authorities responsible for the settlement of VAT fraud, the Department for Fines and Criminal Proceedings (*Bußgeld und Strafsachenstelle* or BuStra) and the department of public prosecution. The BuStra handles the prosecution of criminal tax offenses on behalf of the fiscal administration, and the department of the public prosecutor on behalf of the criminal courts. Unlike prosecutors, BuStra officials are tax experts and receive special training as fiscal civil servants. They have the same authority as prosecuting attorneys when it comes to cases of tax fraud.

The BuStra will handle less serious cases or cases in which a fine is likely. Cases must be passed to the prosecution department if there is a likelihood of pretrial detention or a prison sentence, or if the sum (tax) evaded exceeds the ECU 193,000 to ECU 219,00 range. Both the BuStra prosecutors and public prosecutors may prepare search warrants and punishment orders (which must be signed by a magistrate). Prosecutors may receive a case from the BuStra in its later stages when it becomes apparent that major fraud is involved and prison sentences are likely to be imposed, or if the defendant refuses a punishment order suggested by the BuStra. On the other hand, if it is apparent that other offenses such as forgery or corruption are involved the prosecution department may become involved early on in the investigation, bypassing the BuStra altogether. At any time during the investigation, the prosecution department may remove a case from the BuStra and begin prosecution on its own initiative.

Prosecutors working within the economic crimes division in the court system attend special courses to prepare them for prosecution of difficult tax fraud cases. In addition to working closely with the BuStra, specialist advisors, with university degrees in business management or political economy, aid prosecutors in reviewing material and writing case evaluations.

### 4.3.1 The settlement of VAT fraud

In all countries penalties are similar. While most cases are handled administratively and settled with the payment of arrears and a fine, other, more severe options, to include incarceration, are available to the courts. In Belgium, if a fraud is proven in court, a penalty of between ECU 260 and ECU 13,000 and/or a sentence of confinement from 8 days to two years can be imposed. In the Netherlands, a maximum fine 100% above the sum origi-
nally due may be applied to administrative settlements. In cases involving conviction for fraud\textsuperscript{11} in a criminal court, the penalty ranges from a fine, to a combination of a fine plus a maximum four years imprisonment for violation of a tax offense, and maximum six years if forgery is involved. In Germany a sophisticated system of fines calculated on a daily rate exists (see footnote 66, in the chapter on Germany, Part II). For failing to file a tax return, the tax code provides for a maximum sentence of incarceration not to exceed 5 years or a fine; in particularly serious cases the prison sentence may range from 6 months to a maximum of 10 years. A case bound for court may be suspended if the defendant makes a contribution (equal to the amount of a proposed fine) either to the state or to a charity (this must be agreed upon by all parties concerned). In the case of the U.K., a number of options are available when a case goes to court and results in a conviction. In addition to a fine, the defendant may be sentenced to a suspended sentence, community service, confiscation of property or costs. Offenders may receive a maximum sentence of seven years incarceration; in general, a sentence of two to three years is imposed.

In all countries goods obtained as a result of criminal offenses may be seized. While the failure to pay taxes alone is not a criminal offense, forgery and deceit or other criminal offenses are often committed during the perpetration of VAT fraud. In cases where the operation is sophisticated, suspects are also often charged with participation in a criminal organization. If a criminal offense has been perpetrated, the proceeds of the illicit violation may be seized. This is often done when goods or investments are in the country where the offense was perpetrated. In practice, though, criminal proceeds are often invested in banks or property in foreign countries (see section 5.4). Prosecutors are often unsuccessful in attempts at enforcing forfeiture statutes and seizing proceeds from illicit activities.

\section*{4.4 Central Liaison Office}

In January 1993 the fiscal borders between the member states of the E.U. were abolished. To compensate for the lack of physical control at the fron-

\textsuperscript{11} In the Netherlands fraud is not a legal term. Depending upon the actual offense, those found guilty are convicted of offenses such as violation of a tax statute or forgery, deceit or deceit in bankruptcy.
tiers, a special agency, the Central Liaison Office (CLO), was established in each member state as part of the tax administration, to control intra-Community transactions (ICT's) with goods. Domestic traders are required to provide the CLO with a quarterly ICT-listing which contains detailed information concerning supplies made to companies in other member states. This information is computerized. A comparison between the ICT-listing and the information on ICS’s from the trader’s regular tax return (made to the local tax office) can be made to validate the information.

After three months the information from the ICT-listings, is exchanged with the other national CLO’s via the Value-Added Tax Information Exchange System (VIES) network. The CLO in each member state then receives data concerning supplies from foreign traders to its domestic traders. These data can be divided into certain levels; each higher level refers to more detailed information. The information on ICS’s from the foreign CLO’s can be compared with the ICT-listing and the regular tax return from the domestic traders.

In addition to the collection of data on intra-Community supplies and the quarterly exchange of these data with member state CLO’s, the CLO must maintain a data base with information on domestic businesses issued a VAT identification number. When the CLO receives the quarterly information from their domestic traders, it examines the VAT numbers on the ICT-listing from the foreign traders to determine their validity. Member states are required to provide immediate confirmation of these VAT numbers. The CLO will verify when these VAT numbers were issued, if they are active and if they belong to the persons who used them. Whenever this verification indicates that the VAT numbers used are incorrect, an O-MCTL report will be sent

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12 EG-Council Regulation 218/92 regulates the establishment of the CLO and the functioning of the VIES system.
13 Exchange of information on services was also proposed but has not been accepted.
14 Whenever a trader refuses to submit an ICT-listing, a letter is usually sent requesting his compliance. If the trader refuses to correct his mistake, a further warning is followed by a sanction.
15 Level 1 information: total amounts of supplies of foreign traders per member state to a certain domestic trader. Level 2 information: the total amount per foreign supplier to the domestic business. Level 3 information: supplementary information to level 2 data, such as invoice numbers, data and the amount on the invoices. Unlike levels 1 and 2 information which can be immediately claimed every three months, in order to obtain level 3 information, it is necessary that all domestic sources of information are exhausted. Furthermore, a separate request to the member state involved is necessary.
16 Operation Message Control-report.
to the member state involved. The CLO also provides traders with a confirmation of a foreign VAT number preceding an intra-Community transaction. A VAT number must fit the construction rule of the member state which issued it. Although numbers may fit the construction rule, it is still possible that they do not exist or the combination of number and name is incorrect.

Comparisons between the national ICT-listing and the regular tax return by the CLO are made on a regular basis only in the Netherlands. During the initial phases of the operation of the CLO in the Netherlands, emphasis was given to this method of control in order to ascertain that the information destined for other member states was as accurate as possible. The CLO in the U.K. only compares the ICT-listing with the regular tax return whenever other member states request level 3 information (details relating to specific invoices such as the invoice numbers and the amount of the transaction). In Germany this comparison is seen as tedious. The local finance office makes this comparison only in limited situations with individuals who are not entitled to tax rebates.

The Netherlands, Belgium, and the U.K. allow their tax auditors direct access to the ICT-database of the CLO. In Germany a tax auditor has to make contact with the CLO in order to obtain the information on ICT’s.

While cooperation between the several CLO’s is good, it is influenced by factors such as the formal or informal approach used by the CLO, whether the CLO which was contacted has the same tasks and authority as the CLO which made the request, or the presence or absence of a fiscal attaché. The European Union stimulates the cooperation by organizing seminars and sending the members states questionnaires addressing the manner in which control is implemented. The responses result in reports from the Commission to the Council.

4.4.1 The VIES System: A Mechanism to Identify Fraud?

Is the VIES system a viable mechanism for identifying VAT fraud as a result of fictitious intra-Community transactions? While the system was not established for the purpose of identifying fraudulent practices, matching one trader’s intra-Community acquisitions in one member state, with other traders’ intra-Community supplies from another member state is a way of identifying inconsistencies.

The matching of information from the regular tax return with data from the CLO as a means of identifying fraud is problematic because of the
minimum six month time gap involved. A six month period may elapse between the initial transfer of goods and the return of the ICS report. The moment an audit is made at the presumed fraudulent company, the fraudsters have frequently already closed the business and have moved elsewhere.

There is no legal obligation to give information on mismatches to the involved member state. The information on mismatches can be sent to another member state as a spontaneous message based on Directive 77/799;\(^{17}\) the decision lies with the controller conducting the audit.\(^ {18}\)

Mismatches in the national data base can be a signal of fraud. There are, however, many factors other than fraud which are responsible for mismatches. Simple errors in filling out forms or fluctuations in the currency exchange rate can cause differences in the figures resulting in a mismatch. Another explanation for the mismatch may be that the acquisition was filed in a different time period than the intra-Community supply, or no data at all on ICS’s was submitted on the ICT-listing. Slight mismatches are more common than perfect matches; indeed these perfect matches are probably a better predictor of fraud than slight differences in the figures. Obtaining completely accurate information on ICT’s remains problematic.

The fact that fraud is seldom discovered due to mismatches should not come as a surprise. This has to do with the fact that mismatches are fairly common and there are legitimate explanations for this. Furthermore, matches are no guarantee that fraud is not being perpetrated. Both declarations and listings could be falsified for the purpose of committing fraud (see the *modus operandi* in diagram IV, case 3, chapter 6). Traders in the member states needed approximately a year to get used to the new administrative obligations. In its initial stages a large number of mismatches was found. Because so many of the mismatches were attributed to reasons other than fraud, the mismatches were not directly seen as fraud signals. The CLO in the U.K. receives automatic reviews of mismatches from the VIES system and these are sent to the local VAT offices which can make an autonomous decision as how to deal with this information. In the Netherlands mismatches are han-

\(^{17}\) This directive refers to the mutual assistance of the competent authorities of the member states in the area of direct taxes. The exchange of information on request, automatic exchange of information as well as spontaneous exchange of information is regulated by this directive. Directive 79/1070 changed directive 77/799 by including VAT.

\(^{18}\) Criteria which may influence the auditor’s decision are the relative and absolute financial interests of the member state involved and whether or not the fraud was perpetrated in a fraud-sensitive branch.
dled by the local enterprise unit. Criteria such as financial interest and the sensitivity of a particular branch to fraud, determine if audits are necessary. Random sample surveys and risk-analyses determine further selection. Perfect matches may be checked based on the concept that this is almost impossible. Due to differences in currency rates, small dissimilarities are almost unavoidable. The CLO in Belgium also put the meaning of mismatches into perspective and underlines their complementary rather than their initiative value.

The information from the VIES system has been used by investigators to verify facts and strengthen their investigation when fraud signals had already been identified through other sources. In this fashion, it has served as a valuable investigative tool, particularly in combination with information from other sources on fraud. Perhaps, in time, with the introduction of a single currency, fully cooperative traders, and an increase in investigative manpower, the VIES system will serve not only as a method of tracking intra-Community transactions for the purpose of tax assessment, but will also aid in the direct identification of fraudulent traders and constructions.

4.5 Conclusions

The fact that between 1 January 1993 and September 1995 only 5 cases of intra-Community transaction fraud have been identified, and were limited to two countries in this study, is highly noteworthy. This can be attributed to a number of factors. Either fraud with value-added tax is not being perpetrated, which is a highly unlikely assumption, or the authorities are not able to identify and/or stop the fraud which is occurring. A third explanation is that the identification, investigation and successful prosecution of a sophisticated VAT fraud construction is a time-consuming process. It is possible that such cases which began in January 1993 are slowly being exposed and are just now being handled by the authorities.

There is no doubt that VAT fraud is being perpetrated. As chapter 6 will reveal, VAT fraud is relatively easy to commit, albeit not successfully over a long period of time. The mechanisms to identify such fraud have not been perfected. There is frequently a shortage of manpower and/or lack of

19 Four other cases began prior to the interim regulations. The fraud constructions made use of the regulations governed by the Benelux Treaty. These operations simply continued, usually unaltered, with the passage of the E.U. regulations.
fiscal expertise at the investigative and prosecutorial levels (although this is an area which has received much attention within the past few years).

Although the primary goal of tax control and audit is not the identification of fraud, such control visits can lead to uncovering fraudulent practices. All countries\textsuperscript{20} utilize risk analysis in one form or another, emphasizing either identification of individual companies or fraud sensitive branches. While this study has identified certain branches sensitive to fraud (see chapter 5) there are frauds being perpetrated in non-sensitive branches as well. Auditors and investigators must concentrate energies in both of these areas.

The identification and investigation of VAT fraud will remain problematic. Firstly, in the past, tax fraud was a low priority offense. It is a violation of a tax statute rather than the violation of a moral code. Whether it is perpetrated by a small business or a highly organized operation, the general public still views the tax authorities as the only “victim” and this rarely arouses sympathy. While some improvements have been made in various agencies (such as the introduction of specialization), VAT fraud, in the countries in this research, is only slowly receiving recognition as a serious offense. As long as VAT fraud remains a low priority offense, agencies will continue to receive less attention and fewer resources for its investigation and settlement.

Another problem in the fight against fraud is the lack of resources both in terms of manpower and expertise. Due to the often complex nature of VAT fraud, it is essential to establish expertise in all areas of the system, beginning with auditors and ending with prosecuting attorneys in appellate cases. It is not enough that expertise is concentrated in the fiscal investigation divisions. An arrest is not sufficient if a case is lost at trial or on appeal. The countries in this study have introduced some form of expertise in the auditing branch (in particular, Germany with the VAT Special Audit Service and Belgium with the BBI). All have special fiscal investigative units and have also begun to introduce expertise into the office of the prosecuting attorney and the judicial branch. The United Kingdom must deal with the additional problem of having to present highly complex and technical cases to a lay jury. It remains to be seen whether one a day a judge will replace juries in complex fraud cases.

Capacity problems is one of the most urgent dilemmas in the fight against

\textsuperscript{20} Although Belgium does not currently utilize risk analysis, it is moving in that direction.
fraud. The majority of the control and investigative agencies visited experienced a shortage of manpower. This, of course, has consequences for the length of time it takes to investigate and close (or settle) cases. In a number of cases examined, the fraud had been identified, however it continued to operate for months afterwards. This is due to one of two reasons. Either the investigating agency simply did not have the manpower to terminate the operation and arrest those involved (which was often the case) or more evidence was necessary to identify the leaders of the operation and build a case which would result in a successful prosecution in court. The delay in closing an investigation can have severe consequences for the tax authorities, particularly in cases where repayments have been made in order to avoid arousing suspicion that a company is being investigated.\textsuperscript{21} The fight against fraud will require tax authorities to weigh the financial consequences against the necessity of identifying the organizers and inner circle of the operation as opposed to arresting a strawman or an insignificant assistant.

In addition to the aforementioned problems, another difficulty in the fight against fraud is the communication and cooperation between both domestic and international agencies. On the domestic level, cooperation is essential between the investigating and prosecuting agencies. Firstly, it is important that a case resulting in arrest also be successfully prosecuted in court. Secondly, it is imperative that undue delays do not jeopardize the successful prosecution of a case.\textsuperscript{22} Communication and cooperation difficulties exist on the domestic level. Within Belgium the formal exchange of data between the BBI and the CDGEFID is hampered by the necessity to obtain permission from the investigating magistrate. Within Germany a decentralized government presents potential obstacles to effective communication.

As witnessed in this research, frauds are no longer solely a domestic problem. Large-scale cross-border frauds are occurring. The exchange of information between member states is one of the most essential prerequisites to solving intra-Community frauds. The use of formal procedures for the exchange of information (such as the rogatory commissions) is time consuming and impedes swift and efficient cooperation. For instance, all requests from foreign agencies to tax authorities in Germany must be made to the federal

\textsuperscript{21} There is, of course, no loss to the state coffers if a repayment hold has been placed on a refund request to enable further investigation.

\textsuperscript{22} International law requires that suspects be brought before a court for prosecution within a two year time limit or the case must be dismissed due to unnecessary delays.
tax authorities which must then pass the request on to the appropriate state (Land) authority. In situations where foreign investigative agencies are in need of immediate information concerning tax questions, this formal process is often time consuming.

The former Dutch Minister of Justice appealed for a more simple and efficient manner to combat cross-border crime (see footnote 12, chapter 3). It is essential, then, that in addition to the VIES system and formal channels of communication, informal channels of communication also be kept open (particularly between investigative agencies) to facilitate international investigations. While this has often depended upon individual investigators and their working relationships with investigative officers in other agencies, it should be possible in the future to introduce informal liaison officers into every investigative agency.

While this chapter responded to the first set of issues raised in chapter 2, the following three chapters will address the questions advanced in the second section, namely, what markets are being affected by the practice, how is VAT fraud being perpetrated and who is committing the offense?
5

VAT FRAUD: THE MARKETS IT AFFECTS, THE DAMAGE IT CAUSES

This chapter will examine the goods, in terms of fictitious and real items, and markets affected by VAT fraud. An explanation will be provided to answer the question why particular markets are more susceptible to VAT fraud than others. We will explore the issue of symbiotic or parasitic relationships in VAT fraud constructions and examine secondary criminal activities that were perpetrated in conjunction with VAT fraud. The reader is presented with information (or lack thereof) concerning criminal proceeds. This section closes with a discussion of the damage caused by VAT fraud both in terms of direct material losses as well as unfair trade practices affecting entire markets.

5.1 Goods and Markets

In the 31 cases examined in this research, 29 of them involved trade with real goods. In some of these cases invoices for fictitious goods were also included in the books to supplement a tax refund. Based upon our research it appears that certain branches are over-represented in fraud schemes. Most notable:

* audio/video/compact discs (6 fraud cases),
* luxury automobiles\(^1\) (4),
* textile branch (4),
* gold (3),
* computers and discs (3),
* gasoline (3),
* alcohol and tobacco (2) and
* other (6).\(^2\)

Based upon research into the case files as well as lengthy interviews

\(^1\) Although insufficient information was available to effect a case analysis on VAT fraud with luxury automobiles, fraud in this branch has also been identified in Germany.

\(^2\) This category included single cases of fraud with antiques, expensive jewelry, household goods, carpets and generators. In case 4, the legitimate companies sold merchandise in different branches.
with investigative officers, all of these have been identified as fraud-sensitive branches.

Luxury automobiles are subject to VAT as well as to an additional luxury tax which may amount to as much as 25% to 30% of the value of the car. If a single car can be used in a carousel fraud 3 times, the illegally obtained VAT refund will pay for the actual price of the car.

Gold smuggle is a lucrative practice because gold may be purchased in some countries at 0% VAT, smuggled or simply brought into a country which charges VAT and then sold on the domestic market (without VAT and under the market price). “Smuggling”, also profitable with goods subject to high domestic and excise taxes (such as gasoline, alcohol and tobacco products), remains a problem and a type of fraud impossible to identify through the VIES system. Whereas prior to the abolition of the internal borders in January of 1993, when cars and trucks were subject to random searches, goods can now be freely transported across frontiers. Furthermore, as long as VAT rates in the E.U. remain inconsistent, “smuggling” goods across borders will remain a lucrative practice. This is particularly true in neighbouring countries with large differences in VAT rates.

Other markets sensitive to fraud are those in which goods are in high demand, in which there is high turnover, and in markets in which numerous small businesses are found (in contrast to other markets dominated by two or three major concerns) such as in the computer, video and hi-fi markets. These markets are particularly sensitive to unfair competitive practices which often force smaller businesses into bankruptcy if they are not willing to cooperate.

5.1.1 Fictitious Goods

Despite the fact that the interim regulations allow for a fraud construction to be established purely on paper, this occurred in only 2 of the cases examined. The two cases differ from one another on one very important aspect. In case 4 the fraudsters used legitimate businesses (and fictitious goods) for the purpose of perpetrating fraud. In the second case (22) businesses managed by strawmen were established for the purpose of perpetrating fraud. Both cases will be discussed below in more detail.

CASE 4 This case involves seven legitimate companies in member state

3 The names of the individuals and companies in all of the cases in this report have been changed and bear no resemblance to the original individuals or companies.
A which were approached by a fraudster, Mr. Johnson. He told the companies that he had to ship goods to companies in member state B. He could not ship the goods personally because this transaction would violate sanctioned trade agreements in this particular sector (a legitimate and legal explanation). Johnson told the businesses that he would provide them with purchase invoices and that they should prepare shipping invoices for the goods which he would ship. The companies in member state B were either non-existent or currently operating but had not filed a regular tax return or paid taxes. The legitimate companies in member state A then applied for a refund of prepaid VAT, based upon the fictitious invoices, which they paid to a second fraudster, Mr. Curtis. The companies, in turn, were paid a small fee for their “assistance”.

CASE 22: In the second quarter of 1992, Mr. Cooney, a known fraudster, with the assistance of his bookkeeper, purchased and/or established over 100 incorporated companies both in his own country as well as in the United States. The fraud began in January 1993 – with fictitious domestic purchases and fictitious ICS’s. With the help of false passports and driver’s licenses, the fraudster was able to set up bogus bank accounts and install various strawmen or use fictitious names and non-existent persons as directors in his companies. He entered numerous markets. On paper, ± 60 of Cooney’s companies made bogus purchases. Fictitious ICS’s occurred to 12 companies in 3 other E.U. member states (these companies were bankrupt or non-existent and filed no tax return). Requests for VAT refunds were made. As soon as the money appeared in the bogus accounts it was removed by one of Cooney’s assistants. If one of the businesses was audited by the tax administration, Cooney acquired bogus purchase and sales receipts, or he simply sacrificed the business.

5.2 Symbiotic or parasitic relationships?

When examining the relationship between legitimate and fraudulent businesses in VAT fraud practices, one can explore whether the relationship is parasitic or symbiotic. Parasitic frauds benefit no one except the fraudster and his operation; the victim is the tax administration. Numerous examples of parasitic practices were found in our research. One necessarily thinks of a sophisticated large scale fraud as in case 22, described in the previous section. There are, however, examples of small scale parasitic practices involving single businesses or individuals. In cases 1 and 2 the small family-
run businesses failed to report their intra-Community acquisitions (thus avoiding paying VAT upon later resale). Cases 5 and 12 involved parasitic practices by individuals.

The essence of a symbiotic fraud is that besides the perpetrator and his organization, other (legitimate) businesses benefit as well. Thus, symbiotic relationships benefit all members participating in the fraud scheme, but to varying degrees. In certain branches the market is so competitive that legitimate businesses often take advantage of the low-priced goods offered (without VAT by fraudsters). In the highly competitive market of petroleum involving large scale fraud (case 8), over 60 legitimate gas stations were knowingly involved in the purchase of the tax-free gasoline. In a large scale fraud involving computers and hardware (case 18), approximately 20% profit was made through the evasion of VAT. In a highly competitive market, it was not difficult to find stores willing to make a 5% profit on the purchase of the computers.

Even with purely fictitious goods, symbiotic relationships may be established. In cases 4 and 28, for example, legitimate companies agreed to take purchase invoices into their administration and apply for a VAT refund in exchange for a small fee per invoice. This relationship is not as profitable as in the examples given above, where businesses profited from the purchase of VAT-free goods. Both cases 4 and 28 are examples of large-scale VAT fraud in which legitimate businesses were used to assist in the perpetration of fraud. In such a construction, there is a purely criminal, fraudulent “core” operation making use of legitimate or semi-legitimate companies. Their knowledge of the fraud scheme is usually limited; in some cases the legitimate businesses are unaware of the fact that they are being used. Yet, they do so because of the small profit available to them. This is a much more limited symbiotic relationship which proves to be more of a parasitic relationship if the fraud is uncovered. It is these legitimate companies which must account for the loss to the tax administration.

Symbiotic relationships also develop between fraudsters in different countries when a foreign VAT identification number is needed to feign an export or an intra-Community supply (cases 19, 21, 22).
5.3 Primary and secondary criminal activities

VAT fraud rarely occurs as an isolated offense.\(^4\) Often times secondary offenses occur as a direct result of, or to facilitate the perpetration of VAT fraud. If false customs stamps or fictitious invoices are used the offense of forgery occurs along with VAT fraud. Bribery of customs officials was perpetrated to facilitate VAT fraud (cases 6, 16, 17, 31). Business (and income) tax is always evaded when companies sell goods “off the record”. Excise taxes are evaded when fraud is perpetrated with such goods as alcohol, cigarettes and gasoline (cases 8, 16, 11, 27).\(^5\) Other suspects/offenders were in possession of false identity documents (cases 21 and 25) which were used to open bank accounts.

In the cases in this study, other offenses were committed which were not necessarily a result of VAT fraud. Operations hired illegal workers (cases 2, 8 and 24) or paid workers a small legitimate wage on the books and cash “off the record” (cases 24 and 30) thus avoiding employee income taxes. The international concern (30) also sold half of its products off the books thus evading income and businesses taxes as well. This particular company was also previously involved in E.U. subsidy fraud, illegal contracting and money laundering.

Little is known about money laundering operations. This was not an element in some cases.\(^6\) In other fraud constructions money was not laundered but the goods were. Once the goods brought illegally into the country were laundered through the adoption of false purchase invoices into the bookkeeping, both the goods and the money were “clean”.

According to van Duyne (1993; 21), previous experience over the last ten years in smuggling drugs across European borders has proven useful to the smuggling of goods across those same borders for the purpose of avoiding VAT. Years of previous experience in the labour racketeering field also provided VAT fraudsters with the expertise in creating “smoke screens with false invoices spread over numerous front companies”. This information was verified by investigators as well as a known fraudster, Mr. Aad de Bruyn. It has been hypothesized that some of the individuals involved in professional

\(^4\) When that is the case most countries handle the offense administratively.

\(^5\) In cases involving evasion of excise taxes, the loss of VAT tax is often secondary to the excise taxes which are much higher.

\(^6\) The winnings were too small or repayment fraud was attempted but the tax authorities identified the fraud before a refund was made.
smuggling are also involved in the transportation of drugs (although there was little hard evidence in the files to substantiate this fact)\(^7\), help to evade VAT, and commit subsidies-fraud against, and evade excise duties on items to be paid to the European Union.

### 5.4 Criminal Proceeds

An issue of importance to the tax administration, investigators as well as prosecutors is the source of investment of the criminal gains. The countries in this study have laws allowing for the seizure of assets purchased with criminal profits. The problem, however, is that profits are often invested in foreign countries and the authorities are unable to trace the money-trail. This is one aspect about which little is known. Much information concerning investments of funds was provided by investigators and remains more of a supposition than actual fact. In case 8, for example, it is known that the offenders frequently patronize a particular gambling casino. It is not known whether this is done to launder the money or simply because they enjoy gambling. It is known (and can be proven with bank statements) that some of the money was sent back to the offenders’ country of origin, while other funds were used to purchase almost 200 petrol stations in the north of the country. In case 9, the three organizers of the fraud are known to fiscal investigative officers as “high rollers”. In addition to purchasing expensive cars, it is suspected that much of their earnings are spent on a daily basis to support their lifestyle of luxury. The offender in case 15 was in possession of a castle in another member state. At the time of the research fiscal authorities were trying to determine whether or not the castle had been purchased with criminal proceeds. In case 16 it is believed that one of the prime suspects has money invested in 2 banks on the Canary Islands, and that money is invested in hotels in Luxembourg, Switzerland, and the Cayman islands. The offender in case 18 purchased stocks in Canada and the offender in case 22 is believed to have invested funds in vacation homes in Spain. In case 26 the offender invested most of his winnings in property which was purchased in his wife’s name. A further source of information came from Mr. de Bruyn, who, during an interview, told the researchers that many of his former colleagues invest in property in Portugal or have international bank accounts in off-shore tax paradises such as the Cayman Islands. As most of this is

\(^7\) Van de Bunt and Nelen (1996) and van Duyne (1995) also found little overlap between the drugs and the fraud markets.
speculation, it is clear that this is an area which warrants more attention by investigative and fiscal authorities.

5.5 VAT fraud’s damage to society

Due to the large number of cases which go undiscovered, the financial casualty inflicted upon the state coffers as a result of (VAT) fraud is immeasurable. What can be determined in cases which have been identified, is the amount of money illegally refunded or the amount intentionally withheld from the tax authorities. The United Kingdom has gone one step further and has extrapolated how much financial damage would have been inflicted upon the tax administration had the fraud not been stopped. ‘Evasion prevented’ is a term which, through mathematical calculation, takes into account the amount which would have been lost had the fraud continued. It is estimated that, had the fraud not been prevented, it would have continued for three years, thus, the evasion prevented is estimated at three times the value of the actual loss.

In terms of sheer financial losses, a number of fraud operations inflicted serious financial damages on the tax authorities in the countries under investigation. It is often difficult to determine, with any accuracy, the amount of money evaded in tax fraud because often only a single branch of the operation is exposed. In case 28, for instance, the tax authorities were able to assess the amount of money refunded to 30 garages (ECU 130,000), but suspect there may be as many as 4,000 to 5,000 garages which may have participated in the fraud scheme. In case 31, VAT evaded in one scheme amounted to ECU 225,000; investigators speculate that the main suspect evaded as much as ECU 2.1 million. In case 30 investigators refused to even estimate the amount of money that had been evaded by this international concern. Information concerning financial losses to the tax authorities was not always available (cases 3, 19 and 23). In those cases in which information was available, the losses were significant (over 1 million ECU) in 14 cases. The amounts ranged from a low of ECU 1.1 million (cases 20 and 29) to highs of ECU 6.8 million (case 8), ECU 7.4 million (18), ECU 14.5 million (26) and an estimated ECU 17 million in case 13 and (estimated) ECU 44.8 million in case 16. There is no question that VAT fraud, particularly at these levels, is a serious offense.

On a more concrete level, numerous businesses in this study which fell prey
to professional VAT fraudsters were held accountable for the tax evaded by the criminals. The 7 legitimate business in case 4 were held accountable for the loss of VAT and were forced to refund the tax administration approximately ECU 676,000. One company alone must pay the tax authorities almost half the amount due. The company is threatened with financial ruin.

In cases 6 and 7, shipping companies were used to hold goods before they were to be exported (case 6) or to bring goods into the country (case 7). In case 6 the shipping company was held accountable for repayment of almost ECU 1.9 million. In case 7 the goods entered the country and, under the “transfer rule”, VAT payment was deferred until a later point in time. The compact discs disappeared on the market (VAT-free) and the shipping company was forced to reimburse the tax authorities ECU 50,000. While most shipping agents are insured, these losses ultimately increase the insurance premiums which is an added burden to the entire market. Furthermore, it threatens honest businesses and often takes advantage of business relationships built upon trust.

Direct material losses can be measured not only in terms of lost revenue to the country, but also in the damage inflicted upon particular markets. Unfair competition and trade practices, where real goods are involved in competitive markets, either force smaller companies to participate in the fraud or risk bankruptcy. Such unfair practices can literally ruin entire markets. In case 8 the gasoline bought on the black market was sold at petrol stations well below the market value forcing some legal petrol stations out of business. The same occurred in the carpet market in case 30 where smaller legitimate businesses could no longer compete with the illegal practices of an international concern.

VAT fraud threatens entire sectors and destabilizes legitimate businesses unable to compete against unfair market prices. It creates distrust in markets and can be financially devastating to shipping companies or unsuspecting and trusting participants who are ultimately held accountable for losses incurred.

While VAT and other tax frauds have generally received low priority in terms of investigative manpower and resources, it is clear that the damage it can inflict is far-reaching. Until this is recognized, VAT fraud will continue to destabilize markets, to cost tax administrations countless lost revenue and will continue to operate unimpeded.
FRAUD CONSTRUCTIONS: MODUS OPERANDI AND SAFEGUARDING THE OPERATION

This chapter will examine the modus operandi used by VAT fraudsters to perpetrate their offenses. The reader will be introduced to various classifications and VAT fraud modus operandi presented in diagram form. An in-depth case study will be presented. Additionally, the duration of the fraudulent practice will be discussed. While none of these frauds were completely successful, some were able to operate undetected for periods of over three or four years. What is the construction of such frauds and how do they differ from those which were identified and aborted within the first six months? A last consideration is that of the means that fraudsters use to shield their operation from detection.

6.1 Basic Classifications

6.1.1 Pre- and Post-Interim Regulations

There are a number of different ways of examining modus operandi. Before going into detail into some of the more elaborate fraud constructions, it may be useful to make a preliminary examination of how offenders commit fraud. In its most basic typology, modus operandi can be arranged into the following categories:

(I) frauds before 1.1.93 (both intra-Community and exports outside of the E.U.),

(II) frauds involving the interim regulations (post-1.1.93) within the E.U. Benelux frauds occurring before the implementation of the interim regulations, can be classified with the post-1.1.1993 intra-Community frauds due to the Benelux Treaty and the Transfer Regulation which allowed the delay of VAT payment when a VAT code number was used.

(III) and frauds post-1.1.93 with third countries.

(I) As mentioned in more detail in chapter 3, the transportation of goods
across borders prior to January 1993 required accompanying documents - the T2 document for intra-Community trade and the T1 document for trade with countries outside of the E.U. As shipments were subject to inspection by customs, fraudsters could either falsify customs stamps, bribe customs officials or simply take the risk that the goods would not be inspected. Examples of all three of these practices could be found in our research. In cases 6 and 16 fiscal investigative agencies were/are investigating the involvement of corrupt customs officials. Cases 12, 21 and 28 involved the use of false customs stamps. In case 10, goods (albeit not the value described on the export documents) were shipped and in case 24 an export document was falsified, but in neither case were either the goods examined or did an examination by customs officers reveal a fraudulent practice.

(II) A major change occurred with the introduction of the interim regulations. As of 1.1.93 intra-Community trade had to be transacted with VAT identification numbers which could be verified and the results traced through the VIES system. This would imply that illegal ICT practices relying upon false customs stamps or corrupt customs officials were no longer necessary and would have to come to an abrupt end on December 31, 1992.

This, in fact, happened in case 12 where the defendant used false stamps as an indication of 'export' to other European countries as well as to the United States. His illicit practice stopped in December 1992, no doubt as a direct result of the new regulations. There is no indication of fraud after that date. It must be mentioned here that this was an individual perpetrating fraud to supplement his otherwise legitimate business.

(III) The regulations governing trade with countries outside of the E.U. remained the same prior to and with the implementation of the interim regulation. These offenses usually rely heavily upon false customs stamps or corrupt officials. This, of course, is not always the case. In Case 10 the offenders utilized a legitimate shipping company and actually mailed 2,000 computer disks to a third company in a non-E.U. country. All customs papers were in order. The value claimed on the shipment did not, however, reflect the actual value of the goods. This type of fraud will remain a problem unless customs is able to verify the actual value of all goods being shipped abroad.

The limited number of large-scale intra-Community transaction frauds post

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1 The stamps are often so poorly made that in one case the name of the city was spelled incorrectly.
1.1.93 in our sample was due to a number of reasons. Sophisticated operations may run for months or years before being detected. When they are detected, oftentimes only a segment of the total fraud is exposed. In order to get a clearer picture of the entire structure (and certainly enough evidence to present in court) it is necessary to uncover the flow of goods and invoices and the involvement of both real and fictitious companies. This requires sifting through possibly thousands to tens of thousands of pieces of paper (order, purchase and sale invoices) to find duplicates, altered invoices, etc. In case 30, investigators showed the researchers the material which had been confiscated: three rooms full of files containing over 2 million pieces of information! Due to a shortage of manpower in some fiscal and investigative agencies and the time-consuming practice of extensive surveillance, some cases were still ongoing. In a number of the ICT cases (this holds true also for complex cases prior to 1.1.93) investigators told the researchers that only one segment of the fraud had been identified and disrupted but that the fraud itself, in another form, with new companies or strawmen was continuing.

6.2 Modus Operandi

In terms of the actual modus operandi in the cases examined in this research, these varied from the most basic, simplistic forms (failure to declare ICA's where no attempt was made to alter documents or cover up one's tracks, as seen in cases 1 and 2) to more complex schemes. There were cases which involved falsifying invoices (case 24) or export documents (12 and 25). Smuggling schemes, some quite sophisticated, were used to bring gold (cases 13, 20 and 26) or alcohol (cases 11 and 27) into the country. At the other end of the spectrum are the highly sophisticated frauds with numerous shell companies, strawmen, fictitious invoices (18, 19) and multiple bank accounts obtained with false drivers' licenses or passports (case 22). Below we will sketch the modus operandi of a number of such operations.

In simple terms, VAT fraud involving intra-Community transactions after January 1993 can be differentiated into the non-declaration of intra-Community acquisitions and fictitious intra-Community supplies. This applies to both actual and fictitious goods. The basic principles of VAT fraud using the transitional regulations are therefore quite elementary and will be advanced in this chapter. In addition to these basic schemes, the term carousel-fraud will be used for those instances in which the goods, through a system of shell companies and fictitious exports, are brought back into the country from
which they came. Based upon the cases examined by the researchers, fraud patterns will be described and presented to the reader in diagram form in sections 6.2.1-6.2.4. These constructions are quite basic but they can often take on different and more complex forms. This ploy is used by fraudsters for the purpose of making law enforcement investigation more difficult. In order to understand the accompanying diagrams, the reader must be able to recognize the following abbreviations:

NVR: (No VAT Return) a company that files no VAT return because it is defunct or a legitimate company whose VAT identification number is being used without knowledge or permission.

Shell company: a company that only exists on paper. Usually the address is nothing more than a post office box. The director is a non-existing person or a strawman, someone who is paid for the use of his name and signature, but has nothing more to do with the company. This company probably has a VAT identification number.

ICS: intra-Community supply
ICA: intra-Community acquisition
ICT: intra-Community transaction

6.2.1 Non-declaration of intra-community acquisitions

Scheme II provides the basic principle in the non-declaration of ICA’s. Company X1 purchases goods from Y1. X1 may personally pick up the goods from Y1 and pays cash for them. Y1 reports the ICS on its quarterly ICT-listing; X1 does not declare the ICA on its regular tax return. While an ICT mismatch will occur in country X, a number of months will have passed. In the interim, company X has made a quick profit. Investigation may reveal a strawman as director; in more complex fraud schemes the organization remains, for the most part, out of reach.
In cases 1 and 2 both companies in member state X purchased cloth from the same legitimate company in member state Y. The offending businesses were identified because both failed to report the acquisitions on their regular tax returns while the supplies were reported by the business (on a Benelux 50 form) in the other member state. The offenders in cases 1 and 2 did nothing, however, to try to conceal the fraudulent practice.

Y1 is not involved in the fraud. Because control of the ICT’s will result in a mismatch, company X1 can also purchase the goods using the name and the VAT registration number of another company in country X to hinder the investigation. If X1 doesn’t record the transaction at all it is "obliged" to sell these goods without paying company tax or income tax on the profit it makes. Alternatively, X1 can pretend to have purchased these goods domestically (case 14) by taking false purchase invoices into his administration.

**CASE 14:** Mr. Page (X1) purchased computer parts from domestic companies as well as from foreign companies in 4 other E.U. member states. Some of the goods which were received (ICA) were recorded in his books legally and other purchases were attributed to two domestic shell companies which Page established himself for the sole purpose of producing fictitious sales invoices. He had his shell company invoice the goods to his "legitimate" company. He then filed for a refund of his alleged prepaid VAT. Suspicion initially pointed to the shell companies, not to Page’s legitimate enterprise. This practice occurred for two years until the filing of Page’s tax returns became so irregular that the tax administration decided to conduct an audit. The bogus companies were eventually traced back to him. The VIES system was then used to verify the supply of goods to his bogus companies.

If, under the scheme diagrammed in II, Y1 reports the ICS but X1 does not report an acquisition, a mismatch will occur. However, if both X1 and Y1 do not report this ICT, no mismatch will occur. In essence, this is pure domestic fraud and does not make use of the regulations which apply to intra-Community transactions. In this situation the goods are simply smuggled across the border for the purpose of evading taxes. This type of situation could easily occur where the VAT rates between countries differ. Illegal trade in goods as a result of not reporting ICT’s between businesses in country A (15% VAT rate) and country B (25% VAT rate) could produce a considerable profit for businesses in both countries. An entrepreneur in country B pays the company in country A the price of the goods plus the VAT paid by the company when
the goods were originally purchased. The company in member state B does not claim the ICA, thus it pays no VAT to its tax authorities. The two companies split the profit. Similar situations involving the smuggling of gold, did, in fact, occur. Cases 13, 20 and 26 involved the legal purchase of gold in countries such as Luxembourg, Belgium or Germany with 0% to 1% VAT. The gold was then smuggled back into the countries which charge VAT and resold VAT-free on the domestic market. Smuggling alcohol, tobacco products and petrol for the purpose of evading both VAT and excise tax is also lucrative (see cases 8, 11, 16 and 27). The abolition of the inner-border controls has certainly facilitated this type of situation, although countries like France and Italy use ‘flying brigades’ that stop vehicles for ‘spontaneous checks’. The chance of being stopped and checked, of course, is relatively low.

Another offense is also being committed here. Any time goods are brought into the country and a company does not file a regular tax return on its ICA, the company avoids paying VAT on the goods. As a result of the goods being sold illegally in the country, the company may also avoid paying a company tax or income tax on the income generated by the sale of these goods. Thus, the company avoids both VAT and company taxes.

A variation on this theme is presented in scheme III. On paper X1, a shell company, is involved in business transactions with a legitimate business, Y1. In reality business is being transacted between X10 and Y1. The goods are being delivered to X10 and the invoices are sent to X1. X10 keeps the books in order by making it appear as if the goods were purchased domestically from company X5 (a shell company, as well). While an ICT mismatch will occur in country X, this will point to company X1. Because there is no evidence linking X1 to any of the other companies the initial trail runs cold. If, after some time, the fraudulent practice by X5 (not having paid VAT) is discovered, X10 can continue to maintain that he legitimately purchased the goods from X5 but that X5 must have kept the transactions out of the books. Because there is no administrative link between X1 and X5 it is difficult for the tax authorities to get a picture of the whole organization. X1 and X5 are the actual fraudulent businesses but exist usually only on paper. To prevent any link being drawn between X10 and Y1, payment is made through an exchange broker via certified bank cheques so that the payment can not be traced back to X10.

This scheme is an abridged and simplified diagram of case 18 which will be discussed (and diagrammed) in more detail in section 6.3 of this chapter.
6.2.2 *Fictitious intra-Community supply, real goods*

Scheme IV portrays the basic form of fictitious ICS. The goods are purchased domestically with VAT. The fictitious supply from one company (X2) to another company (Y1) in another E.U. country (Y) is dealt with administratively in the books and inconsistencies are covered up through the use of fictitious sales invoices. The so-called ‘payment’ can be made to oneself (X2) with guaranteed bank cheques. Y1 (who may or may not be an accomplice in the fraud organization) does not report this ICA so that at some point in time a mismatch will occur between the quarterly ICS-listings (reported by X2) and the regular tax return submitted by Y1. Based upon X2’s ICS declaration, Y1 will be questioned. When the authorities turn up nothing here, they must turn the investigation over to country X, where X2 must be investigated. This process can easily take up to six months or longer. Company X2 remains adamant that it delivered the goods to Y1 which must have kept the acquisition out of the books. X2 may even produce a transport document. In an ideal situation X2 may be uncovered, but this is no guarantee that the organization has been exposed.

On paper it involves an ICS from X2 to Y1, but in reality the goods are sold VAT-free domestically (or in another member state). X2 is the fraudulent company. X1 and Y1 may or may not be involved.
SCHEME IV: FICTITIOUS ICS WITH REAL GOODS

Before 1.1.1993 the goods had to be either physically transported across the border and then smuggled back into Country X to be sold there or one could feign an intra-Community supply and hope that customs would not perform a physical inspection of the vehicle.

CASE 19: Mr. Maxwell (X2) legitimately purchased textile goods and sundry items in member state X (from X1 and was thus entitled to a VAT refund) and supplied them to shell companies (Y1, Y2, Z1, Z2) in two other member states. Because the alleged ICS's are zero-rated, Maxwell could apply for a refund of VAT. The goods were never ICS’ed but were sold on the domestic black market. The shell companies in member state Y are owned by fraudster colleagues who are part of a network of contacts Maxwell built up over the years.

In a variation of scheme IV, company Y1 in another E.U. country is now an accomplice involved in the fraud construction and does file a regular tax return on its ICA but does not resell the goods so no VAT is paid. Y1 assumes the tax authorities will not immediately notice or may entirely overlook the inconsistency. In order to complicate matters, Y1 may file quarterly declarations on ICS’s and declare these ‘sales’ on its regular tax return as though it had sold the goods to a company in a third E.U. country. Under this circumstance the fraudulent practice would take even longer to come to light and the investigation and prosecution would become even more difficult.

In this particular scheme, if X2 purchases goods domestically and then supplies them (ICS), he is entitled to a VAT refund. If the goods are purchased from other E.U. or foreign countries (as was the situation in
case 3, below), X2 is not entitled to a VAT refund, but must pay VAT when the goods are sold on the domestic market. If, as in case 3, X2 feigns an ICS, then no VAT is owed the tax authorities.

**CASE 3:** X2 purchased household goods from companies in other E.U. member states as well as from countries outside of the E.U. One of the two principal fraudsters, Mr. Thornton, established a company (Y1) in another member state and began to falsify ICS’s to this company. As this transaction is zero-rated, Thornton owed no tax on the sale. He reported his ICS on the regular tax return as well as on his quarterly ICS listing. His company in another member state (not one in this study) reported the ICA’s, thus there is no mismatch. The goods, in fact, never left the country but were subsequently sold on the black market without VAT.

The fraud portrayed in diagram V is, in principle, described in the above portrayed schemes. Company Y2 purchases goods (with VAT) from a domestic company Y1. An ICS occurs to a shell company X1. Based upon this transaction Y2 requests a refund of his prepaid VAT.

X1 fictitiously supplies the goods to a shell company in another member state (Y3), thus no tax is owed the authorities. Instead of the fictitious trans-
action between X1 and Y3, the goods are sold to X2.

Here, too, the problem for the investigative authorities lies in determining which business is responsible for paying VAT taxes. Further problematic is the fact that often only the last link in the chain is investigated, thus leaving the rest of the operation unexposed.

6.2.3 Fictitious intra-community supply, fictitious goods

Scheme VI portrays a fictitious transaction of goods which results in the refund of alleged pre-paid VAT. Company X5 fictitiously purchases goods within its own country from X1. It then feigns an ICS of the goods to company Y1 in E.U. country Y. This ICT is handled administratively through the use of fictitious sales invoices and cash payment by the foreign receiver. This results in X5 requesting reimbursement of prepaid VAT on its fictitious purchase; at the same time it does not have to pay VAT on the ICS. In order to hinder investigation of the operation a number of fictitious companies and transactions can be situated between X1 and X5.

As a result of the abolition of customs control at the internal borders the perpetration of fictitious ICS fraud has become easier. The control of ICT's between these X companies and company Y, however, will result in a mismatch. Eventually X1 and X5 will be exposed by the tax authorities, however the organization has, by no means, been harmed. This operation involves numerous non-existent ('shell') companies with fictitious persons or strawmen as directors. Those businesses identified by tax or law enforcement authorities are simply replaced by other shell companies.

This scheme involves transactions on paper with false invoices. The 'profit' is made by company X5 which requests and receives a refund of the so-called 'pre-paid' VAT on the transaction with X1 (this, of course, is a ficti-
titious transaction). At the same time X1 does not file a tax return (and therefore pays no VAT) on the same transaction. X1 and X5 are part of the fraud organization. X5 fabricates an ICS to a company (Y1) in another member state.

This model exemplifies case 22 (mentioned in greater detail in chapter 5. On paper, Mr. Cooney (X5) purchased goods from non-existent companies (X1, X2, X3, etc.). He falsified ICS’s to shell companies in four other member states (Y1, Z1, etc.). On the basis of his false purchases from approximately 40 shell companies (or legitimate businesses which were established or purchased by Cooney for the purpose of producing false sales invoices), Cooney filed for a refund of his alleged prepaid VAT. Refund requests were kept small and shell companies were rotated to avoid arousing suspicion.

6.2.4 Fraud Carousels

A carousel-fraud involves the flow of goods and invoices between two (or more) countries creating the illusion that the goods are being supplied to a country and then brought back into the country from which they originally came. The carousel may turn numerous times. Bogus companies are created to produce false domestic sales invoices so that VAT can be reclaimed. Oftentimes the goods never leave the country of origin: the carousel is created in the paperwork. The carousel-fraud portrayed in diagram VII is based on the failure to file a regular tax return on the ICA’s and thus, upon resale, non-payment of VAT. Company X2 purchases goods (from X1) and delivers them (VAT-free) to company Y1 in another E.U. country. X2 then requests a VAT refund. Y1 delivers domestically to Y2 but, not having filed a tax return on its ICA, does not pay the required VAT. Y2 in turn sells (ICS’s) the goods to X3 (a shell company). Y2 does not have to pay VAT on this transaction with X3, whereas it claims a VAT refund on the transaction with Y1. The companies (Y1 and X3), which in fact are committing VAT fraud, will eventually (after a few months) be identified through the control of ICT’s. Upon discovery, their limited liability as shell companies with a strawman as director allows them to be easily sacrificed. New companies are introduced and the operation continues. X3 may begin the entire process again with fictitious intra-Community supplies to other companies in member state Y.

Profit: VAT repayment twice (Y2 and X4), while no VAT has ever been paid (Y1 and X3).
Since 1.1.93 the actual transportation of goods is no longer necessary. The goods may be brought directly from X1 to X4 and the invoices will indicate intra-Community supplies back and forth between member states X and Y. It is even possible to construct a carousel-fraud with fictitious goods.

X2, X3, X4, Y1 and Y2 are part of the fraudulent organization. X3 and Y1 are committing the actual fraud: they make no VAT payments to the tax authorities on the “sales”. If they are investigated and the fraud is discovered, they simply desist their operation and are replaced by new bogus enterprises. A number of buffer companies can be established between Y1 and Y2 as well as between X3 and X4 in order to make the exposure of the organization more difficult. As seen in the diagram in scheme VII, the profit results in two VAT repayments and in two cases in which VAT was due but was never paid. This scheme can be multiplied numerous times using different companies allowing for two or three (or possibly more) turns of the carousel. The loss to the fiscal authorities in such carousels can be enormous.
CASE 23: This is a simplified model of the fraud carousel between two member states which was initiated at the beginning of 1993 and which is still in progress. Three previous VAT offenders approached a number of legitimate companies as well as individuals managing shell companies. The companies were asked to take false purchase and sales invoices into their books. They were then asked to make fictitious supplies to shell companies in member state Y. These shell companies then sold the goods domestically to other companies (providing for a VAT refund). The goods were then sold back to shell companies in member state X.

6.3 A Case Study

In sections 6.2.1 through 6.2.4 the reader was introduced to a number of theoretical fraud constructions based upon actual cases examined in our preliminary research. In this section we will present, in-depth, a case study of a complex fraud construction involving numerous real businesses and shell companies involving more than three member states. This case was selected for presentation because of the immense detail available concerning the offenders, the number of companies involved, the flow of invoices and goods, and the time period in which certain companies were involved. Another interesting aspect of this case was the method of payment used to transfer funds from the illegal to the legitimate companies as well as knowledge concerning the investment of illegal funds.

CASE 18: Mr. Thomson began a legitimate business in 1982. Within a few years he began experiencing financial difficulties. In mid-1992 he met and was aided by an experienced fraudster who introduced Thomson to the world of VAT fraud. This case involved a highly sophisticated VAT fraud with computer parts. Thomson’s business, Compusell, purchased computer parts from a number of legitimate companies (in a number of E.U. countries and one non-E.U. country). Sales invoices, however, were made out to various shell companies in A-land. Some of the bogus companies were established to “receive” the sales invoices from the legitimate companies, while others were created to produce bogus sales invoices (with VAT) to Compusell so that VAT refunds could be requested and the goods would enter the market legitimately. There is no link between the 5 shell companies which allegedly purchased the goods and the 4 shell companies which produced sales invoices to Compusell. The fraud can be viewed as occurring in three different phases. On paper (in phases II and III) the
computers were rerouted from one country to another to help obscure the actual flow of goods. Each phase will be described separately as each encompasses not only various shell companies in different countries, but also different methods of payment.

**Phase I:** Four legitimate companies, LC1, LC2, LC3 and LC4 (located in two different member states and one non-E.U. foreign country), as well as other smaller suppliers provided computers and parts which, unbeknown to them, went directly to Compusell in A-land (or, on occasion, went directly to the wholesale purchasers). The invoices, however, were made out to 5 different shell companies (1 through 5)\(^2\) in A-land, managed by strawmen, to obscure the flow of goods. The shell companies were only used for short periods of time to avoid being identified. Approximate dates of the invoices to particular shell companies are provided on the scheme. The 'invoice trail' ends with the five shell companies. In order to bring the goods 'legally' onto the market, other bogus companies (6 through 9) were created in the same member state for the purpose of producing sales invoices with VAT. Behind companies 6 and 7 were the well known fraudsters who initially approached Thomson. Based upon fictitious pur-

\(^2\) Companies 2 and 3 were managed by the same strawman.
chase invoices (with VAT), Compusell requested repayment of VAT. It then sold these computers to 2 large companies (A and B) and to individual customers in A-land. In order to cover the trail and to prevent arousing suspicion of the legitimate suppliers, payment was made via an exchange bureau (or via one of the shell companies) through a false account set up to prevent identification of Compusell as the recipient of the goods. This scheme involved shipments of goods between June and December 1992.

Phase II: This phase becomes notably more organized and sophisticated. Instead of shell companies in A-land, shell companies were established in B-land (an E.U. member state, but not one of the four countries in this study) as the alleged recipients of the goods. This further complicates the investigation into fraudulent practices. In addition to payment via the exchange bureau, bank cheques are used. As no name appears on these bank
Two distinct routes are identifiable in phase II. Three of the previous suppliers (LC1, LC2, LC3) and other new suppliers were involved in this phase. This time the goods were again sent directly to Compusell or to the actual wholesale purchasers (A, B, and C) but were invoiced to two shell companies (10 and 11) in B-land. From there the paper trail disappears. In A-land sales invoices (with VAT) were produced by two other NVR companies (12 and 13) to Compusell to cover the goods. Compusell’s books were in order; Thomson requested a refund of his alleged prepaid VAT and the computers were sold and invoiced to the three wholesale computer companies A, B, and C, who were involved in the fraud construction, and to others who were not involved. On this transaction Compusell paid VAT. These two schemes occur from January to September of 1993.

Phase III: While Compusell discontinued operations as a result of an in-
vestigation by the fiscal authorities, Thomson continued with VAT fraud by invoicing computers from his own personal computer at home. He established another company (Computersoftware, in B-land) and a strawman was assigned to “manage” the operation. The goods were purchased from domestic, E.U. as well as foreign companies and were invoiced to Computersoftware in B-land. They were subsequently invoiced to company Computerama in C-land. Both of these are shell companies. At this point the paper (invoice) trail ends. The goods were brought directly to storage areas in member state A. The computers and parts were then provided directly to different wholesale companies, two of which (A and C) were involved in phase II, and one, D, which is a new company, but, in fact, is a continuation of Compusell. Company Buy-Sell Computers was established to produce sales invoices with VAT to the wholesale computer companies. In order to justify a legitimate sale, purchase invoices had to be adopted into Buy-Sell Computers’ books. Therefore, four shell companies (14-17) were used to produce fictitious sales invoices to each other and then to Buy-Sell Computers. If one traces the paper trail of the computers back to their original point of sale, the following scheme appears: Shell companies were used to provide invoices (with VAT) to company Buy-Sell Computers (controlled by Thomson). Buy-Sell Computers invoiced to the 5 purchasers (A through E) with VAT, which Thomson paid so that his books were in order. Payment was made via the exchange bureau to Computerama in C-land which then paid Computersoftware in B-land, which in turn paid the original legitimate suppliers of the goods.

6.4 Duration of the Fraud

The length of time a fraud construction operates may be closely linked with the *modus operandi*. In other words, one can examine whether fraud constructions designed to seek small refunds over a long period of time are more successful than “the big sting”. In order to answer this question the operations were divided (beginning with the first false tax application or invoice to the time at which the fraud was identified and/or an arrest occurred) into the following categories: less than 6 months (5 cases), 6 months to one year (2), one to two years (8), and more than 2 years (9).³

³ Some cases are difficult to categorize. While the illegal trade in cars (case 9) with different companies has been occurring from 1985 to the present, one specific branch operated for 5 years, another for only 15 months. Other investigations were still in progress.
Of particular interest are those short-term and extremely long-term cases. Do the cases which operated for less than six months differ significantly in *modus operandi* than long-term cases? In cases 10 and 25 the fraudster(s) requested excessively high refunds on a single transaction ("the big sting").\(^4\) In another case (11), the fraud may have been successful for a longer period of time had an anonymous complaint not been made to the tax authorities. In case 7 the transfer rule was utilized to defer payment on goods brought into the country. The fraud was only designed to operate for a limited period of time as the fraudsters used the VAT identification number of a legitimate business and it was inevitable that within a short period of time the owner of the legitimate business would object to the practice (and refuse to cooperate).

What accounts for the success of the fraud constructions which operate for a much longer period of time? Of the total number of cases which continued for a period of more than 2 years, 3 of them (cases 12, 13 and 19) operated for more than four years. Case 12 involved fictitious exports through the use of false customs stamps by one individual. The refund requested was so small that the individual aroused no suspicion whatsoever. His fraud came to light 2 years after he had stopped as a result of a routine investigation into stolen property. In case 13 the success may be attributed to the high degree of organization and sophistication of the operation: a fleet of identical cars with identical license plates smuggled gold, which was professionally welded into the body of the car, into the country. Case 19 has been in operation since 1988 when the fraudster set up his business and falsified exports to colleague fraudsters in two other E.U. member states. The success of this fraud can be attributed to its sheer size and degree of organization.

Case 30 is unique to this study. It involves a huge international business which is predominantly legitimate. Its criminal history, however, includes abuse of E.U. subsidies, hiring illegal workers or paying half of workers’ salaries “off the books” and perpetration of large-scale VAT fraud in at least two E.U. countries. The investigation in one member state resulted in an administrative settlement; the second investigation is still in progress. The relative success of this fraud is attributable not only to the sheer size of the business but also to the legitimacy of its reputation.

\(^4\) In case 10 it was the fraudsters’ only business transaction.

and could not be categorized, or investigators were unsure of when the initial fraud had begun.
The length of time that a fraud continues to operate may not necessarily be due to the degree of organization or sophistication of the operation. The fraudster's success in case 12 can be attributed to the small refund requests. Other factors also influence the length and success of an investigation. Certain types of frauds are given higher or lower priorities. Failure to pay tax due generally receives lower priority from investigating authorities than repayment frauds. The fact that certain types of frauds occur repeatedly in certain countries may be due also to the fact that investigators have become adept at identifying and investigating those types of frauds. A shortage of manpower, a problem in all countries, will also affect the length of investigations and the success in bringing a case to closure.

6.5 Safeguarding the operation

Safeguarding the operation against exposure by the tax authorities involves everything from aggressive means such as the use of threats or violence, to more non-violent defensive and offensive means, such as corruption.

The use of, or threats to use physical violence was present in only 3 of the cases in our study. In case 8, illegal workers were intimidated, and violence and threats were utilized as a means to ensure their cooperation. On rare occasions strawmen in case 31 were threatened to assure that they did not cooperate with investigating authorities. In case 28, the individuals responsible for organizing the fraud threatened garage owners if they cooperated with authorities in the investigation. Other non-violent protective measures were also taken in case 28 to avoid detection by the tax authorities.

CASE 28: A highly organized carousel with luxury cars began in April 1993. A number of fraudsters approached legitimate and well known garages around the country with the following story. The individual (fraudster) wanted to buy a luxury car and already had a purchaser for the car in a foreign (non-E.U.) country. Because he had problems pre-paying the VAT on the car (which he would later have refunded upon export) he requested that the garage assist in the process. The individuals offered the

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5 In case 8 the family threatened employees with violence, however not while perpetrating VAT fraud. They were, however, employing the workers illegally and evading social security and employee taxes and the threats were used to support and cover up these frauds.
garages the invoices (including the VAT) for the cars. When the individu-
als returned to the garage two or three days later with the export docu-
ments properly stamped and cleared through customs, the garage refunded
the individuals the VAT, and the garages, in turn, submitted the invoices
and were reimbursed VAT by the tax administration. The garages were
paid a small fee ECU 1300 to ECU 2600 for their service. The criminal
organization absconded with the VAT.
Certain cars were used every two or three days and information pertaining
to these cars could be found in the books of more than 15 different ga-
rages. As a means of safeguarding the operation, a garage was used only
a few times before the fraudsters changed companies. Garage owners
were later threatened with physical violence if they cooperated with the
tax authorities. After being used in the carousel a limited number of times,
a car was then sold on the domestic market. Over 30 legitimate garages
were involved at the point of the initial investigation. On average, each of
the 30 garages involved evaded approximately ECU 132,000. Investigat-
tors believe that the garages were initially unaware of the illegal practices.
An investigation, which began in November 1993, is continuing into other
garages which may have been involved. It is estimated that fraud has been
perpetrated in excess of ECU 3.95 million.

Bribery of officials and corruption were also utilized in cases 6, 16, 17 and
31. It is not, however, clear at this point whether the bribery is solely a means
of perpetrating the fraud or whether it is also a means of safeguarding the
operation.

Use of limited and incorporated companies and strawmen is another means
of safeguarding the operation. Once the initial fraud construction is designed
(fictitious ICS’s or exports to companies in third countries) it is necessary to
have a number of shell companies which can be utilized in the construction.
If one company is discovered by the authorities (for failure to file a tax return
or pay taxes), the entire operation is not exposed. This one company can be
sacrificed and others used in its place. The use of numerous shell companies
was a means of protection in cases 4, 6, 8, 9, 16, 18, 19, 22, 23, 26 and 29.
Case 22 is a model case with approximately 60 shell companies in use at the
time that the operation was exposed (40 more were available but had never
been used), both domestic and abroad (non-E.U.), for the purpose of per-

6 In a number of the fraud constructions in this research, incorporated companies in the
U.S. were established for the purpose of falsifying an export or receiving fictitious goods.
Time magazine publishes advertisements for U.S. corporations and limited liability
petrating fraud and safeguarding the operation. This case also involved the use of numerous bank accounts so that if one were identified and the account frozen, only small financial losses would be incurred by the fraudsters. In case 18, the owner of the computer company perpetrating fraud utilized an exchange bureau with a false account and later bank cheques to pay the legitimate supplier of goods. In this manner, the legitimate suppliers were unaware of the fact that they were invoicing sales to certain companies but that the goods were actually being sent to another one.

Other fraud operations utilized legitimate businesses to safeguard their own illegitimate practice. In case 29, the fraudsters utilized legitimate garages to process their purchase and sale invoices. The garages were fairly large and for the most part legitimate. It was the legitimate reputation of these garages which prevented the arousal of the tax authorities’ suspicions.

Another means of protecting the operation (as well as facilitating in the perpetration of fraud) is the possession of false passports and other identification (driver’s license). Offenders in two cases were in possession of false documents (cases 22 and 25).\(^7\)

Other, more simple means were used to protect the operation in cases 5 and 22. The suspect told the tax authorities who had come to perform an audit of the books, that the bookkeeping had been stolen (case 20) or that the bookkeeping was at an arbitration company in another member state and had not yet been returned (case 5). In fact, the books simply vanished.

Among those studied, the classic case (13) involved a sophisticated operation to “protect” cars smuggling gold from Luxembourg to another E.U. member state. The defendant, Mr. Dillon, previously convicted for VAT fraud and the prime suspect in this case, had his name legally changed and operated under a number of aliases. For the purpose of smuggling gold, a fleet of cars was purchased – the same make, model and colour. False license plates with the same numbers were (illegally) made so that the cars were virtually identical. One car was left in a parking lot in a city in another country. An identical car was picked up from the same parking lot and driven to Luxembourg where gold purchased with 0% VAT was welded into the body of the car. The car laden with gold was brought back to the country where the gold was sold without VAT. Vari-

\(^7\) It is possible that offenders in other cases were in possession of false documents, however this information was not available in the files.
ous assistants and couriers accompanied Dillon on these purchasing trips. He never rode in the car once it contained the gold but had a courier drive the car back to the country. The courier who was finally stopped, claimed she knew nothing about the contents of the car. All she was told was that she was not smuggling drugs into the country. The welding job was so professionally done, that it took a trained mechanic from the fiscal investigation division six hours to find the gold in the car. The operation continued for a period of 4 years until it was finally terminated, resulting in arrests and relatively long prison sentences for most of the seven involved. While vehicles were needed to transport the gold, it was not necessary to have a fleet of identical cars and license plates. Nor was it necessary to change drivers and assistants as frequently as was done. These actions were viewed as elements of safeguarding the operation rather than the actual *modus operandi*.

In conclusion, it appears that two types of frauds tend to be more successful: those in which the profit is so small that the refund requests arouse no suspicion, and the highly sophisticated operations. In general, it appears that the more safeguards employed to protect the enterprise, the more complex the schemes, particularly those involving numerous shell companies, the more likely an operation is to avoid detection and function successfully for a longer period of time. This is undoubtedly so when compared to operations in which an attempt was made to secure a large repayment from the tax authorities (the “big sting”). Such highly organized constructions tend to operate for years before they are either partially or wholly exposed. Even partial exposure may do little damage to the operation, particularly if other shell companies can replace those identified by the authorities.

### 6.6 Conclusions

Data gleaned from this research suggest that large-scale fraud operations by experienced fraudsters with extensive networks were not (and will not be) hindered by changes in the E.U. regulations. Fraudsters simply reorganized and found new ways to commit fraud. As case 18 exemplified, VAT frauds can be incredibly complex. Investigators in case 22 presented the researchers with 3 different diagrams of the fraud. The diagrams radically changed as new shell companies were introduced into the fraud and the purchase and sale patterns between companies was altered. Months, if not years, are nec-
ecessary to fully expose such a fraud and bring those involved to justice. Successful investigation and prosecution demands a high degree of patience and expertise.

When the researchers presented some of the preliminary findings to Mr. de Bruyn, director of the Foundation for the Prevention of Economic Criminality, they were told that the _modus operandi_ identified in the cases in this study were passé and that VAT fraudsters have created new methods to perpetrate fraud. What appears to be currently in vogue is the use of legitimate businesses to obtain an advanced VAT refund. The fraudsters supply the legitimate companies with (fictitious) invoices including VAT. The companies then provide intra-Community supplies and receive a VAT refund from the tax administration which they pay to the fraudsters. For their services the legitimate businesses are paid a small sum.

This was the method used by the fraudsters in cases 4 and 28. These two frauds occurred in two different countries. If, in fact, VAT fraudsters are altering their _modus operandi_, it is even more essential that investigators share information with other agencies to alert neighbouring member states to new patterns of fraud. It is inevitable that, within time, these fraud patterns will traverse the borders.

It is essential not only to have an understanding of the methods used by fraudsters, but also of the individuals behind the operation, their criminal backgrounds and contacts. The following chapter will address these topics.
VAT FRAUD PERPETRATORS

This chapter will examine the offender population in terms of demographic variables and criminal antecedents. This is followed by a discussion of the nature of the organization and of the offenders involved. The reader is presented with an analysis of offenders as it parallels the businesses in which they are involved. An attempt will be made to answer the question of whether we are dealing with relatively legitimate businesses which dabble in illegitimate practices, or whether those involved are purely fraudulent businesses.

7.1 Offenders: demographic variables and antecedents

This section introduces the reader to basic demographic variables and judicial antecedents of the offender population. The question of whether one can identify “a typical VAT fraud offender” may depend upon whether one considers only the inner circle or a wider range of players. Participation can be divided into three levels. Inner circle participants are those responsible for designing and organizing the fraud as well as their immediate assistants. Their names may not necessarily appear on documents, but these are the actual “brains” behind the operation. Then there are those belonging to the outer circle. They fulfil different functions and their degree of participation varies. These are the strawmen, ad hoc participants, or more peripherally, accountants or lawyers who are instrumental in facilitating the fraud. Their role is more limited but their assistance is valuable in carrying out the fraud. The value is inherent in the function, not in the individual. They are generally aware of the fraudulent practice. On the outer perimeters are the facilitators. These may take the form of businesses which purchase VAT-free goods or may aid the fraudulent practice by including invoices in their bookkeeping (for example the 7 companies in case 4). Frequently those in the outer circles

1 Judicial antecedents comprise the following data: police antecedents (arrests), as well as judicial antecedents which include convictions as a result of a court trial or cases which were handled by compounding or transaction. If cases were dismissed as a result of a management decision, the case was included in the data. Technical dismissals (due to lack of evidence) or acquittals were not included. Information was not always available concerning dismissals or acquittals.
and the facilitators are not known to fiscal or law enforcement officials. In case 28 highly respectable garages were taking (false) invoices into their books and applying for a refund of VAT upon export. Other than their involvement in this offense, these garages were believed to be completely reputable.

If one considers the key figures instrumental in establishing and carrying out the fraud constructions, 74 persons were identified as main suspects – those identified as such in the police investigation and based upon their essential role in a case. Information was requested from the judicial documentation register in the Netherlands and investigation agencies in the other countries. Detailed information on the total number of antecedents, the nature and length of sentences was only available for the Netherlands. Information, on a more general level, was obtained from the U.K. and Belgium. Because of privacy laws concerning tax files in Germany, data on offenders were not available.

No data were available on 8 of the 74 persons. With the exception of three females (two of which were involved in one fraud construction), all of the fraudsters were males. Of the 62 fraudsters for whom information was available concerning age, the majority (25 offenders) were between the ages of 40 and 49, followed by the 30 to 39 year age group (15 offenders). Notable is the fact that over two thirds of the population are between the ages of 35 and 55 years old. Unlike crimes of violence, VAT fraud seems to attract an older population. A possible explanation for this is that it simply takes time to learn the tricks of the trade. A more detailed distribution is provided in table 2.

Table 2.

<table>
<thead>
<tr>
<th>Age of principal offenders</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>25-29 years</td>
<td>8</td>
</tr>
<tr>
<td>30-34 years</td>
<td>6</td>
</tr>
<tr>
<td>35-39 years</td>
<td>9</td>
</tr>
<tr>
<td>40-44 years</td>
<td>14</td>
</tr>
<tr>
<td>45-49 years</td>
<td>11</td>
</tr>
<tr>
<td>50-54 years</td>
<td>8</td>
</tr>
<tr>
<td>55-59 years</td>
<td>3</td>
</tr>
<tr>
<td>60-64 years</td>
<td>2</td>
</tr>
<tr>
<td>65-69 years</td>
<td>-</td>
</tr>
<tr>
<td>70-74 years</td>
<td>1</td>
</tr>
</tbody>
</table>

2 It is suspected that top management was completely unaware of this practice and that the action was approved by middle management.
Fraudsters involved in eleven cases were members of an ethnic minority (non-European origin). In two large fraud cases and in one smaller case, ethnic minority family groups were involved. One case concerned a clan of gypsies and the other a large and extended Pakistani family.

In terms of age, gender and ethnic background, the “typical” VAT fraudster is a middle-aged man of predominantly indigenous background.

The offender population in this research was actively involved in various criminal activities. The number as well as the nature of judicial antecedents provides information about the fraudster population. In table 3, information is provided on the judicial antecedents of the principal fraudsters in this study. Of the 66 persons on which background information was available, 30 had one or more criminal antecedents, 36 of them had no criminal record and on eight suspects no information was available.

Table 3. Number of offenders with criminal antecedents

<table>
<thead>
<tr>
<th>Offenders</th>
<th>Property</th>
<th>Violence</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>*</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>*</td>
<td>*</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td></td>
<td>*</td>
<td></td>
</tr>
<tr>
<td>Total: 30</td>
<td>26</td>
<td>8</td>
<td>2</td>
</tr>
</tbody>
</table>

Twenty-six suspects had antecedents for property offenses, to include various types of fraud, theft, receiving stolen property, forgery and theft by deceit. Eight suspects had previous antecedents for acts of violence and two for other offenses. The violent offenses included assault, violent theft, and destruction of property. Despite a willingness to use violence, this was not a means frequently used by the fraudsters during the perpetration of VAT fraud. It appeared in isolated cases, as in case 28, when violence in the form of intimidation was used to force the legitimate garages involved in the scheme to remain silent about the fraud. Within the organization, VAT fraudsters never used violence to sanction disobedient assistants.

Drug offenses were not found in the antecedents, however, investigators involved in case 8 strongly suspect the family to be implicated in the

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3 Both suspects were charged with forcing women into prostitution.
4 One person in the outer circle had antecedents for drug offenses.
drugs trade in their home country. These data underline the rather strict borders between the drugs and fraud scene described by Van der Bunt and Nelen (1996) and Mr. A. de Bruin.\(^5\)

Of the total number of offenders on which data were available, 22 suspects\(^6\) had previous judicial antecedents for fraudulent activities. Table 4 shows the number of offenders with prior convictions per fraud offense. Eight of the 22 suspects had two or three previous convictions for fraudulent activities, establishing the total number of fraud antecedents at 31.

Table 4. Number of offenders with fraud antecedents

<table>
<thead>
<tr>
<th>Number of offenders</th>
<th>General Fraud</th>
<th>Tax fraud</th>
<th>VAT fraud</th>
<th>Excise fraud</th>
<th>Forgery</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>*</td>
<td></td>
<td></td>
<td>*</td>
<td></td>
</tr>
<tr>
<td>1</td>
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Notable is that almost all of the antecedents for property offenses are for fraud offenses. Taking into account the population of fraudsters with previous convictions, 73% of them have committed fraud or fraud-related crimes in the past. Forgery, in particular, is a frequently committed crime, followed by VAT fraud.

Seven offenders had previous VAT fraud convictions\(^7\) (cases 4, 6, 8, 11, 13, 18 and 22) and two for state tax fraud (cases 5 and 22). Based upon information provided by investigators, six other individuals were known for involvement in VAT fraud (although they had no record of conviction) and in one case, (28) the group of foreigners had also been previously admitted.

\(^5\) In an interview, he described the differences as follows: in the drug world everyone wants to have a larger share of the market; competition is stiff. In the world of VAT fraud, fraudsters help one another in order to increase the profit for everyone involved.

\(^6\) Members of one of the families involved in the fraud also had criminal antecedents however it is not known how many persons this involves.

\(^7\) In some cases these were serious enough to warrant prison sentences.
involved in this offense. Others were known for involvement in diverse offenses such as illegal subcontracting, forgery, robbery, auto theft and prostitution, although this was not substantiated by judicial antecedents. Levi (1993) reports that most fraudsters never commit any other type of crime; this appeared to be the case as well with this offender population.

Information obtained from file analysis and interviews with investigators substantiates the fact that there are a number of highly experienced/professional (habitual) fraudsters operating in the Netherlands, Belgium and the U.K.. There also appears to be a network of fraudsters operating as a type of “criminal trading community” between the Netherlands and Belgium. Information provided by the director of a fiscal investigative unit (Steufa) in Germany confirms the fact that there, too, certain fraudsters are well known to the authorities as habitual offenders. No conclusion is possible with regard to the existence of a fraudster network in Germany.

7.2 The nature of the organization

An indication of the kind of persons and organizations involved in VAT fraud may be found in the structure and degree of organization. Is the fraud a one-man operation or are more people involved? The organization may vary from solo performers on the one hand to highly organized associations on the other hand. In between, network-like forms of cooperation exist, where individuals work together, usually for a limited period of time, because mutual cooperation is more profitable than working alone. The following cases will illustrate degrees of cooperation used in fraud constructions. A number of elements will be examined. For both solo offenders as well as criminal groups the intention behind the operation, the amount of damage inflicted on the public finances as a result of VAT fraud as well as the methods used to safeguard the operation will be considered.

7.2.1 Solo performers

In the thirty-one cases investigated, eight of them involved a single fraudster who initiated and executed the fraud operation without assistance from other persons (1, 5, 12, 14, 15, 20, 24 and 25).

8 Access to files was limited in Germany.
9 Van Duyne (1993, 1995) found the same network patterns in his research.
Is it possible to differentiate between VAT fraudsters? Can one be defined as being more criminal than another? If it is possible to categorize fraudsters into different "degrees" of criminality, then a number of elements must be considered. The degree of organization, the intention or motivation behind the operation and the criminal background of the offender(s) are various indicators. There are those who are opportunists, who supplement their otherwise legitimate business(es) with illegal activities. They may gradually build up their business(es) and contacts. Their business is, for the most part, legitimate and there is a certain commitment to the business. They may be facing financial difficulties. An opportunity presents itself to make a little extra money. The profit is small; the fraudulent practice usually continues over a long period of time. The individual is interested in maintaining his legitimate business but has no objection to making a little extra money on the side.

CASE 24: Mr. Fedder had a legitimate transportation company in one member state bordering on another member state. He drove his truck on a regular basis to the other member state to purchase tax-free "red" gasoline. He then falsified the purchase invoices and pretended to have purchased gasoline with VAT, and based upon the Eighth Council Directive applied for a refund of his prepaid VAT.

In contrast to the "predominantly" legitimate businessmen, there are those who are interested in making a profit, who establish and (possibly) later sacrifice shell companies for the sole purpose of making money. These are criminals who use businesses to further their aims. This individual establishes his entire operation for the sole purpose of defrauding the tax authorities. There is no loyalty to the company. It serves only to aid in the perpetration of fraud.

CASE 5 Mr. Mayfield was able, over a period of almost 2 years, to falsify exports of CD's to another member state and falsify his tax returns in such a way that he even paid the tax authorities amounts ranging from between ECU 5,000 and 13,000. In fact he owed much more because the goods, instead of being supplied to another member state, were being purchased from that member state and sold on the domestic market. Over a period of approximately 21 months, Mayfield claimed to have exported approximately ECU 2.9 million requesting VAT refunds in the amount of almost ECU 780,000.
In other cases it is more difficult to classify the individuals into these two categories. The business may have begun as a legitimate business. At the time of the first fraud, when the suspect in case 15 realized how simple and profitable it was to deceive the tax authorities, the emphasis of the business shifted from the *bona fide* to the *mala fide*.

**CASE 15:** Mr. Fagan ran a small jewelry business selling individual pieces that he himself created. The business was in operation for 2 years during which time Fagan sold jewelry on the domestic market. In 1990 he perpetrated his first fraud. With goods destined for a customer in a non-E.U. country, Fagan went to the airport to have the exit documents on the jewelry stamped. After having obtained the necessary stamps and having cleared customs, he simply exited the departure hall at the airport and drove home. With the customs documents showing the jewelry had left the E.U., Fagan could sell the jewelry on the domestic market without paying VAT. It became so profitable to perpetrate fraud in this fashion that the bulk of his previously legitimate business was now supplanted by this illegitimate practice.

Not only can one assess the individuals behind the operation based upon their intentions (predominantly legitimate businessmen dabbling in fraud as opposed to criminals who use businesses to further their aims), one can also examine the way in which they operate. It is clear from studying fraud cases that the construction of such operations may take on various forms. In its most basic form, fraudulent operations can be divided into two groups. There are those which are established for the purpose of making a large and quick profit ("the big sting"). Shell companies are established (and later sacrificed) for the sole purpose of making money. On the other hand there are those operations which commit fraud over a long period of time. Illegal profits may be small, but there is usually less risk in such a venture. This is "the long slow haul".

While the construction, "the big sting" versus "the long slow haul" is inextricably linked to the modus operandi, it also reveals the offender's attitude toward crime. Perhaps it says something about the maturity and certainly about the experience of the offender. Those with less experience and maturity are reckless (no measures are taken to protect the operation) and greedy (they want a bigger portion of the profit and they want it immediately). These offenders perpetrate "the big sting". Those offenders with more experience and maturity may perpetrate fraud in a different manner. They may perpetrate fraud with smaller sums of money over a
longer period of time. The refund requested (as a result of ICS’s or export to non-E.U. countries) on the regular tax return is so small that it does not arouse suspicion and such fraud is likely to continue unnoticed for years (“the long slow haul”). Another means used by more sophisticated fraudsters is to employ measures to safeguard the operation. These two techniques may be combined so that a fraudster perpetrates fraud over a long period of time and also safeguards his operation. More often, though, safeguarding measures are taken with large-scale fraud. The distinction between “the big sting” and “the long slow haul” will be illustrated below.

“The Big Sting”

CASE 25: Mr. Monroe already had a chequered revenue history when he established his company in the beginning of 1993. It appears that this company conducted legitimate business until December of that year. Monroe then began using false purchase invoices from a legitimate company with which he had previously done business. He falsified purchase orders for expensive generators and then added these 3 generators onto an invoice for goods which were exported to a country outside of the E.U.. Monroe then requested a VAT refund of ECU 90,000. He was never reimbursed because a refund request for such a large amount aroused suspicion and an investigation was initiated.  

“The Long Slow Haul”

CASE 12 Mr. Brenner began his antique business in 1973. Due to financial problems sometime around 1986, Brenner began supplementing his legitimate business with fictitious exports. He began using false customs stamps from two other E.U. countries and alleged that the goods were being supplied to companies in E.U. member states and the United States, thus he was entitled to a refund of VAT. Over a period of six years, from 1986 to December 1992 when the fraud stopped, Brenner evaded VAT amounting to almost ECU 14,000. Due to the small amount of the refund requested, the fraud was so successful that Brenner was not caught until 1994 as a result of an investigation into stolen goods. He could not even

10 The “big sting” was also attempted by the fraudsters in case 10. In this case, too, their request was investigated prior to a refund and the offenders were arrested. In neither case did the member state suffer financial losses.
be prosecuted for violations occurring within the first two years because they exceeded the statute of limitations.

It is clear that excessive greed led to the downfall of the “big sting” operation and that with more patience and smaller refund requests, the likelihood of being caught is diminished. The issue is not quite as clear when attempting to determine whether the predominantly legitimate businessmen or the principally criminal businessmen are “more dangerous” in terms of the financial damage that they inflict. On the whole, the criminals in cases 5, 15 and 20 inflicted more damage, ranging from a low of ECU 160,000 (case 15) to ECU 780,000 (case 5) and ECU 1.1 million (case 20). Offenders in cases 1, 12, 14, 24, and 25 were classified as predominantly legitimate businesses which perpetrated fraud on the side. The damage inflicted was relatively small (the refund request was not honoured in case 25 and the others remained under ECU 20,000). Case 14 was an exception. While the business was predominantly legitimate, the nature of the fraud was more sophisticated than that perpetrated by the other “criminal businessmen”. False invoices were used on a relatively consistent basis and the damage inflicted approached ECU 3 million. While the criminal businessman and the predominantly legitimate businessman take different approaches to the perpetration of fraud, both can inflict severe financial damage upon businesses and the tax authorities in the countries in which they are operating.

Do individuals utilize means to safeguard their operations? With the exception of two offenders (cases 5 and 20), none of the other single offenders employed means to protect their operations. Even in these two cases one cannot speak of sophisticated measures. In case 5 the offender protected his operation from a tax audit by claiming that his books were located at a settlement office in another member state and could not be located. The offender in case 20 claimed that his bookkeeping had been stolen. Beyond these two crude attempts to avoid confiscation of the books, none of the other offenders employed any methods whatsoever to secure the operation.

7.3 Criminal groups

Eliminating the solo performers, 23 cases involving multiple participants remain. The organizations will be examined based upon the degree of cooperation and organization, division of labour and hierarchical structure. These cases will then be analyzed based upon a number of different criteria: the
intentions or motivations of the groups as well as the damage they inflict and the measures they take to safeguard their operations. A discussion then follows over organized crime and whether any of the cases in this study can be classified as such.

7.3.1 On a continuum from loose networks to structured organizations

Criminal groups can be placed on a continuum. On the one hand are those loosely structured groups comprised of friends or acquaintances. The number of participants is small. The group structure is informal, with no division of labour. On the other hand are those operations hierarchically organized into several levels with a strict division of labour. Scattered along the continuum are network-like connections between persons who interact on an irregular basis frequently rotating members and reassigning specific tasks as participants come and go. Where should groups be placed on the continuum between informal associations, on the one hand, and highly structured organizations on the other?

There are three cases (4, 10 and 17) in which only two offenders were involved. In one case (17) there is a clearly defined business relationship between the offenders (boss and secretary). The relationship between the two offenders in the other frauds appears to be based upon friendship or acquaintance relationships. Cases 4 (which was discussed in greater detail in chapter 5) and 10 can be classified as purely criminal enterprises established solely to perpetrate fraud.

CASE 10: The offenders were young, well educated foreigners (one from a wealthy family). They came to country A and established two bogus companies at accommodation addresses for the purpose of transacting a single sale of computer discs.11 The goods were in fact shipped outside of the E.U., however their value was greatly overestimated. The two individu-

11 The 2,000 computer discs were allegedly extremely expensive and so the two companies made an arrangement that Software Export would purchase the discs and pay Software Sales in instalments. Software Export exported the goods and then requested a refund of the prepaid VAT. Software Sales had not paid the VAT because it was allegedly waiting for a payment from Software Export – which claimed that it could not make a payment to Software Sales until it received a refund from the tax authorities (staggered repayment). The fraud lies in the fact that a refund claim is made by Software Export, while Software Sales has no intention of paying.
als in this construction (the only ones involved) flew into the country any
time business had to be transacted. With this one transaction the two
fraudsters asked for a VAT refund of ECU 1.3 million.

Cases 4 and 10 differ markedly from one another. While the two fraudsters
in the first case (4) utilized different legitimate businesses to perpetrate the
fraud over a long period of time, case 10 involved only the two offenders
committing a rather naive and unsophisticated “big sting” operation. In con-
trast to the criminals in cases 4 and 10, case 17 is a perfect example of a
predominantly legitimate businessman making use of a new regulation in
order to perpetrate fraud.

CASE 17: With the introduction of a new treaty in October 1990 allowing
tax-free trade between German merchants and Soviet troops, Mr. Jenkins,
a legitimate businessman, began falsifying sales invoices indicating that
goods (jeans, fur coats, leather jackets, video and hi-fi equipment) were
being sold to the Soviet troops. This he did through the use of false stamps
on sales documents obtained by bribing foreign authorities with a few
video machines. Before the fraud came to light, Jenkins had requested the
repayment of VAT and evaded payment in the amount of ECU 187,000
plus ECU 97,000 customs and import taxes.

It was anticipated during initial analysis that distinct differences would be
found between these smaller cases and those in which larger, more stable
groups were operating. It would be assumed that small groups of friends
involved in a fraud construction would be incapable of inflicting the type of
financial damage upon the tax administration that would be found in the
larger, more highly organized operations. To a certain extent this is true. It
does not mean, however, that small operations are incapable of inflicting
serious damage. In case 17, 2 individuals were capable, within an eleven
month period, of defrauding the tax administration of ECU 187,000. In case
4, the tax authorities estimate that between ECU 2 and 2.5 million have been
evaded.

Of particular interest are the remaining cases which vary from loose net-
works with no formalized internal structure to those highly organized opera-
tions which involve division of labour and hierarchy. If the subordinates in
a criminal cooperative venture are free-lance employees instead of members
of the group, the structure more nearly resembles a network rather than an
organization. Another characteristic is the strict division of labour. In cases
where, beside the leader of the operation, there are assistants, strawmen, facilitating companies, exchange bureaus and other employees, each with his or her own specific task, the structure more nearly resembles an organization. These two elements together often aid in distinguishing loose networks from organized structures.

There were numerous examples of loose networks in this study. Both the level of expertise and sophistication of the tasks as well as the internal structure varied greatly. In case 7, for example, four acquaintances did nothing more than pick up CD’s from the shipping company at the airport and then transfer them to a private apartment to be sold at a late date to companies without VAT. In case 21, fraudsters in one member state supplied documents with false customs stamps to the main suspect in this case. They further supplied fictitious domestic purchase invoices. While in case 7 the tasks were relatively simple, they were more complex in case 21. Still, in neither case does there appear to be any strict division of labour or hierarchical structure.

In his description of (moderately) organized criminality, Weschke (1986) uses the terminology ‘netzstruktur kriminalität’. This describes a loose structure of (specialized) offenders and offender groups without a clear hierarchy, who, depending on their situation and tasks, establish a group for a limited period of time. The following case provides the reader with a more structured network where there is a more defined difference between the leadership and participants, and where certain companies are given defined tasks.

**CASE 9**: This is a loose network of fraudsters working the luxury automobile market between two member states. There are three top organizers who have been involved in the operation since 1985. Their names never appear on documents, but investigators are certain that they are behind the scheme. Two large, predominantly legitimate garages were deeply involved in the fraud, one as a purchaser, the other as a supplier. Numerous other garages, shell companies and strawmen were used at various times to provide false sales and purchase invoices so that prepaid VAT could be reclaimed from the tax authorities. There are various branches of this fraud operating with different garages at different periods of time.

The cases described above and others (6, 8, 18, 19, 23, 28, 29, 31) provided a variation of forms of networking. Typical in all of these cases are the loose contacts between the persons which could serve predominantly illegal as
well as legitimate businesses. These persons have their own fraud circuit but cooperate for a limited time because of common commercial interest. In cases involving legitimate businesses, the managers simply integrated illegal activities in their bookkeeping to make extra money. Contacts with legitimate businesses are made by way of legal business relations or via contacts in the fraud scene.

Rebscher and Vahlenkamp (1988) depict the interwoven relationship between offenders in their work on organized criminality in Germany. In evaluating structures of organized criminality, their starting point is the connection between offenders. They view individuals as illegal business partners instead of members of an organization. They identify another indicator to typify forms of cooperation vis-à-vis criminal organizations or criminal networks: criminal expertise. Short-lived, spontaneously-born networks have difficulties when the criminal activities require more expertise and sophistication. Due to the weak ties between the persons involved and the brief existence of the networks, the investment of valuable ‘know-how’ is seen as involving risk. Thus, the necessity for high quality specialization and knowledge can be viewed as an indication of a criminal organization rather than a criminal network.

Distinguishing between networks and criminal organizations is sometimes difficult. Especially in the larger fraud cases,12 cooperation between fraudsters could be characterized as a combination of networking and a hierarchically-modelled organization. Case 31 is typical of a well structured criminal organization which also made use of loose networks.

CASE 31: This case involves an ordered, hierarchically structured organization of over 40 individuals involved in an international VAT fraud construction with luxury automobiles. There is a clearly established leadership. The organizer of the fraud, Mr. Zack, owns and manages a highly respected car dealership which he used to facilitate the perpetration of fraud. His role was that of supervisor, financier and assigning tasks to his so-called “lieutenants”. He alone had sole decision-making powers over major aspects of the fraud. Directly under him worked four lieutenants who were responsible for managing a number of different activities such as supplying false sales and purchase invoices, assuming responsibility for

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12 Larger refers to the number of persons involved as well to the complexity of the modus operandi and the amount of taxes evaded.
the import and delivery of cars from other countries and controlling the activities of the strawmen. These lieutenants were given the authority to make decisions in limited circumstances and operated autonomously within their own territory. The third level of the hierarchy comprises approximately 30 strawmen. Their responsibilities were limited to signing blank invoices for the businesses which they represented. In the fourth level, comprising loose associates or collaborators, individuals were used on an ad hoc basis in concrete, isolated situations when something was needed, such as the provision of blank invoices. The associates were often involved in their own fraud enterprises. Contact between the various levels was limited to business.

In addition to a hierarchical structure and division of labour, other elements of a highly structured organization were present. Numerous shell companies were established to provide false sales invoices. Customs agents were bribed by lieutenants to validate fictitious export documents. While violence or physical threats were not a regular practice within the organization, on occasion a strawman was threatened to guarantee his silence. Conflicts were negotiated and if certain conditions were not met compensations had to be made.

7.3.2 Intentions

While it is not difficult to differentiate between purely legitimate and purely fraudulent practices, oftentimes complex fraud constructions involved both aspects. There were examples of purely criminal operations, and other cases in which relatively legitimate businesses participated (some willingly, others unknowingly) in the operation.

The participation of legitimate businesses in fraudulent constructions can also be viewed on a continuum; the differences between these legitimate businesses and purely criminal enterprises may be quite small. One may consider the degree of knowledge or criminal intent as well as the assistance provided or action taken by the business in supporting the fraudulent practice. There are those who allow themselves to be inadvertently used (but are nonetheless actively involved), such as the businesses in case 4 (discussed in greater detail in chapter 5). Other companies are less actively involved in the perpetration of the fraud, but knowingly purchase VAT-free goods on the black market (and place fictitious invoices in the books along with legal purchases). In other cases “legitimate” companies are more criminally involved by knowingly and actively pro-
viding false sales invoices to fraudsters who then used these to apply for refunds when they alleged an ICS.

While the fraud constructions which involved only the transfer of fictitious goods on paper can be classified as purely fraudulent (cases 4 and 22), so can numerous others involving real goods. Case 10 (described earlier in this chapter) involved trade in real goods (computer discs) but the businesses were established for the sole purpose of perpetrating VAT fraud. Other businesses, too, were established for the sole purpose of perpetrating fraud.

**CASE 6:** This large and sophisticated fraud operation involved 11 purely fraudulent companies which issued false invoices and at least 10 semi-legitimate businesses which purchased the television and video equipment without VAT. A number of shell companies were established for the purpose of bringing the goods from one member state, A-land, to another, B-land, and then shipping them to a third, C-land. From there two different fraud constructions were devised. One involved fictitiously exporting the goods to a company in a country in Africa (for this purpose a customs official was bribed so that the necessary export documents were properly stamped). The goods were then smuggled back into B-land. For the second scheme, the goods were transported back to B-land and shell companies were created there to produce false domestic purchase invoices so that a refund request for alleged prepaid VAT could be made. All goods in both schemes were sold in B-land without VAT. Losses as a result of VAT fraud amounted to approximately ECU 1.92 million.

The fact that an operation contains both legitimate as well as illegal aspects makes it no less criminal than the purely fraudulent operations. The trade in excise-free goods is so lucrative that the illegal trade with such goods becomes much more profitable than the legal trade.\(^{13}\) The legal trade is then sustained to mask the illegal trade. Such was the situation in case 8.

**CASE 8:** This is a family-owned operation in the petrol station business. The family entered the market legitimately through an initial purchase, over a three year period, of 3 petrol stations. After having met a known fraudster who introduced them to the lucrative practice of purchasing VAT-and excise-free petrol, the family then began supplementing legitimate purchases with VAT- and excise-free (illegal) purchases of petrol from

\(^{13}\) The evasion of VAT is secondary to the evasion of excise taxes.
another E.U. country. Fictitious domestic sales invoices were taken into the books to cover the illegal purchase of petrol. Based upon the false invoices it appeared that the petrol was purchased domestically so that upon its resale, a VAT refund could be requested. The petrol was then distributed to numerous stations under the control of the family. Investigators involved in this case have indications that the initial investment in the petrol market was financed by drug money from a non-E.U. (the family's home) country and have traced bank accounts showing the transfer of funds back to the country of origin. Furthermore, there are indications that this family is involved in arranging marriages for living permits and has used violence and threats to force employees to work long hours for low wages.

There was only one example of the “big sting” among criminal groups and that was perpetrated by two rather young, naive and inexperienced friends (case 10). Larger criminal groups, in particular, were established with the intention of perpetrating fraud for longer periods of time.

In conclusion, in the smaller cases of fraud, the cooperation between the fraudsters was typical for networking: predominantly short-lived and spontaneous working relationships where the nature of the activities is rather simple. In larger fraud cases, elements of a hierarchical model of cooperation and networking are often mixed. This increase in sophistication is due to the higher demand in terms of quality of labour, the number of persons involved and the complexity of the *modus operandi*.

### 7.4 The relationship between VAT fraud and organized crime

The previous section examined the intentions of criminal groups. While some of the groups can be characterized as predominantly legitimate, others are purely fraudulent. This section will focus upon those criminal groups and address the question of whether or not there is a relationship between organized crime and VAT fraud.

#### 7.4.1 Theoretical Underpinnings

When one thinks of large-scale fraud operations, naturally, organized crime comes to mind. To create an automatic link between these two phenomenon is both naive and incorrect. Tax fraud is, after all, a crime of opportunity. For fraud operations to become organized and operate successfully, the market
must remain stable for a period of time to allow fraudsters to make the proper business connections. What may eventually result is an operation with ties to legitimate, as well as to illegitimate businesses. Levi (1993) has adopted the term “enterprise crime” as the distinction between “white collar” and “organized crime” becomes more obscure.

Whether one uses the term organizing criminals or organized crime, a consensus must be reached concerning the phenomenon which is being measured. Definitions and elements of organized crime vary and there is no single, universally accepted definition of organized crime. While some individuals and agencies emphasize the type of activities that fall under the term organized crime, others are more concerned with the perpetrators and the relationship between the members (Abadinsky, 1990). Whether or not one can speak of “organized crime” depends upon the elements included in the definition.

Based upon research on organized crime conducted in the Netherlands (Fijnaut, et al. 1996), this study has adopted the following definition of “organized crime”: a group of people motivated by profit obtained through the commission of systematic or ongoing, serious offenses. The group resorts to any means to safeguard its interests from investigation or seizure by the authorities (to include, in particular, the use or threats of violence, intimidation, corruption, or deception).

Thus, the following elements are essential in our categorization of cases into the organized crime category:

1. more than 2 people
2. committing serious crimes for profit
3. the crimes are committed on a continuing basis (long-term fraud rather than ‘the big sting’)
4. safeguarding the operation (anything from aggressive means such as threats or use of violence to more non-aggressive means such as corruption. Included in this element are defensive or offensive strategies used to distract or divert the investigation).

There are a number of problems with this definition. Firstly, what constitutes a serious crime? Because VAT fraud violates economic regulations, not moral codes, one could argue that VAT fraud, in itself, is not a serious offense. If one recognizes the seriousness of VAT fraud, the question then becomes, ‘what constitutes a serious VAT fraud?’. If “seriousness” includes the element of “serious consequences for society”, is this determined only by the
amount of money denied the tax authorities? Does it have to do with the number of businesses which go bankrupt as a result of unfair market competition? Does it have to do with the number of persons cooperating in the fraud structure or is the length of time that a construction operates of significance? Even if the damages are minimal (the fraud is identified and stopped at an early stage), should the potential fiscal damage which could have been inflicted by the operation be a significant consideration?

The safeguarding requirement also presents somewhat of a problem. If safeguarding the operation is viewed in narrow terms and only the elements of violence or intimidation are included, the number of cases of "organized crime" will be far fewer than if a broader interpretation is used and the elements of deception, or offensive and defensive strategies are included. Furthermore, certain means of safeguarding the operation may also be part of the modus operandi of the operation. In other words, corruption of officials may be the means of carrying out the fraud or it may be a means of ensuring the safety of the operation. Therefore, cases which contain this element are more easily challenged as meeting the requirements for classification as organized crime than those in which violence, threats or sophisticated money laundering schemes are used.

Despite the fact that these elements present some problems, the following sections will analyze the cases in this study using the aforementioned criteria. In examining the amount of damage inflicted and the means utilized to safeguard the operation, an assessment will be made of the number of VAT fraud cases in this study which qualify as "organized crime".

7.4.2 Organized crime in VAT fraud

Based upon the criteria "serious damages inflicted" (discussed at length in section 5.5) and "safeguarding the operation" (detailed in chapter 6.5), a number of cases in this study qualified as examples of organized crime.

Whether one agrees to classify a case as organized crime or not, may depend upon how narrowly or broadly one interprets the criteria used. In considering serious offenses, the cases were limited to those in which large losses (over ECU 1 million) were incurred. In terms of "safeguarding the operation", a narrow interpretation was used: an action is considered a form of safeguarding the operation if the action was not necessary to perpetrate the offense, as opposed to those actions which could also be viewed as part of the modus operandi. Violence, for example, is never necessary to perpetrate VAT fraud. On the other hand, when customs officials were bribed to stamp false export documents, this could be
viewed as an element of *modus operandi* as well as safeguarding the operation and was therefore excluded as an element of safeguarding.

There were five large-scale fraud cases which adhered to the criteria of organized crime established in section 7.4.1. The taxes evaded ranged from a low (case 28) of ECU 130,000 (estimates by the fiscal investigation agency, however, place the loss at ECU 3.95 million) to a high of ECU 17 million (case 16). Fiscal experts estimate the loss in this case at approximately ECU 45 million. Having met the criteria as serious fraud in the sense of large financial losses, attention was then directed to the means used to safeguard the operation.

In three of the cases (8, 28, 31) threats of violence were used to intimidate participants in the fraud or employees of the operation. Case 13 was also defined as organized crime due to the sophisticated offensive means (multiple cars and fake licence plates) utilized to protect the operation. The safeguarding elements in these cases were described in more detail in section 6.5.

The following case\textsuperscript{14} not only fulfilled all of the requirements (including large-scale corruption, involvement of lawyers and bankers and sophisticated money laundering operations) but the operation was also characterized as a perfect example of organized crime by the investigators involved.

**CASE 16:** This is one branch of an extensive, Europe-wide oil fraud which began in 1986 and may, to this day, be in operation. Between November 1989 and April 1991 petrol was smuggled into a member state, B-land, via five tankers and trucks. An invoice for export was made to a non-E.U. country or to another E.U. country under the cover of a T-2 document. Through the use of false customs stamps or with the assistance of corrupt customs officials (in two countries, A-land and C-land), the T-2 document was stamped as if the petrol arrived in one E.U. country (C-land) when in fact it was smuggled through to another E.U. country (B-land). Because the petrol products were not accompanied by a purchase invoice, a shell company was created (in B-land) which provided false sales invoices, thus the petrol was now legitimately on the B-land market. VAT appeared on these false invoices, and the company which "allegedly" paid the VAT now requested it back from the tax authorities. A number of different shell companies were created to produce invoices. Oftentimes legitimate companies with an established reputation were purchased. They were used in

\textsuperscript{14} See Van Duyne (1993; 1995) for a more detailed description of this case.
the fraud until they became suspicious and were then sacrificed and other companies were used.

There are various phases to this fraud. The initial fraud, which began in A-land, was managed by 2 notorious fraudsters who introduced an American family to the fraud and the B-land market. The father (with assistance from his son) was behind the company in B-land which served as the main receptacle for the smuggled oil. The oil was then passed on to a company which he created for the purpose of distributing it to approximately 140 local gas stations. In the books of the distribution company are purchase invoices from various shell companies (the two notorious VAT fraudsters are behind two of them). When the American got out of the oil scheme it was then taken over by one of the fraudsters who had provided the false purchase invoices. This individual is also responsible for having approached the family in case 8 and teaching them how to commit VAT fraud as well as providing them with the fictitious sales invoices.

There is a clear hierarchical structure in this fraud construction. The American was the head of the operation, assisted and later replaced by his right hand man. There was a second tier, represented by those who managed the distribution company. The third level includes those who established shell companies and supplied false invoices or arranged for the clearance of false T-2 documents. The fourth tier encompasses the petrol stations which purchased the VAT- and excise-free petrol. There was a clear division of labour and permanently assigned tasks.

This organization exemplified a perfect and worldwide organization (Belgium, the Netherlands, Germany, France, Panama, the U.S.A., Cayman Islands, Liechtenstein and Switzerland). Mafia-style methods were used: the corruption of public officials, a sophisticated money laundering system with transfers to and payments from a network of foreign accounts in tax paradises, the establishment of shell companies to serve as covers as well as the use of false invoices from bogus companies. The losses in one country alone represented astronomical amounts: the total loss to fiscal authorities in B-land is estimated at ECU 44.8 million.

While this study, based upon the criteria established in section 7.4.1, identified 5 cases of organized crime in VAT fraud, it is possible to include others.

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15 The father was under the U.S. Witness Protection Program for allegedly having testified about the activities of the Costra Nostra in the United States.

16 This sum is only for the fraud which occurred in B-land. A similar fraud in A-land resulted in a loss of approximately ECU 1.3 billion. This sum does not include the losses as a result of other frauds linked to this operation in two other countries.
in this definition as well, if one modifies the current definition. The determination of any operation or organization as 'organized crime' will be influenced by the definition selected and by the liberality or conservatism of the boundaries of the definition.

7.5 Conclusions

This chapter examined criminal antecedents of the primary suspects and the nature of their organizations. A large number of suspects had criminal antecedents for property, and particularly fraud offenses. A contrast was drawn between the predominantly legitimate businessman who dabbles in fraud as opposed to the criminal who establishes fraudulent constructions as a main business endeavour. Criminals tended to inflict more damage than legitimate businessmen. In general, fraudsters operating on an individual basis or with one friend or associate inflicted less financial damage than larger operations. They also tended to take no, or less sophisticated measures to protect their operation from exposure.

The discussion then turned to larger and more highly organized operations. A definition was provided for organized crime. The focal point of this last section was to answer the question of whether any of the cases in this study could be classified as organized crime.

Based upon a narrow interpretation of the definition utilized in this study, five cases of organized crime in VAT fraud were identified. This last case, case 16, shares some similarities with case 8. Both, in addition to amassing huge gains through VAT and excise tax evasion, have international aspects. The initiator of the fraud scheme in case 16 was allegedly linked to the American Cosa Nostra. In case 8 the offenders were alleged to have had ties to the drug trade in their country of origin. Of further significance in case 8 is the fact that the offenders were involved in the illegal trade of persons by bringing them into the country and arranging marriages for living permits and forcing them to work as cheap labour.

The other three cases, while operating on a smaller scale, still meet the criteria of organized crime based upon the definition provided in section 7.4.1. While other fraud operations failed to meet the last criteria of safeguarding the operation against the authorities, some still managed to operate for rather long periods of time and inflict severe financial damage on the state coffers.
Some experts challenge the notion of organized crime in VAT fraud. This may be due, in part, to the preconceived notion of organized crime based upon the American and Italian models: hierarchical structures utilizing excessive violence. Does organized crime exist in VAT fraud? The answer will always depend upon the definition of organized crime selected in the research. Whether or not one agrees to label the selected cases in this study as organized crime, what was evident in this research is the existence of highly sophisticated and organized criminal associations and networks. The potential for fiscal damage is great.
SUMMARY AND CONCLUSIONS

Research questions and methods

The focus of this research was upon two major areas. The first emphasis was upon depicting the control systems in the various member states. To accomplish this goal, it was necessary to talk with experts working in the field in order to better understand how the system works in practice. Questions addressed in this area, and covered in an abbreviated form in chapter 4, include:

- What are the existing control mechanisms and how do they operate?
- What public bodies are responsible for the fight against VAT fraud and what are their competencies?
- What are the possibilities to exchange information between member states on VAT irregularities and how are these put into action?

Beyond a purely juridical approach to studying VAT fraud, this project emphasizes a sociological or criminological approach by addressing the subject of the actual operation of the fraudsters. This objective was accomplished through empirical research into the structure and modus operandi of crime-entreprises involved in (organized) VAT fraud. The following questions were addressed in chapters 5 through 7:

- What techniques of VAT fraud are being used?
- Which legitimate branches of industry are being affected by this fraud in the sense of
  (a) damage inflicted and
  (b) complicity of the ‘legitimate’ entrepreneurs?

- What are the structures of the organizations or networks and what are the profiles of the crime-entrepreneurs involved?

Four countries were selected for this research. In addition to the Netherlands and Belgium, permission was granted to conduct research in the United Kingdom and Germany. Interviews were arranged in all four countries with individuals from the tax administration, investigative agencies and the Cen-
central Liaison Office. Additionally, access was granted to examine case files in the Netherlands, Belgium and the United Kingdom for the purpose of understanding the *modus operandi*, the structure of the organization and the individual offenders. In total, thirty-one cases were examined. The researchers examined eleven cases in the Netherlands, eleven in Belgium, eight in the United Kingdom and one in Germany. File analysis began in September 1994 and ended in September 1995.

Information was requested from the judicial register in the Netherlands as well as from investigating officers in Belgium and the United Kingdom concerning the backgrounds of the principal offenders. Often investigators were able to provide information, not available in the files, concerning the organization, relationships between offenders and previous involvement in fraud offenses (when no judicial antecedents were recorded). This combination of file analysis and interviews with experts, for which measurement instruments were designed (see Appendices 1 and 2), provided a fuller picture of the phenomenon of VAT fraud.

**Conclusions**

This report illuminates the phenomenon of VAT fraud in the European Union. Insight is provided into the markets affected, the *modus operandi* and the perpetrators of VAT-fraud. A brief overview of the control and investigation mechanisms in each country is provided. The reader is presented with the basic laws and directives which regulate the taxation of trade between E.U. member states. Insight is given into a number of treaties and conventions promoting intra-Community cooperation between member states, as well as an E.U. approach to regulating the problem.

Changes introduced into law in January 1993 greatly affected not only the levying of taxes, but also the flow and control of goods across borders, and the manner in which fraud could now be perpetrated. With the introduction of the transitional regime in January 1993 opportunities to commit VAT fraud changed but certainly did not decrease. Under the old system (with the exception of trade between the Benelux countries), VAT had to be paid at the borders and controls existed which resulted in the possibility of a physical inspection of the vehicle and goods. Fraud was then perpetrated by falsifying T2-documents (transportation documents) or customs stamps, or bribing customs officials. Although the physical inspection of goods at the frontiers occurred infrequently, the abolition of such controls resulted in the removal of a psychological barrier. The abolition of physical controls made the new
system, in comparison to that which existed previously, more sensitive to fraud. The system of allowing VAT payments to be delayed and submitted with the regular tax returns, and for transacting intra-Community supplies (ICS) against the ‘zero-tariff’, coupled with the removal of physical controls at the borders, provides ample opportunity to commit fraud. Experience has shown this to be true in the Benelux countries where networks of fraudsters have developed and continue to operate. The practice of open borders and the implementation of the “transfer rule” in the Benelux countries under the Benelux Treaty simply provided an earlier opportunity to Dutch and Belgian fraudsters to master the “tricks of the trade”. There is no reason to believe that this pattern will not extend to other E.U. countries.

Despite the removal of physical controls at the borders, improvements were made in the administration. Prior to 1993 no national administrative tracking system existed to regulate VAT practices. Under the current system, controls are carried out through the use of the computerized VAT Information Exchange System, VIES. A company’s ICS-listings are matched against its regular VAT returns, and these regular VAT returns are matched against the ICS-listings submitted by the national Central Liaison Offices in other countries.

The Central Liaison Office in the Netherlands claims that this new administrative control, the VIES system, has actually reduced the opportunities to commit fraud. The fact that intra-Community transaction (ICT) data can be matched for the purpose of identifying certain types of frauds, illustrates the preventive or deterrent aspect of the new system. A major weakness in the present system, however, is the time lag between the alleged transaction and the information being submitted to the Central Liaison Office. Even then, the system relies heavily upon the accuracy and veracity of the data, and upon identifying mismatches in information. As shown in chapter 6, fraud may very well be perpetrated without a mismatch ever occurring and mismatches may result from non-fraudulent practices. It must be kept in mind that the VIES system was created as a regulatory system to control intra-Community transactions. Its primary objective was not the identification of fraud. In the 31 cases in this research, the VIES system never produced the initial fraud signal, although in a few cases it was used by investigators to verify information during the course of an inquiry. This implies then, that control and enforcement agencies can not rely upon the VIES system to signal inconsistencies, but must take a proactive rather than a reactive approach to identifying VAT fraud.
This study identifies specific markets susceptible to fraud. In the 31 cases examined, fraud occurred most frequently in branches involving audio/video/compact discs, luxury automobiles, the computer market, and products with high excise taxes (petrol, tobacco and alcohol). These markets (barring luxury automobiles) are particularly sensitive to fraud because of the high demand and quick turnover of the goods. With the opportunity and a stable demand for a particular market, crime enterprises will expand and flourish. Notable, however, is the fact that in two large and well organized fraud constructions in this study, the fraudsters entered various “non-fraud-sensitive” branches to avoid arousing suspicion and investigation.

Examining a population of 74 principal offenders, the following picture emerges: VAT fraudsters are almost exclusively male. Over a third of the sample, 25 suspects, were between the ages of 40 and 49 years. While the majority were natives, ethnic minority offenders were involved in 11 of the 31 cases. While ethnic minority participation usually involved only individuals, there were two examples of quite large and well organized family-like operations.

Almost half of the suspects had one or more criminal antecedents. Twenty-six offenders had antecedents for property offenses, of which 22 were for fraud-related offenses. Seven suspects had antecedents for previous involvement in VAT fraud. One suspect was involved in excise fraud, two in general fraud, two in tax fraud and 19 offenders had been arrested for, or charged with (or convicted of) forgery. Other suspects had no formal judicial antecedents, however investigators identified them as known fraudsters. This research supports the claim that there are a number of habitual offender VAT fraudsters operating in at least three of the countries. Too few files were available in Germany to make an accurate assessment. Further file analysis and interviews support the fact that there is a network of fraudsters operating between the Benelux countries.

Eight of the cases involve fraud by solo performers. In three cases, which were creatively constructed and orchestrated, the losses to the state coffers surpassed ECU one million. The other five cases involved less sophisticated constructions and smaller losses. In the remainder of the 23 cases, groups of offenders ranging from two-person partnerships to highly structured organizations with numerous levels, functions, bona fide and mala fide businesses were involved.
This study examines the difference between fraud by otherwise legitimate enterprises and enterprises established for the sole purpose of defrauding other companies and the inland revenue. There are numerous cases in this study in which relatively legitimate businesses knowingly and willingly participated in the fraud. This type of receptive environment can be viewed as a fraudulent landscape in which experienced fraudsters and highly organized operations can flourish. In the highly competitive world of business, small margins may mean the difference between success or failure. The opportunity to purchase (VAT-free) goods slightly under the market price provides that competitive edge so necessary to many businesses. It is impossible to determine whether the motivation was a matter of greed or whether their cooperation was motivated by the necessity to survive in a competitive market. The fact that goods obtained as a result of VAT fraud can be sold at a much lower price than legitimate goods, may force otherwise legitimate businesses into cooperative VAT fraud ventures. In general, “professional” fraudsters, (habitual offenders or those with ties to criminal networks), tend to inflict more damage than predominantly legitimate businessmen dabbling in fraud. There were, however, cases of relatively legitimate businesses involved in significant fraudulent practices. The extent of organized business crime is difficult to evaluate and it is virtually impossible to determine how much fraud is being perpetrated in a particular market. Only after a fraud has been exposed, is it possible to estimate the damage to the fiscal authorities or to other businesses, particularly those held accountable for the losses. The underlying threat to entire markets (petroleum, computer, luxury automobiles) is immeasurable.

Data obtained from this research suggest the existence of experienced fraudsters who maintain contact with one another for the purpose of providing favours: VAT identification numbers, shell companies, fictitious invoices, etc.. Furthermore, the fraudsters (particularly those in the Benelux countries) were so familiar with the new system and potential loopholes that the changes introduced in the interim regulations provided no hindrance. In one case a fraudster even used the last half of 1992 to establish a network of almost 100 domestic and international shell companies so that he could begin perpetrating fraud in January 1993. Large-scale fraud operations by experienced fraudsters with extensive networks, the cross-border crime community, was not (and will not be) hindered by such changes. They simply reorganized and found new ways to commit fraud. With the provision of each new law comes another opportunity to perpetrate fraud. This was nowhere
more evident than in case 17. The passage, on 3 October 1990, of a treaty providing tax-free trade between German merchants and departing Soviet troops afforded the opportunity to falsify sales and avoid paying VAT while selling the goods VAT-free on the domestic market. This fraudulent practice began the same month that the treaty was enacted.

This study identifies only 5 intra-Community transaction (ICT) frauds after 1.1.93, all of which occurred in two countries. It must be assumed that fraud is occurring, thus the reason that so few frauds have been identified may be a result of the time necessary to expose the operation and gather enough evidence to get a successful conviction in court. There may well be another explanation. It is not unlikely that the fraudsters needed time to learn the regulations and the markets well enough to establish their constructions. Thus, it is possible that ICT fraud is just beginning. The file analysis in this research ended in September 1995. Toward the end of 1995 a number of large-scale ICT frauds were beginning to be uncovered by various agencies in different E.U. member states. A large-scale fraud is affecting the computer market in at least six E.U. member states. The magnitude of the fraud is impossible to calculate, but it is estimated that the losses will run into the hundreds of millions of ECU’s. At this time three E.U. countries are exchanging information in an attempt to expose the operation. The extent of the organization and operation is currently unknown.

The fiscal investigative agency in the Netherlands, the FIOD, is witnessing an overall increase in fraudulent activity since the end of 1995. Markets in which little activity was previously noted (audio-video) are suddenly becoming targeted again. A large-scale ICT VAT fraud was perpetrated with lorries, and another country is currently being affected by carousel-fraud with luxury automobiles.

Organized crime has traditionally been linked to, amongst others, the drug market. This study, supported by other research (Van de Bunt and Nelen, 1996, Van Duyne, 1995) finds no link between the drugs trade and VAT fraud. Is there, then, a relationship between organized crime and VAT fraud? Based upon the definition presented in chapter 7, five cases were classified as organized crime, of which three included an element of violence or threats to use violence. Two cases involved fraud in the petrol market, two in luxury cars and one involved a sophisticated gold smuggle. In the cases involving the petrol market, as well as in another case involving computers, numerous “legitimate” businesses were more than willing to purchase the VAT-free goods. This finding subscribes to the notion that a symbiotic relationship can
easily develop between criminal organizations or organized crime and legitimate businesses.

**Recommendations**

There are numerous obstacles to a swift and successful investigation of VAT fraud. Such frauds are often complex and involve numerous businesses and transactions. Goods may be purchased, sold and supplied between numerous countries which further convolutes the picture. Case 18, portrayed at length in chapter 6, illustrates the complexity of establishing the flow of invoices, goods and money in an international VAT fraud construction. A further problem in the investigation of VAT fraud, particularly in carousel-fraud, is the tendency to control or investigate only the last link in the chain. Exposure of one segment of the operation does not close the operation down, but simply alters its structure. A shortage of manpower, a constant problem in most agencies, coupled with the complexity of such cases (an agency may be investigating more than one large-scale, sophisticated fraud construction at any given time) and it is clear why recognition of the problem and the necessity for international cooperation is so critical.

Chapter 4, and the individual country chapters in Part II of this report, demonstrate the complexity of the control and investigation systems in each country. The complexities extend beyond domestic borders. International VAT frauds require international cooperation which is often hindered by legal formalities, language barriers and lack of knowledge as to which agency in another country has jurisdiction. This confusion simply facilitates the perpetration of fraud.

What becomes evident from examining files and interviewing investigators is that certain types of fraud were prevalent in particular countries: large scale gold frauds and the smuggling of alcohol products prevailed in the U.K. The illegal trade in luxury cars was a serious problem in Belgium and, according to the authorities, such cases have been identified in Germany, as well. Carousel-frauds between the Netherlands and Belgium occurred frequently, while in the U.K. and Germany this did not appear to be a problem. This phenomenon may be due to the fact that (a) these types of frauds are truly occurring at a higher rate in the countries concerned, that (b) these are the types of frauds which are given high priority by investigators, or that (c) the fiscal investigative officers have become so adept at identifying these types of frauds, that these are the types of frauds which are most easily identified and terminated. The latter explanation probably explains this find-
ing. If it is true that certain investigative agencies have accrued the expertise in specific areas, and particularly with unique types of fraud and *modus operandi*, it is imperative that this expertise be exchanged, on a formal as well as an informal level.

If the fight against fraud is to succeed it is clear that certain conditions must be met: recognition, cooperation, and proactive enforcement. Fraud must be recognized as a serious problem both in terms of economic losses, but perhaps more importantly for the damage it inflicts upon legitimate businesses and the consumers' trust in trade and industry practices. The victims of VAT fraud are numerous. This demands that action be taken to fight fraud, and the approach must be a proactive one; waiting for ICS's to be processed through Central Liaison Offices for comparison with regular tax returns gives fraudsters too much time and may allow sophisticated schemes to go unnoticed. Additionally, the fight against fraud will be successful only if countries are willing to cooperate with one another to avoid a 'displacement' effect.

Although the member states of the E.U. subscribe to the concept of cooperation in the fight against international crime, it is to be expected that VAT fraud will continue to maintain a low public profile. This is due to a number of reasons. Firstly, offenses such as VAT fraud violate economic regulations; they infringe upon economic interests rather than violating moral codes, thus, public concern does not rank enforcement of such violations as a top priority. It is questionable whether VAT fraud is even perceived as an offense in some countries, which are either unaware of, or deny its existence entirely, or devote little energy in the investigation of the offence. The fact that the countries in this study demonstrated interest in the research and quite clearly recognized the seriousness of VAT fraud as a criminal offense, may indicate a shift in attitude. Their intentions and hard work are of limited value, however, without the support of other E.U. member states.

A number of treaties regulate cooperation between member states in the area of legal assistance. However, the European Commission has limited authority in regulating intra-Community cooperation. It must also be kept in mind that while mention is made of a European 'Union', the E.U. in fact comprises 15 countries with differences in language, fiscal rates and markets, fiscal law enforcement organizations, and penal codes and practices. Furthermore, a deep mistrust between countries exists which impacts negatively upon their mutual cooperation. One possible solution to the problem would be to give the Commission supranational authority concerning the fight against fraud.
At present, however, this is an unrealistic option and one which may create more problems than it solves, namely, the unjustified transfer of responsibility for the fight against fraud to the European Commission and would further require the member states to relinquish their autonomy. It appears unlikely, however, that the member states will be receptive to the involvement of a supranational authority or to giving up their autonomy. The Commission should, however, create new measures to encourage international cooperation and must play a coordinating role in sponsoring research, workshops, and international exchanges for the furtherance of integration in the fight against fraud.

APPENDIX 1

FILE ANALYSIS

I. Offense Variables: Methods and (Criminal) Organization

1. Code name (for each case)
2. Description of the criminal offense(s)
3. Use/transfer of real goods or fictitious transactions?
4. History of the organization
5. Which means were used?
   a. how were contacts initiated and maintained?
   b. storage of goods / warehouses
   c. subsidiary enterprise
   d. mailbox-incorporated companies
6. Over what period of time was the organization in operation?
   a. beginning date
   b. end date
   c. suspected period of time of operation
   d. what time frame can be proven?

II. Offender Characteristics (per offender)

1. Person(s) involved
2. Age
3. Gender
4. Nationality
5. Antecedents
   a. criminal career (involvement in previous criminal activities)
   b. history of drug or alcohol use
   c. (history of) financial problems
   d. known to tax or law enforcement authorities
6. Function and place within the group
   a. inner/outer circle
   b. leadership role
   c. financial advisor/bookkeeper
   d. strawman/helper
   e. courier
   f. chauffeur
7. In which enterprises or businesses was (s)he involved?

8. Penalty
   a. administrative court
   b. criminal court
      1. fine
      2. prison sentence
      3. other

III. Organization of the Criminal Enterprise and the Environmental Variables (per enterprise)

1. Theoretical structure of the organization
   a. hierarchy
   b. division of labour
   c. family relationships/organization

2. Practical structure
   a. who made the decisions
   b. who gave the orders
   c. mutual relationships
   d. sanctions
      1. violence
      2. threats

3. Agreements and connections with other criminal matters, criminal networks

4. External contact with the legitimate networks/businesses
   a. lawyers
   b. financial advisors
   c. political contacts
   d. payment to customs officers
   e. corruption of other (law enforcement) officials

5. Organized crime or corporate crime
   a. characteristics of the operation

6. Businesses involved
   a. main activity
   b. secondary activity
   c. number of businesses
   d. legitimate or criminal enterprises
   e. country of operation (foreign country?)
   f. task or function of the business
   g. role within the organization
7. Brief description of the branch in which the criminal enterprise is actively involved
   a. to what degree is the branch in question sensitive to contamination by fraud or other forms of criminality

IV. Financial Overview

1. Source of capital to begin fraudulent practices
2. Criminal gains
3. Costs
4. Investments of the criminal enterprise
   a. reinvested in the operation
   b. invested in other operations
   c. invested in drug operations
   d. foreign banks

V. Investigation

1. Cause for the investigation
   a. the first sign of fraud
   b. date of the first sign of fraud
   c. did investigation begin as VAT fraud or was it a result of investigation into other offenses (drugs)
2. Investigating agency
   a. tax authorities
   b. law enforcement
      (special fiscal police)
   c. cooperation with foreign countries
3. Length of investigation
4. Size of investigation
   a. how many agencies were involved
   b. how many officers were involved
5. Description of the investigation
   a. special investigative tools
      1. wiretaps
      2. undercover officers

VI. Other
APPENDIX 2

QUESTIONNAIRE FOR EXPERTS

I. General

1. Is the VAT transitional regime concerning the transactions of goods and services more or less sensitive to fraud than the previous regulations? Why or why not?

2. Will the possibility to commit fraud be reduced with the introduction of the “country of origin” regulation scheduled to go into effect on 1 January 1997?

3. Is a sanction imposed upon a business which fails to file a return or provides incorrect or incomplete information on the quarterly tax return?

4. Is it possible to make use of the different VAT tariffs in member states to commit VAT fraud? If so, how is this done?

5. Which modus operandi are used to commit fraud?

6. What changes have been ascertained in VAT fraud modus operandi since the transitional regime on 1 January 1993?

7. In general, do fraudsters adopt a permanent modus operandi or do they select different modus operandi each time?

8. Are fraudsters involved in small, middle-sized or large enterprises?

9. Do fraudsters themselves possess special professional knowledge or do they obtain this from others (bookkeepers, accountants, lawyers?)

10. How do fraudsters select and recruit other entrepreneurs into their fraud-carousels?

11. What is the prosecution’s policy in dealing with cases of VAT fraud?
12. Is a businessman obligated to determine (research) the trustworthiness of his business partner?

13. Are there loopholes in the law which can be used for the purpose of evading VAT? How can the law be revised to prevent this?

14. Can recommendations be made for improvements in the control system, the investigative system, and/or the prosecution or settlement system in terms of VAT?

15. Are there European Union institutions which have a coordinating, policy-making or operational role in the fight against (VAT) fraud? If so, to what degree and what impact do these institutions have at the national level?

16. Is the introduction of a supranational control/investigative system (in the area of VAT) necessary in addition to the present national agencies?

17. Do linguistic problems form a barrier to international cooperation and if so, how are these problems overcome?

II. Central Liaison Office

18. The Central Liaison Office (CLO) processes information concerning ICS’s and sends these data, after a three-month period, to the CLO’s in other member states. In practice, is this three-month period adhered to?

19. Are countries required to exchange information concerning mismatches? In practice does this (always) occur? Does it occur in a timely fashion?

20. To what degree does the Central Liaison Office compare the VAT declaration with the quarterly report? When inconsistencies occur comparing these two documents, what occurs in practice? How important does the CLO judge this comparison?

21. To what degree and with which documents does the CLO compare
information from foreign CLO’s with information which is available from the domestic tax authorities? In practice, what occurs when a mismatch is identified?

22. How many mismatches occur and what percentage of these involve fraud?

23. Are the VAT identification numbers of foreign companies checked by the Central Liaison Office?

III. Investigative and audit services

24. What are the responsibilities, operating procedures and the authority of the investigative or auditing agency concerned?

25. Is there a specific unit within the investigative/audit agency that is responsible for work in the area of VAT fraud?

26. To what degree is there a difference between auditing and investigating agencies and what consequences does this have for the fight against fraud?

27. What signals alert auditing/investigative agencies to fraud? How often do legitimate businesses report on-going fraud-carousels to law enforcement or tax authorities?

28. What is done when a fraud signal is discovered? What authority and which means (resources) are available to deal with the situation? In which area is there a shortage of means or authority?

29. How are investigative agencies alerted to fraud when there is no case of mismatch?

30. Can you describe in general the manner in which most fraud is committed? Does it involve transportation of the goods or fraud with invoices? fictitious or real transactions? domestic or cross-border fraud? within the E.U. or with third countries? small scale fraud over a long period of time or the quick ‘big sting’? organized fraud-carousels or fraud committed by entrepreneurs while exploiting their business?
31. Are officers involved in the investigation/audit of VAT fraud provided with additional (expert) training?

32. Do investigative services cooperate with other investigative services or control agencies in the investigation of VAT fraud? If yes, please explain.

33. Do the investigative/audit agencies make use of the data from the Central Liaison Office or other data banks (IRENE, SCENT-FISCAL, CIS, etc.)? What has been your experience thus far with the reliability and usefulness of these data?

34. Are companies allowed to submit a yearly tax return? If so, does this create problems in the investigation of or fight against fraud?

35. Do investigating agencies work proactively in relation to VAT fraud? Are directed risk analyses conducted or is the proactive investigation a general one?

36. Are there branches which are particularly sensitive to fraud? If so, which are these and why?

37. Do investigating and auditing agencies take preventive measures to fight VAT fraud?

38. How is international cooperation with other E.U. member states in the processing of VAT fraud cases on the following levels?
   - administratively
   - judicially
   - politically
   - other: (e.g. personal networks and contacts)

39. How many cases of VAT fraud were discovered in the period 1991-1992 and how many of these were settled administratively (fine, transaction or other administrative settlement) and how many were processed through the criminal justice system? The same applies to the periods 1992-1993 and 1993-1994?
# APPENDIX 3
## ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbr</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>Benelux</td>
<td>Belgium, the Netherlands and Luxembourg</td>
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<tr>
<td>CLO</td>
<td>Central Liaison Office</td>
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<td>DG</td>
<td>Directorate-General</td>
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<td>ECU</td>
<td>European Currency Unit</td>
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<td>E.U.</td>
<td>European Union</td>
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<td>FIOD</td>
<td>Fiscal Information and Investigation Service</td>
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<td>IC</td>
<td>Intra-Community</td>
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<td>ICA</td>
<td>Intra-Community Acquisition</td>
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<td>ICS</td>
<td>Intra-Community Supply</td>
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<tr>
<td>ICT</td>
<td>Intra-Community Transaction</td>
</tr>
<tr>
<td>NVR</td>
<td>No Vat Return</td>
</tr>
<tr>
<td>UCLAF</td>
<td>Unité de Coordination de la Lutte Anti-Fraude</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>VIES</td>
<td>VAT Information Exchange System</td>
</tr>
</tbody>
</table>
APPENDIX 4

CASE SUMMARIES

The names of all individuals and companies in this report have been changed and bear no resemblance to the original individuals or companies.

CASE 1

This case involved a small family-owned business (husband and wife) which imported material (cloth) from one E.U. country to another. The business was predominantly legitimate with no known contacts to criminal enterprises. The fraud involved a simple non-declaration of the acquisitions from a neighbouring E.U. country worth approximately ECU 72,000. This offence resulted in the evasion of approximately ECU 19,000 in VAT. Further illegal practices involved claiming refunds on prepaid VAT for fictitious subcontracting work to companies which never filed a regular tax return. The VAT fraud occurred from January 1992 until June 1993; other frauds occurred over a period of 4 years from 1990 until 1994. Discrepancies arose when the legitimate business reported the supply, but the offending business failed to report the acquisition. The business was audited and the case was handled administratively. The offenders had to pay the amount originally owed to the tax authorities for the evasion of VAT and income tax, fictitious subcontracting, and other minor offences as well as an administrative penalty totalling ECU 103,000.

CASE 2

A family-run tailoring business imported material from one E.U. country to another between 24 June 1992 and 24 May 1993 and failed to record or pay taxes on the acquisitions. This family also hired illegal workers to work in the small family business and thus avoided paying income tax. There appears to be some degree of organization involved. It is believed that the father masterminded the operation, although his name never appears as the company owner on any documentation. Ownership, on paper, is passed between the

1 All figures have been converted to ECU's and are estimates.
aunt and two sons. There is a bookkeeper/economic advisor but it is unclear whether or not he is involved in the fraud. A proactive search by the fiscal law enforcement agency involved, revealed a mismatch between the regular tax return and the document showing import of material (Benelux 50). An audit was conducted. Despite suspicions, which were supported by energy bills, that the company had been operating illegally as early as 1988, the case was handled administratively. Although the time frame for the VAT evasion from June 1992 until May 1993 can be proven, the company was given an administrative penalty for evasion of VAT and employment taxes for only a period of 2 months, including a 100% penalty increase, amounting to ECU 137,000.

CASE 3

This more sophisticated international VAT fraud involves 2 main and 2 secondary suspects, and a number of people in the outer circle. Authorities suspect that this fraud construction began in 1993 and is still in operation. The investigation has not yet been completed.

Silverware, pots and pans and other household goods were bought from companies in other E.U. countries as well as from countries outside the E.U. Some of the goods were sold legitimately on the domestic market and VAT was paid on these goods. The remainder of the goods were allegedly supplied (ICS) to a company, established by the principal fraudsters, in another E.U. member state. Both the ICS’s as well as the ICA’s were reported, thus there was no mismatch. The goods which were allegedly supplied to the company in the other member state were sold instead by groups of salespeople on the domestic black market. It is estimated that by the end of 1994 the suspects had evaded over ECU 300,000.

CASE 4

Beginning in 1993, two fraudsters (Mr. Johnson and Mr. Curtis) utilized seven legitimate businesses in A-land for the sole purpose of perpetrating fraud. The seven legitimate companies in A-land were approached by Johnson and told that he wanted to ship goods to four different companies in B-land. He could not ship the goods personally because this transaction would violate certain sanctioned trade agreements. Using an intermediary company is a quite common and legitimate practice for avoiding trade re-
strictions and aroused no suspicion among the cooperating legitimate companies. The degree of knowledge of the fraud on the part of the 7 companies is questionable. Mr. Johnson told the businesses that he would provide them with purchase invoices and that they should prepare shipping invoices for the goods which he would ship. The companies then applied for a refund of prepaid VAT which they then paid to Mr. Curtis. The companies, in turn, were paid a small fee for their "assistance". The four companies to which goods were allegedly shipped in B-land, were either shell companies or those which did not file regular returns.

Between 1993 and the first quarter of 1994, ECU 583,000 was refunded by the tax authorities. The case was still under investigation at the time of this research. It is estimated that between ECU 2 and 2.5 million have been illegally obtained.

CASE 5

This case involved a single individual, Mr. Mayfield, who exported compact discs against the 0% tariff in order to reclaim his alleged prepaid VAT. From 1 January 1989 until 1 January 1991, Mayfield allegedly (on paper) purchased CD’s in his own country, A-land, and in B-land. He then sold them domestically and in C-land. The CD’s were actually purchased in C-land and sold domestically so VAT was due on the sale. The interesting aspect of this case is that Mayfield falsified his regular tax return in such a way that he either requested a small repayment on his regular tax return or (over the period of three quarters) even paid the tax authorities (ranging from ECU 5,000 to 13,000 per quarter). From the first quarter of 1989 to the third quarter of 1990, Mayfield claims to have exported goods valued at approximately ECU 2.9 million. The accused claimed the tax authorities owed him ECU 777,000 for his prepaid VAT upon subsequent export.

A proactive analysis by fiscal investigators revealed that the amount of money owed was almost the same as the deductible prepaid tax, a most unusual phenomenon. The fact that A-land is an importing country, not an exporting country when it concerns CD’s, Mr. Mayfield’s business practices aroused even more suspicion. An audit and investigation failed to produce the books and receipts which Mayfield claimed were in D-land. Mayfield was arrested and a subsequent trial resulted in a sentence of 2 years and a ECU 530,000 penalty.
CASE 6

The following carousel scheme involved numerous businesses in three countries. This large and sophisticated fraud operation involved 11 purely fraudulent companies which issued false invoices and at least 10 semi-legitimate businesses which purchased the television and video equipment without VAT. Five main fraudsters were involved in a sophisticated paper trail of invoices and the transfer of television and video recorders. There is a division of labour and one man, Mr. Tierney is thought to be the brain behind the operation. During the period of November 1988 to December 1989, goods were purchased from three legitimate large electronics concerns in A-land by a shell company in B-land. This company then invoiced and sold the goods to a shell company belonging to Mr. Tierney in C-land. Two fraud constructions are utilized. The first involves the fictitious export of the goods to a company in an African nation and one in Kuwait via a legitimate shipping company. In reality, the goods were picked up from the shipping company by Tierney's nephew, Mr. Smythe. A cheque was used to cover the VAT. When Smythe returned with the stamped customs forms indicating the previous shipment had left the country (for this purpose one or more customs officials was allegedly bribed to validate the false shipping documents), the VAT was returned to Smythe by the shipping company.

In the second fraud circuit, Tierney's company in C-land invoiced the goods back to a shell company in B-land, which then invoiced them on to various legitimate as well as shell companies in B-land. While the invoices took this route the goods followed another route. The goods were brought back into B-land to a store belonging to Tierney's assistant. Fictitious invoices were generated by a shell company in B-land to create the illusion that the goods had been purchased legitimately on the domestic market. The goods were then sold to at least 10 retail stores in B-land without VAT.

The owner of the shipping company noticed that the goods were not leaving the E.U., despite proper customs documents, and notified the tax authorities. An investigation was initiated and the shipping company was held liable for refunding the loss of ECU 1.92 million to the tax authorities in member state B.

CASE 7

This was a loose construction of 4 individuals with no particular division of labour. Their role was limited to picking up the goods from the airport.
During the time frame of 10 December 1990 until 1 February 1991, a fraud construction was set up and use was made of the VAT identification number of another business. The transfer rule, which allowed goods to be imported and the tax payment to be deferred until a later point in time, was abused. Compact discs and cassettes were brought into A-land (through the airport) from outside the E.U. via two shipping companies. While the goods were billed to company ABC Kitchen goods, they were being sent to ABC Music. A number of events triggered an investigation. Differences existed between the address on the sales invoice and the owner of the VAT identification number on the one hand, and the company which was ordering the goods on the other hand. Furthermore, a complaint was filed with the fiscal investigation division by a legitimate business claiming that CD’s had been offered for sale below the standard wholesale price.

The suspected organizer of this fraud lives abroad (outside of the E.U.) and could not be located. The degree of involvement of the four individuals in the fraud scheme, beyond picking up the goods, is questionable, therefore no further action was taken against them. The dispatchers were held responsible for the money owed the tax authorities for import: ECU 50,000. The goods which were being held in the customs storage area were seized.

CASE 8

The Adams family, 5 brothers, came to A-land in the late 1980’s seeking political asylum. The family began with the purchase of one gas station/car wash/parking garage which was later followed by the purchase of others. Currently, the Adams family is in possession of 200 petrol stations. It is suspected that the money used to originally finance the purchase of gas stations was obtained through the illegal trade in drugs in their country of origin.

Three brothers and 4 nephews were involved in the fraudulent scheme. One of the brothers is clearly the leader of this operation. Others manage specific stations. At this point there is no clear hierarchical structure although there does appear to be a clear division of labour. Contact was established with other notorious fraudsters, well-known to fiscal investigators in two E.U. states.

The case involves the evasion of VAT and excise taxes on petroleum (gasoline). The family also employees illegal workers from their country of origin and thus avoids paying employee- and social security taxes. It is
further involved in arranging marriages for living permits and using threats and violence to force illegal employees to work long hours for low wages.

The investigating authorities have identified different schemes in three time phases during which the fraudulent practices occurred. Phase I occurred prior to 1992. Phase II occurred between September 1993 and February 1994. The third phase began in August 1994. The schemes in the various phases are similar. Briefly described, the petroleum sold against the 0% tariff in A-land, is sent directly to the gas stations owned by the Adams family in B-land from company Oilsupply in A-land (a notorious fraudster in behind this scheme). In order to prevent a link between himself and the Adams family, an interim shell company is necessary. The invoice from Oilsupply in A-land is sent to a shell company, Oilspill, in B-land, instead of the individual petrol stations. Oilspill (B-land) then invoices the petrol to one of the brothers. Six different schemes from 1 January 1993 through the end of 1994 have been identified. What differs in each of these schemes is the supplying company in A-land and the shell “receiving” company in B-land. In each case, one of the brothers claims to have purchased the petrol from the shell company on the domestic market (and thus to have paid VAT and excise taxes which he now wants to have refunded). The family has created its own shell companies for the purpose of generating false invoices and uses strawmen to run these companies.

An anonymous letter was sent to the Ministry of Finance, complaining of the petrol stations’ practice of underselling competitors. This triggered the investigation. Action was taken in November 1994. Books were seized at 160 stations and 40 individuals were investigated. At this time the investigation is still in progress.

Total criminal gains are unknown. Invoices exist to prove losses for the second phase. Over a period of approximately 22½ weeks, almost ECU 6.8 million VAT was evaded. Figures for the other two phases are unknown. The Adams family is known to visit gambling casinos. It is suspected that this venture allows the illegal money to be laundered.

CASE 9

The following ongoing carousel fraud which began in 1985, was perpetrated by a group of individuals and involves the fraudulent trade in luxury automobiles. On paper the cars were bought and sold between various legitimate and shell garages. The cars then allegedly left the country for another E.U.
member state and then later reappeared on the domestic market at a lower price. The price was once again raised as the same car was bought and sold. Oftentimes the car was simply parked in a garage while on paper the car exchanged hands and companies. There was always a shell company situated between the legitimate companies. This shell company issued a sales invoice, including VAT, to a legitimate company. According to the invoice the legitimate company paid the shell company VAT, thus upon resale, it was entitled to a refund of VAT from the tax authorities. The shell company acquires the car again against a lower price and the whole operation begins again. The fraudsters were so greedy and careless that in some cases a garage sold a car, on paper, before it had even purchased it!

There is no established organization. New legitimate or fraudulent businesses are constantly being introduced into the scheme. The group functions more as a loose network. There appears to be a hierarchy with three loosely structured levels: At the top are three men who have all spent time in prison and are known for illegal involvement in the auto business, to include car theft. The second level consists of a close inner circle involved in numerous transactions (two “legitimate” businesses in particular). The third level comprises a looser circle of associates who were involved in the business of buying, selling and trading second hand cars.

The fraud operation began in 1985 and investigators suspect that it is continuing today. Two major schemes were identified. One was in operation for a period of 5 years and other for a period of 15 months. ECU’s 562,000 and 927,000, respectively, were evaded during these two fraud constructions. Other smaller operations have also been identified although no estimates have been provided on the amount of loss to the tax authorities.

Between August 1990 and July 1991, 3 complaints were filed with investigating authorities concerning the illegal activities of two garages involved in the carousel fraud. The investigation lasted over three years and has been turned over to the public prosecutor.

CASE 10

This case involves two non-E.U. residents, Mr. McQueen and Mr. Lord, who, in November 1993, established two shell companies in A-land for the sole purpose of perpetrating fraud. The scheme involved what is known as a staggered repayment\(^2\) fraud: Software Sales sold goods to Software Export.

\(^2\) Tax point is based upon the date of invoice or time of payment (ex. restaurants/pubs).
Software Export exported the computer discs to a non-E.U. country and reclaimed its prepaid VAT before Software Sales paid the VAT it owed. Software Sales claimed that it could not pay the VAT until it got the money from Software Export, which claimed it could not pay the money owed on the goods until it got a refund check from the government.

This is the "big sting". In December 1993, a single sale was transacted. Software Sales copied 6,000 computer disks which were then sold to Software Export with a 218,000% mark up (allegedly for ECU 7,580,000). Software Export then sold them to another company in a non-E.U. country. The disks were shipped via a legitimate shipping firm. Software Export and the third company in the non-E.U. country are both owned by Mr. Lord.

Upon export, Software Export requested a ECU 1.3 million VAT refund, before the VAT was paid by Software Sales. The investigation agency was alerted to a possible fraud because of the large amount of the request and because both businesses were registered at accommodation addresses. An investigation resulted in the fraudsters’ arrest. Each spent 10 months in pretrial confinement; at the time of trial they both plead guilty and were sentenced to time served and then deported.

CASE 11

Between November 1993 and June 1994 Mr. Henderson, a previous VAT fraudster, aided by his girlfriend/secretary and a salesman, smuggled alcohol between A- and B-land, created false invoices and suppressed sales for the purpose of evading VAT and excise taxes. While the others assisted in the operation, Henderson was clearly the leader.

Two distinctly separate methods of excise and VAT evasion have been identified. Between November 1993 and January 1994 Henderson purchased a total of 27 consignments of duty free beers. Duty was paid on the first consignment with all remaining consignments supposedly having been paid off over a number of years, the output tax (VAT) is due based upon the point of invoice – even if no money changes hands or the company ever gets paid. A staggered repayment means that payment of tax is due at different times. It would have been possible for Software Export to claim repayment before Software Sales paid the tax owed. This situation does not necessarily imply that fraud is involved, assuming that Software Sales intended to or actually did pay the VAT owed.
exported to another member state. Most of these goods were supplied directly to Henderson's customers and the remainder to his own premises. The vast majority of consignments of wines from yet another member state were simply not declared. Of the 200 consignment which were imported, only 7 were claimed. Henderson issued sales invoices, all bearing the same number, to his domestic customers. This invoice number appeared only once in the appropriate sales book and was related to the very first consignment on which duty was paid. The remaining 26 consignments were therefore, totally suppressed and the VAT that was charged was not paid.

In January 1994 Henderson set up his own company in B-land. Between January and June 1994 he exported approximately 250 consignments of duty free beer to this company. The vast majority of these consignments were diverted back into his own country without being properly declared, thus no VAT or excise taxes were paid. The subsequent onward sale to domestic customers was totally suppressed. Investigating authorities were notified as a result of an anonymous complaint.

Henderson was previously involved in VAT and excise fraud, for which he received 240 hours of community service. The modus operandi for this and the previous case are essentially the same, although the excise/VAT arrears in this case were considerably larger: ECU 1.2 million in VAT and ECU 4.5 million in excise. Henderson and his cohorts were arrested. Henderson faces criminal prosecution. No more is known at this time.

CASE 12

Mr. Hudson supported his financially-strapped legitimate business by falsifying exports of antiques on an irregular basis. His legitimate business had been in operation since 1973. Hudson falsified exports of antiques to other European countries and the U.S. using false customs stamps and export documents. The goods were then sold on the domestic market and no VAT was paid. On 17 VAT returns between October 1988 and December 1992 Hudson falsified 89 invoices. The falsified VAT forms were signed by him but prepared by his accountant. They were based upon copies of invoices in the duplicate books held by Mr. Hudson.

Hudson stopped using the stamps and terminated the fraud in December 1992, some 18 months before the commencement of the investigation. It may be assumed that the fraud with the stamps stopped because with the introduction of the interim regulations on 1 January 1993, customs stamps were no longer necessary to move goods across E.U. borders. Why the
stamps were no longer used to “export” the goods to the U.S. is not clear. The revenue obtained, as a result of the fraud, over a 4 year period is approximately ECU 13,700. Evidence suggests that the fraud had been in operation for 6 years.

Police were conducting an investigation into stolen goods at antique dealers in the neighbourhood. Mr. Hudson was arrested for possession of stolen goods and the tax authorities were alerted that there were possible irregularities in the paperwork of the antique business. An investigation was initiated and completed in December 1994. Even though the amount evaded falls below the minimum amount generally considered for criminal prosecution in this particular country, criminal charges were brought against Mr. Hudson as a warning to other antique dealers. At this time nothing more is known about the outcome of the case.

CASE 13

A highly sophisticated smuggling ring was responsible for bringing large amounts of gold into the country. The gold was then sold on the domestic market without paying VAT. The operation used fleets of identical cars with identical license plates which were interchanged. Different couriers were also used to throw off surveillance. The smuggled gold was actually welded into the body of the car. The fraud was perpetrated from sometime in 1986 until October 1990. During this time frame 110 smuggling trips were made. The estimated criminal gains are ECU ± 17 million.

The construction was highly structured. The principal organizer, Mr. Dillon, was a known fraudster with numerous aliases and a previous conviction for VAT fraud. Supporting the operation were 3 female couriers and 3 male assistants who accompanied Mr. Dillon on his buying trips (among them are Dillon’s stepfather-in-law and stepson), a financial advisor, and the “legitimate” businesses which willingly purchased the gold from Dillon.

The case first began as a missing trader investigation. Mr. Dillon had been identified as a missing trader in another VAT fraud case involving gold. Extensive surveillance was conducted for the better part of 12 months. The seven people involved were arrested. Prison sentences of

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3 Businesses which collect VAT on goods sold to other businesses are required to pay the VAT to the tax administration. Businesses which do not do this, but simply “disappear from the picture”, are labelled missing traders.
between 2 and 7 years were handed down. Mr. Dillon received the maximum 7 years and confiscation orders were levied against Dillon and his major purchaser.

CASE 14

This is an intra-community transaction fraud which began after 1 January 1993 and was perpetrated by a single individual, Mr. Page. Page owned a computer company, which acquired computer parts from domestic companies and from companies in 4 other E.U. member states. Some of these purchases were legally recorded in his books and reported to the tax authorities. Others were registered as domestic purchases from two shell companies, both owned by Mr. Page. The shell companies were established for the purpose of requesting a refund of Page's alleged prepaid tax on the fictitious domestic purchases.

Page began his legitimate business in November 1989. The fraudulent practices began in July 1993 with the first fictitious purchase order. The fraud can be proven for the period from July 1993 until March 1995, however it is suspected that the fraud continues to this day. Mr. Page did not file his tax return on a regular basis, then filed two at one time. This activity aroused the suspicion of the tax controllers who decided to carry out an audit of his business. Information obtained from the VIES system was used to verify Page's purchases. Criminal gains are estimated at ECU 3 million.

The case was handled administratively. Mr. Page's accounts were blocked and his house, boat and horses were seized. In addition, he had to repay the VAT owed and received a penalty. The total owed the tax authorities amounted to ECU 8.3 million.

CASE 15

Mr. Fagan turned his legitimate business into a predominantly fraudulent practice by pretending to export expensive jewelry to foreign purchasers in non-E.U. countries. His scheme was to meet these foreign purchasers in a non-E.U. country, transact the sale, and return home. Fagan purchased a

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4 Page employed an assistant and his wife served as the bookkeeper. Investigators are uncertain as to whether these two individuals were aware of the illegal practices.
plane ticket and went to the airport with export papers for his expensive, custom-made jewelry. After having cleared customs and having obtained the necessary export stamps on the paperwork, Fagan left the departure hall and returned home with the jewelry which he subsequently sold illegally on the domestic market (without VAT). Fagan’s legitimate jewelry business began in February 1988. His fraudulent practice spanned a period from February 1990 to April 1992.

An astute customs agent found it unusual that Mr. Fagan appeared at the airport 4 hours early for an intra-European flight. He followed Fagan, who exited the departure hall and drove home. A search was conducted and Fagan was arrested. Over the 26 month time frame, Fagan evaded approximately ECU 160,000 in VAT. Income tax was also evaded. The tax authorities demanded a total5 ECU 1.6 million. Fagan’s apartment was sold and the proceeds were used to pay the debt. The investigation is still in progress to determine if further property can be seized.

CASE 16

This case involved a sophisticated organization involved in the smuggling of petrol into two E.U. countries6 resulting in the evasion of excise and VAT taxes. This case examined only one aspect of the fraud involving the smuggling into one E.U. country. Petrol was purchased on the international market and brought to a large European port city (A-land). Using false customs stamps and assisted by corrupt customs officials, the T-2 documents were stamped as if the goods had been shipped to C-land. Instead the goods were smuggled into B-land. Because the petroleum products smuggled into B-land from A-land were not accompanied by a purchase order, a shell company was established to provide sales invoices. The goods were then "legitimately" in B-land.

The initial fraud was managed by a family from a non-E.U. country.7 They managed the main receptacle, company Oilfree, for the smuggled oil. It was then invoiced to another company (Oilsale), which then invoiced it

5 An initial sum of ECU 277,000 was demanded. Because Fagan refused to pay, the tax authorities raised the amount to ECU 830,000.

6 The fraud discussed in case 8 is a smaller part of this case.

7 This family was alleged to have had ties to the Costa Nostra. The main suspect was recently convicted for his leading role in a major fraud scheme in the USA.
to numerous “legitimate” petrol stations. All transactions occurred in cash. In Oilsale’s bookkeeping were purchase receipts from a number of domestic shell companies (which were major suppliers to the Adams family in case 8). These invoices all contained VAT, which Oilsale could reclaim from the tax authorities upon resale. The shell company from which the petrol was allegedly purchased, however, does not pay the tax authorities. New shell companies were established and sacrificed as needed.

After the family exited the market, the operation was taken over by another well known fraudster. All of the major players in this operation were well known to tax and investigative authorities in the two countries between which the petrol was smuggled. The organization was well structured with an established hierarchy and division of labour. There were familial ties between the employees in Oilsale and those in Oilfree. A large scale investigation netted 132 petrol stations which purchased the gasoline. The head of the operation (the fraudsters who managed the operation after the family left) was arrested in November 1992.

From 6 shell companies, alone, the damage to the fiscal authorities was almost ECU 17.1 million. It is estimated that the total taxes evaded (VAT and excise) is ECU 44.8 million.

**CASE 17**

On 3 October 1990 a treaty was signed between an E.U. and a non-E.U. country regulating the trade between businesses of the former and specific professional groups of the latter. This treaty provided for VAT-free trade between the two, provided that certain conditions were met.

Mr. Jenkins took advantage of this new opportunity. He promoted his secretary to manager of his business. She functioned as a straw woman and unquestioningly approved all documents. Between October 1990 and August 1991, Mr. Jenkins, under the cover of his legitimate business, allegedly sold clothes (jeans, fur coats, leather jackets) and video and hi-fi equipment to the involved professional group. False stamps were used to verify the sale. Those officials who cooperated by providing stamps were rewarded with a few video recorders. The goods were never sold to the professional group but instead sold to stores on the domestic market without VAT. Approximately ECU 187,000 VAT was evaded, as well as ECU 97,000 in import and other customs taxes.

A special investigation conducted by the tax authorities resulted in the pretrial detention of both individuals. Jenkins was sentenced to a 1.5 year
suspended prison sentence and placed on probation. The secretary was fined ECU 5,000.

CASE 18

Mr. Thomson began a legitimate business in photocopiers in 1982. In 1991 he established a computer business, Compusell. Stiff competition threatened his business. Thomson discovered that incredibly low prices (and thus more business) were possible as a result of tax fraud. In 1992 Mr. Thomson met a fraudster who supplied him with the “know-how” to establish his own fraudulent operation. Shell companies were established to produce false domestic sales invoices of computer parts in order to reclaim alleged prepaid VAT.

The fraud construction can be divided into different routes spread across three phases. The phases differ in terms of the degree of organization, the first link in the purchase chain (shell companies) which purchase the goods and the method of payment to the legitimate companies.

**Phase 1:** there is a loose network of individuals perpetrating fraud. Compusell in A-land purchases goods from legitimate companies in B- and C-land and one non-E.U. country. According to the sales invoices, the goods were sold to five different shell companies in A-land. Further sales invoices indicate that the goods were purchased by Compusell from four domestic companies (which appear to be bogus companies of notorious fraudsters). Compusell then sold the goods to large computer companies in A-land and requested a refund based upon the fictitious purchase invoices from the four bogus companies. Payment to the legitimate companies was made via bearable cheques, issued by an exchange bureau to cover the trail and to prevent arousing the suspicion of the legitimate suppliers.

**Phase 2:** In phase 1 all shell companies are located in A-land. In this phase the fraud becomes more structured and organized. The shell companies to which the invoices of the legitimate companies are sent, are now located in D-land. Another difference is found in the payment which now is made via bank cheques issued through the exchange bureau. As no name appears on these cheques, it is impossible to trace the payment back to the original purchaser of the cheque. Further complicating the investigation is the fact that original sales invoices indicated the sale of computer parts to companies in D-land, whereas the fraud occurred in A-land. Thomson was involved in the fraud construction from June 1992 through June 1994. The fraud construction was so well organized that when Thomson was investi-
gated and his operation was closed down, a new operation was immediately assembled and continued (officially) without Thomson (phase 3).

**Phase 3:** Although Compusell discontinued its operation, Thomson remained in the background and continued with VAT fraud by invoicing goods from his personal computer at home. A new shell company was established in D-land to which the legitimate suppliers sent their invoices. In reality the goods were supplied to a new company, Computersoftware, established by Mr. Thomson. Shell companies are established in A-land. These shell companies invoice to each other as well as to Computersoftware. A complex payment scheme is created involving shell companies in two countries.

While the organization originally began as a loose structure of acquaintances, by phases 2 and 3 it took on a more organized form, with Thomson in the role of key organizer. There were facilitators who provided contracts and false invoices. Additionally, there were strawmen behind the shell companies, and there were large computer concerns which willingly purchased the computers from Thomson. The exchange bureau facilitated illegal payment and aided in the purchase of stocks in a foreign country worth ECU ± 630,000. In total, ECU 7.4 million was evaded.

During an investigation into another VAT fraud, invoices from Thomson’s business were found in the bookkeeping of the business under investigation. As the investigation expanded, Mr. Thomson became the focus of an investigation into his illegal practices (August 1993). The investigation expanded based upon complaints filed by companies which had provided goods and were not paid. The tax authorities uncovered the shell company. By tracing the invoice trail in the books of various companies, the authorities arrived at Thomson’s company in September 1993. He was forced to stop. In June 1994 an investigation into ICT’s from legitimate companies in another member state revealed the entire pattern. Thomson spent six months in pretrial custody. The investigation is still in progress.

**CASE 19**

Mr. Maxwell began his predominantly illegitimate enterprise in textile and sundry items at the end of 1988. He purchased goods and fictitiously supplied them to 4 shell companies (or companies which did not file tax returns), in two other member states. In reality, the goods disappeared on the
black market in the country of origin. The companies in the other two member states are owned by individuals who are part of a network of contacts Maxwell built up over the years. These individuals established contact with one another in a city in which numerous fraudulent companies are located. Maxwell operated on his own, but was aided by the foreign (fraudulent) companies which also profited from this fraud.

Suspecting a fraud carousel between two member states, the fiscal investigative agency, in December 1993, initiated an investigation into the refund requests from several companies. In February 1995 Maxwell’s bookkeeping was confiscated. The investigation is still in progress.

CASE 20

In 1988, Mr. Baldrick founded a one-man business in the purchase and sale of precious metals. Baldrick purchased gold from a company in a neighbouring member state. He smuggled the gold into his own country and sold it to three domestic companies. With false purchase invoices from fictitious domestic suppliers, Baldrick requested a refund for the fictitious prepaid VAT (and under-reported the actual sales). Fiscal investigators believe the entire smuggling operation was financed by a well known fraudster earlier involved in illegal contracting. Between January 1988 and March 1990, the tax administration lost ECU 1.1 million in taxes owed and in false refunds claimed by Baldrick. The profits Baldrick made were invested in his luxury apartment.

The probe into another large gold fraud led the investigation agency to Mr. Baldrick’s business. Based upon the fact that Baldrick received social security benefits and his turnover was high, the decision was made to audit his bookkeeping. Mr. Baldrick was convicted and sentenced to two years imprisonment.

CASE 21

In 1990, Mr. Marx established his business in A-land. In addition to his legitimate trade activities, Marx fictitiously supplied audio-video goods to companies in B-land, known to be owned by notorious fraudsters. Marx

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8 One of these companies was also prosecuted for having purchased the smuggled property.
feigned sales to the companies. Tax declarations were falsified and export forms were stamped with false custom stamps provided by one of these fraudsters. Feigning a sale against the 0% tariff, prepaid VAT could be re-claimed. The goods were then sold domestically on the black market. Between January 1991 and December 1992, Marx requested a VAT refund of ECU 216,000 from the tax administration.

Although Marx was assisted in his business activities by his wife, daughter, an accountant and an administrative assistant, his wife was probably the only one aware of the illegal practices.

A VAT fraud investigation in November 1992 of businesses in B-land resulted in the authorities there requesting that a search be executed at Marx’s business. The authorities in A-land found evidence of numerous fictitious sales to notorious fraudsters in B-land. Verification of the declarations and sales documents led to the discovery that false customs stamps had been used. In February 1993 the tax administration levied a fine. Mr. Marx was forced to repay the VAT evaded plus a 10% fine.

CASE 22

The organizer and leader of this fraud operation, Mr. Cooney, had a history of involvement in fraud. Together with an accountant, an administrative assistant and a strawman/handyman, Mr. Cooney set up a fictitious network of ± 100 domestic and foreign (non-E.U.) shell companies during the second half of 1992. Some of the companies were purchased as legitimate businesses (a previous solid reputation meant that they could operate for longer periods before coming under suspicion). Other businesses were established for the purpose of perpetrating fraud.

The actual fraud began in January 1993. The operation is unique in that the fraud existed only on paper. There were never any real goods being traded. Mr. Cooney falsified invoices of domestic purchases and ICS’s. Approximately forty companies were used to provide fictitious sales invoices; the fictitious goods were then supplied to companies in three other member states. These companies were shell companies or legitimate companies unaware that their VAT identification was being used for fraudulent activities. Based on the fictitious domestic purchases and ICS’s, a VAT refund was requested. When the activities of a business aroused suspicion,

9 In addition to the aforementioned persons, there were approximately seven other persons involved on a less structured and routine basis.
the company was sacrificed and a new shell company was utilized. Safeguards were built into the operation by requesting relatively small VAT refunds, by utilizing different branches to prevent links between the companies, and by establishing numerous bank accounts (with false passports and driver’s licenses) so that when refund payments were made, the cash could be immediately cleared out of the account. Almost ECU 3 million had been refunded by the tax administration.

As a result of a proactive investigation by fiscal authorities into the refund requests from various companies, an administrative audit was conducted in October 1993. Three months later fiscal investigators detected the crimes. In March 1994 the three main suspects, Mr. Cooney, his accountant and the strawman/handyman were arrested, tried and convicted. Mr. Cooney was sentenced to 4 years imprisonment, his accountant to three years and the strawman/handyman to six months incarceration and one year on probation.

CASE 23

This fraud carousel between two member states was initiated in the beginning of 1993 and is still in progress. Fictitious intra-Community supplies occurred between several businesses in A-land in the textile branch and shell or legitimate companies (unaware that their VAT identification numbers were being used) in B-land. A VAT refund, based on bogus invoices, was requested. Real as well as fictitious goods were involved. Goods were then sold on the black market in A-land or were actually supplied to companies in B-land. The (shell) companies in B-land made fictitious supplies to other shell companies in A-land. Goods were again sold on the black market in B-land or transported to a shell company in A-land and then again sold illegally. Legitimate companies were frequently situated between shell companies which complicated the investigation.

Investigators believe that the carousel is organized around the contacts of the three main fraudsters from A-land who are well-known to the tax authorities because of their previous involvement in VAT fraud. They built up a network of contacts with legitimate as well as shell companies. It is likely that these three men approached companies in both member states asking the companies to take false invoices into their bookkeeping and to make intra-Community supplies. The companies received the requested VAT refund which was turned over to the fraudsters. The businesses were then rewarded with a percentage of the invoice.
In November 1993, the large refund requests of a few companies in A-land aroused the suspicion of fiscal investigators. The investigators recognized familiar names from the fraud scene among the trading partners and discovered that shell companies were involved. In February 1995, the pattern of this carousel changed completely. Several shell companies disappeared and new (shell) companies were used in the carousel. Because the main part of this carousel is occurring in B-land, the decision was made in March 1995 to hand the case over to investigators there.

CASE 24

Mr. Fedder owned a transportation company in A-land near the border of B-land. Mr. Fedder drove to B-land on a regular basis to fill his trucks with so-called (VAT-free) 'red gasoline'. He feigned having purchased regular gasoline (including VAT) in B-land and requested a refund for the VAT based on the Eight Council Directive (70/1072/EEC) at the Overseas Repayment Unit in B-land. In addition to this, Mr. Fedder inflated his invoices to ensure an increased VAT refund. He made 'off the record' payments to his temporary drivers and thus also evaded taxes on wages. From 1 January 1990 until 31 December 1992, Mr. Fedder fraudulently reclaimed about ECU 14,000.

Fedder’s fraud was uncovered after a routine examination of one of his claims at the refund office. An investigation was initiated. Mr. Fedder was tried, convicted and had to repay the VAT plus a penalty of 25%.

CASE 25

Mr. Monroe already had a chequered revenue history when he founded his company in the beginning of 1993. Using his cable manufacturing company, he committed VAT repayment fraud. Monroe pretended to have purchased electrical generators domestically using false purchase invoices and quoting a previously cancelled VAT registration number of one of his former suppliers. He then feigned an export of these generators to a company in a non-E.U. country. He instructed his secretary to alter a shipping document on which his real supplies to the foreign company were listed and added the information.

10 This council directive deals with arrangements regarding the refund of VAT to taxable persons who are not established in the territory of the country.
tion pertaining to the generators. While his secretary acted on his instructions, all evidence pointed to Monroe as the sole perpetrator of this fraud. In a single transaction he requested a ECU 90,000 VAT refund.

Because it aroused suspicion, Monroe’s tax declaration was referred to an investigation unit. Further investigation resulted in Monroe’s arrest in May 1994. He plead guilty. No information is available on the sentence.

CASE 26

This case involves a major gold fraud perpetrated in A-land. The fraud occurred between May 1992 through March 1993. Gold was purchased at a company in B-land at a 0% or 1% VAT rate. Prior to 1 January 1993 the gold was smuggled into the country; after that date and the abolishment of the frontiers, gold was simply transported to A-land. Mr. Tadler was the leader of this fraud operation. The gold was initially divided among ten “legitimate” companies which were involved in the fraud. These companies used fictitious invoices from five shell companies to simulate domestic purchases. Upon resale to Tadler, the 10 companies requested the alleged prepaid VAT from the tax authorities. The profit secured was divided amongst the smugglers, the legitimate companies and the five shell companies. Approximately ECU 14.5 million in tax was evaded.

Tadler invested his profits in real estate but was clever enough to register the property in his wife’s name. It is suspected, but not proven, that Tadler also used this gold fraud as a way to launder friends’ drug money.

Based on a proactive intelligence investigation, Tadler was spotted as a purchaser of very cheap gold. The investigation in this fraud case was initiated in March 1992 with one smaller section of this fraud.\(^{11}\)

In June 1992 the investigation into the larger fraud scheme started and was finished in March 1993. Sixteen persons, including Tadler, have been prosecuted in this fraud case. The results of the trial were not known at the time of this research.

\(^{11}\) In this case (from May until August 1992) gold was purchased at a bank in another member state without VAT and smuggled into the country. There it was sold to a legitimate company, GoldInc, which used invoices from a shell company to pretend the gold had been purchased domestically. GoldInc sold the gold to Realgold which sold it to Tadler’s company. In August of 1992 four persons involved in this part of the fraud were arrested: two smugglers and the managers of two of the legitimate companies. Upon conviction in June 1993, one smuggler received a sentence of 18 months imprisonment and the manager of one of the companies received a 12 month suspended prison sentence.
CASE 27

Between October 1992 through December 1993, nine people were involved in the VAT- and duty-free purchase and smuggle of liquor and tobacco. The fraud occurred in A-land. The goods were purchased in several supermarkets in B-land, managed by people from A-land who sell duty/VAT free goods to residents of A-land. The fraudsters smuggled the goods to A-land and sold them without VAT or excise taxes. The main offenders were two females who ran bed and breakfast establishments for refugee women. The other seven persons involved functioned as drivers and assistants who acted on the main offenders' instructions. Tax evasion was established at ECU ±7,300. The investigation was initiated as a result of information provided by an informant. During a search of the premises, the investigators found documentary evidence which detailed buying costs and expected return by way of sales. The investigation of the VAT fraud was finally dropped because the VAT evasion was relatively small in comparison with the evasion of excise taxes. The authorities were still involved in the case concerning excise tax evasion and no further information was available concerning the processing of the case.

CASE 28

In April 1993 a clan of foreigners began approaching large garages in one member state with the offer to earn quick and low-risk money. The foreigners claimed that they wanted to buy and export an expensive car but were having problems pre-financing the VAT on the car. Waiting for the necessary time involved with the VAT refund would take too long. They offered to pay the garages a small sum of money if they would pre-finance the VAT. The fraudsters told the garages owners that they would take care of the necessary formalities for the export of the car, to include processing and customs documents and stamps. The foreigners offered an invoice of the luxury car (from a shell company and including VAT) and requested that the garages take the invoice into their bookkeeping. The garage would pay the VAT to the foreigners and the VAT would later be returned to the garage by the VAT administration based on the invoices and export documentation provided by the foreigners. A garage could earn about ECU 1,300 to 2,600 with every invoice. The fraudsters kept the transactions limited to one garage for a short period of time and then switched to another one. On occasion, garage owners were threatened by the fraudsters to keep silent.
The investigation began as a regular audit visit to a number of garages by a customs investigative unit. It was discovered that either stamps were missing on the export documents or false stamps had been used. Between November 1993 and June 1994 fiscal investigators conducted investigations into thirty garages which were under suspicion. Many of the garages questioned, responded that they had acted in good faith. Approximately ECU 130,000 was fraudulently reclaimed by these thirty garages. In August 1994 fiscal investigators sent information to the control offices of the VAT administration concerning four to five thousand garages which still must be audited. By the end of 1995, no further results were available in this case.

**CASE 29**

Mr. Morgan, a notorious fraudster, is the 'invisible' brain behind this fraudulent scheme with a certain type of luxury car. Although his name does not appear on any documents, during the interrogation of some of the persons involved in this fraud, his name was mentioned. Morgan set up a construction whereby cars were fictitiously supplied to companies in B-land while in reality they were sold without VAT in A-land. Exotic Cars, a large distributor of cars in A-land, pretended to sell and ICS numerous cars against the zero-tariff to Car Care, a shell company in B-land. The manager of Car Care, a strawman, receives ECU ±20 for every transaction. In reality, the cars were sold without VAT to two legitimate companies belonging to Mr. Wilkins in A-land. This method gave Exotic Cars the opportunity to increase its turnover. Wilkins’ companies fictitiously supplied the VAT-free cars to Dream Cars, a shell company in B-land. In reality, the cars were sold to shell companies in A-land which sold the cars on the black market, sometimes without even making profit. Based on the invoices, the investigators suspect that every link in this fraud construction made a profit of at least ECU 130, excluding the VAT profits. The amounts on the invoices increased by this sum with every new link in the chain. The shell company usually got a fixed amount for the (ab)use of its VAT number.

Mr. Morgan is known and was seen by salesmen at Exotic Cars and made contact with several fraudulent links in the chain. Wilkins also had contact with Exotic Cars. He made the contact with the person who later functioned as the strawman of Car Care in B-land. The customs cell of the fiscal investigative division in A-land became suspicious of Wilkins’ com-
panies because of the large number of cars imported from B-land. Comparison of the chassis numbers of the cars involved in the fraud and those in the bookkeeping of the distributor of these cars, Exotic Cars, revealed that the cars went directly from Exotic Cars to Wilkins’ companies instead of to B-land. The position of Wilkins’ companies in this scheme, could be replaced by several other suspicious companies. The shell companies in B-land are the key points in this scheme. There is documentary evidence for this scheme from mid 1993 until February 1994. This fraud pattern stopped when the fiscal authorities started an investigation.

The tax administration could prove that Wilkins evaded about ECU 1.1 million in VAT in this and other fraud constructions in the period from 1992 until 1994. Wilkins was taken to court; no further information is available on the verdict. On 23 February 1995, a complaint was filed with the public prosecutors office concerning Morgan and Exotic Cars. It is expected that Mr. Morgan will be prosecuted.

CASE 30

Mr. Orly is the manager/director of this family-managed international business, with its headquarters and place of residence in B-land. Mr. Orly, several family members and many of his employees committed several criminal offences within the legitimate activities of this concern. Besides illegal contracting, money laundering and fraud involving income taxes and E.U. subsidies, a few VAT fraud constructions were also part of the many criminal offences committed. Additionally, employees received low legitimate wages but this was supplemented with illegal payments off the books. The investigation in the following VAT fraud cases is part of a larger dossier on several criminal offences perpetrated by Mr. Orly, his family and employees.

VAT fraud 1: From approximately 1987 until 1989 several of Orly’s companies in B- and C-land sold carpets 50% below the market price or sold the carpets completely ‘off the record’ to wholesalers in A-land. This method provided “black” money which resulted in the evasion of income tax on 50% of the value of the sales of Orly’s companies in B-land. Another method used to reduce taxes was to settle the payments with fictitious discounts. The loss of VAT for A-land occurred with the domestic transactions: the sales of the wholesalers. They sold goods under value goods or ‘off the record’ in A-land and paid either no, or minimal VAT on these sales. The partial cash payments
of the wholesalers to Mr. Orly's concern were smuggled into B-land and put into a secret bank account. It is suspected that this illegal money was invested into Orly's companies.

Traders involved in the carpet branch questioned transactions of certain wholesalers which were able to sell goods purchased from Orly's companies below market prices. These signals were picked up by the fiscal investigative agency in A-land which initiated an investigation in the beginning of 1989. The wholesales' invoices revealed incorrect prices. During a large carpet exhibition, Orly's family members and employees were arrested and interrogated. Prosecution was avoided and the case was settled out of court by paying a fine of almost ECU 5 billion. The wholesalers were prosecuted separately.

VAT fraud 2: Several of Orly's companies in B- and C-land made bogus exports of carpets and textiles to companies in a non-E.U. country. Mr. Calden, an acquaintance/business relation of Mr. Orly's, owned these companies and gave fictitious invoices to the managers of the companies involved. Calden was paid a certain amount of money for these invoices. The goods were never exported but were instead sold 'off the record' domestically. Two invoices were used for these transactions: invoices from the company Carpetcountry and those of Mr. Orly's companies. The Carpetcountry invoices were used for customs and were heavily underrated to prevent high import duties. The invoices of Mr. Orly's companies, with inflated prices, were used to reclaim the VAT. Another method used by these companies was the fictitious export of carpets to two eastern European countries. Fictitious invoices were supplied to Mr. Orly's companies by a domestic company, Carpet World. Carpet World is managed by an organized crime group from eastern Europe. Carpet World made real and fictitious exports to companies in eastern Europe. The carpets from this company were either sold in eastern Europe or disappeared on the domestic (black) market in B-land. The VAT due the tax authorities in B-land disappeared into foreign bank accounts or left the country in cash. This VAT fraud was discovered as a result of a larger investigation into the dealings of Mr. Orly's concern. During searches, heavily undervalued invoices were found at participating companies in B- and C-land. Since 1993, eight investigators have been working on the case and the larger investigation is still in progress. The total amount of VAT evaded has not yet been determined.
CASE 31

The main suspect in this case, Mr. Zack, is one of the largest distributors of a certain type of car in A-land. Zack’s fraudulent trade with cars began prior to 1993. He was assisted by five or six full-time, trustworthy, close assistants who managed specific parts of the fraudulent activities. In isolated cases Zack also used his network of fraudsters to provide certain favours. Zack used fictitious invoices from shell companies to allege a domestic purchase so that a VAT refund could be requested. Prior to 1993 Zack always used a legitimate company in the transaction with his own company to shield himself from suspicion. After 1993, when the borders vanished between the member states, the fraud was altered to adapt to these changes. Instead of purchasing cars from one only member state, as was the case prior to 1 January 1993, Zack now turned to companies in other E.U. countries to supply the cars. As cars were coming in from other countries, Zack altered the modus operandi slightly to simplify the operation and removed the legitimate dealer with whom he was trading. In only one small aspect of this case, between May and August 1994, 56 cars were supplied from several E.U. countries to a shell company in A-land. This shell company sold the cars to Zack who reclaimed his fictitious prepaid VAT from the tax authorities. Invoices in this scheme prove a tax evasion of approximately ECU 225,000. Tax authorities suspect that Zack owes a total of approximately ECU 2.1 million for fraud perpetrated from 1992 through 1994. No information is available of the processing of this case.
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