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STATSREVISORERNE**



**FOLKETINGET  
RIGSREVISIONEN**

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# **VAT control**

# 1. Introduction and conclusion

## 1.1. Purpose and conclusion

1. The report concerns the Danish Ministry of Taxation's response to companies that fail to declare or settle Value Added Tax (VAT) correctly.

2. We have examined the tax authorities' response to companies that fail to declare or settle VAT, and their effort to ensure that the companies file correct returns. Our study covers the years from 2016 to 2018. We have also, to the extent possible, looked at the consequences of the tax authorities' actions in the same period in terms of lost tax revenues resulting from the companies' failure to file VAT returns, filing of incorrect VAT returns and failure to pay VAT.

3. VAT is an important source of revenue to the Danish tax authorities and almost all companies are VAT registered. Annually, Danish companies file positive VAT returns of approx. DKK 425 billion and negative VAT returns of approx. DKK 225 billion. Overall, this means that every 5th Danish krone collected for taxes is coming from VAT payments. The fact that the companies are not required to provide any documentation in support of their positive or negative VAT returns, is a characteristic feature of filing VAT. This practice increases the risk of error and fraud considerably compared with other types of taxation that are filed by a third party. In recent years, a number of major VAT fraud cases have demonstrated that an increasing number of companies have found ways to commit fraud.

4. The purpose of the study is to assess whether the Ministry of Taxation is adequately checking that the companies settle VAT correctly. The report answers the following questions:

- Have the tax authorities adequately followed up on companies that fail to declare VAT?
- Have the tax authorities adequately checked whether the VAT returns filed by the companies are correct?
- Have the tax authorities adequately responded to the companies that fail to settle VAT?

Rigsrevisionen initiated the study in January 2019.

### **VAT declaration and payment**

Declaration of VAT and payment of VAT take place in two independent processes, which means that correct settlement of VAT is achieved only if both the declaration of VAT and payment of VAT are correct.



## Main conclusion

**In the period examined, the Ministry of Taxation's monitoring of the companies' settlement of VAT can be criticised and entails an increased risk that the government loses billions in lost VAT revenues. Moreover, companies have been allowed to continue to do business and accumulate VAT debt, despite their failure to file and settle VAT.**

The Ministry of Taxation recognises that the administration of the VAT area is challenged and has taken various steps to improve control and compliance in the area.

### **The tax authorities' follow-up on companies failing to file VAT returns can be criticised**

The study shows that the tax authorities are not exercising their statutory right to enforce compliance by issuing instructions to or imposing fines on companies that fail to file VAT. The tax authorities make a preliminary assessment of the companies' VAT liability, but are not ensuring that the companies replace the preliminary assessment with a VAT return. The number of preliminary assessments has therefore increased considerably in the period from 2013 to 2018, and by the end of 2018, the VAT liability of 59,000 companies had been preliminarily assessed by the tax authorities. One of the reasons why the companies do not replace the assessment with a VAT return could be that the assessed liability is so low that they have no incentive to do so. The tax authorities have checked 733 companies with the outcome that the tax liability of 85% of these companies was increased by a total of DKK 576 million. The total value of the remaining preliminary assessments made in the same period was DKK 2.8 billion by the end of 2018, but taking into consideration that the companies' assessed tax liability was considerably increased following the tax authorities' scrutiny, it is Rigsrevisionen's assessment that the actual tax liability is significantly higher.

Moreover, companies with four consecutive preliminary assessments have only to a limited extent been sanctioned by the tax authorities and had their VAT registration cancelled. This means that the tax authorities have not exercised their statutory right to prevent companies that fail to file their VAT returns from doing business. Often, companies that do not file VAT returns accumulate debt, and the inadequate response by the tax authorities has therefore had the consequence that several companies have been able to continue to accumulate debt. By the end of 2018, companies whose VAT liability had been assessed, had registered VAT debts of DKK 6.7 billion.

The Ministry of Taxation has prepared an action plan and allocated funds to strengthen the area, and it is the ministry's expectation that with effect from 2021, all companies with four consecutive preliminary assessments of their VAT liability will lose their VAT registration, unless they file their VAT returns at the request of the tax authorities.

### **Preliminary assessment of VAT liability**

If a company fails to file a VAT return, the tax authorities will make a preliminary assessment of the company's VAT liability. The intention is that the company subsequently replaces the preliminary assessment with a (correct) VAT return. Preliminary assessments that have not yet been replaced with VAT returns filed by the companies, are referred to as open preliminary assessments.

### **The tax authorities' monitoring of the companies' filing of correct VAT returns can be criticised**

First, the tax authorities have generally not implemented input checks that could contribute to ensuring the correctness of the VAT returns filed by the companies. This in spite of the fact that the framework set for VAT returns leaves it to the companies to decide what amount they want to file. The result is that the companies either file or settle less VAT than they are required to, or that they file negative VAT and claim VAT refunds to which they are not entitled.

Second, it is Rigsrevisionen's assessment that the checks made by the tax authorities have not adequately ensured correct VAT returns. Only 2% of the companies are checked by the tax authorities a year, although the checks showed that more than half of the companies had filed incorrect VAT returns, and all the companies combined had under-declared VAT by DKK 18.1 billion in the course of the three-year period. On going through refund claims, the tax authorities detected an error with a value of DKK 6 billion in one single VAT return. The size of the adjustments is a reflection of the fact that the companies are checked based on risk assessments. However, it is Rigsrevisionen's assessment that the overall risk of considerable VAT revenue losses is significant for the 98% of the companies that are not checked every year.

Rigsrevisionen's assessment takes into consideration that the companies have opportunity to under-declare VAT and is based on the following: 1. The tax authorities' checks of relatively few companies resulted in very large adjustments of VAT liability. 2. A representative analysis of small and medium-sized companies made by the tax authorities indicated that there were errors in one or several VAT returns filed by every second company, and 90% of the errors concerned under-declaration of VAT.

The Ministry of Taxation has informed Rigsrevisionen that the intensity of checks carried out in the VAT revenue area reflects that the tax authorities prioritise the overall resources according to risk and materiality. It follows that carrying out more checks of VAT would thus reduce efforts made in other risk areas, that have also been prioritised based on assessments of risk and materiality. The ministry also refers to international studies of VAT gaps, according to which the VAT gap in Denmark is on level with other comparable countries.

### **The tax authorities' response to companies that fail to settle VAT is unsatisfactory**

First, despite the fact that they are legally required to do so, the tax authorities do not send payment reminders to the more than 40,000 companies with old debts, before they transfer them for collection. This means that the tax authorities transfer VAT liabilities worth DKK 4.1 billion for collection without having first reminded the companies to pay their debt. Second, the tax authorities are not exploiting the opportunities legally available to them to prevent the accumulation of debt among companies that have failed to settle VAT for a long period of time. The study shows that the VAT liability of VAT registered companies increased from DKK 10.3 billion in 2014 to DKK 16.7 billion in 2018. In the same period, the total VAT tax liability of these companies increased from DKK 18 billion to DKK 43.8 billion.

### **The VAT gap**

The VAT gap is the difference between expected VAT revenues (at 100% compliance) and actual VAT revenues collected. The VAT gap cannot be determined accurately, but various methods are used to estimate the gap.