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Compliance checks of VAT on EU trade

1. Introduction and conclusion

1.1. Purpose and conclusion

1. This report concerns the effort of the Danish Ministry of Taxation to ensure that Danish businesses report correct VAT, when they trade with VAT-registered businesses in other countries in the European Union (EU).

2. VAT is a very significant source of income for the government. In 2020, 520,000 businesses were VAT-registered in Denmark, and VAT accounted for approx. one fifth or DKK 228 billion of the government's revenue. Many of the businesses trade with other EU member states.

VAT is also characterized as a high-risk area, partly because it is the responsibility of the businesses to file their VAT returns and they are not required to provide any documentation in support of the information they provide. This practice increases the risk of error and fraud considerably compared with other types of taxation like, for instance, income tax, where data are reported by a third party. The Danish Tax Agency estimates that close to one in two businesses make mistakes in their VAT returns, and approx. one in ten businesses cheat deliberately.

3. In itself, EU trade entails a risk of error and VAT fraud; either in the form of simple VAT fraud, where a single business neglects to settle correct VAT, or in the form of organised VAT fraud, where several businesses based in different countries collude to commit large-scale VAT carousel fraud. In recent years, there has been examples of serious VAT fraud involving EU trade.

In the EU, the VAT Information Exchange System (VIES) allows the member states to check data on sales made to other member states. VIES is primarily providing the tax authorities of the member states with a tool for checking that businesses submit correct VAT returns on their EU trade. The tax authorities in the EU are therefore obligated to ensuring that the information in VIES is correct.

Third-party reporting
Third-party reporting refers to data reported by another party than the tax authorities and the party that the tax return concerns. Banks and public authorities, for instance, provide third-party data.

VIES
VIES is a joint system shared by the EU member states. Its purpose is to reduce VAT fraud in relation to intra-EU trade. VIES was introduced, when the EU single market was established in 1993.

VIES is an electronic database containing data on EU trade submitted by businesses that sell to VAT-registered businesses in other EU countries. EU trade reported by a business to VIES must be identical with the information reported by the business in its VAT return.

4. The purpose of the study is to assess whether the effort made by the Ministry of Taxation to ensure that businesses report correct VAT on EU trade is sufficient. The report answers the following questions:

The Tax Agency
The Tax Agency is one of ten agencies under the Ministry of Taxation. Since July 2018 – following a re-organisation of the former Danish Tax and Customs Administration – the Tax Agency has been responsible for ensuring that citizens and businesses pay correct taxes and fees, including VAT, on time.

- Has the Tax Agency, to a sufficient extent, identified the level of risk associated with VAT on EU trade?
- Has the Tax Agency made a sufficient effort to establish structural solutions that support correct reporting of EU trade?
- Is the Tax Agency maintaining an adequate level of ex-post control of EU trade?

We have particular focus on whether the Tax Agency in the period from 2014 to 2020 checked VAT returns submitted by the businesses against VIES.

Rigsrevisionen initiated the study in January 2021. The study builds on Rigsrevisionen's compliance audit of the Tax Authority in the late summer of 2020.

Main conclusion

The effort made by the Ministry of Taxation to ensure that businesses report correct VAT on EU trade is worthy of criticism. The consequence is a risk of very large VAT revenue losses in Denmark and in the other EU member states.

The study showed that the Tax Agency has identified significant VAT risks in connection with EU trade, including many differences between the EU trade reported by the businesses in their VAT returns and VIES. However, the agency has not monitored the development in differences systematically in the period from 2014 to 2020, nor has it examined the causes of the differences. Rigsrevisionen has estimated the total amount of differences in the value of EU trade (ex VAT) in the period from 2014 to 2020 at an average of DKK 261 billion annually on EU purchases and DKK 54 billion annually on EU sales. Several businesses are responsible for differences of more than DKK 1 billion. In some cases, the differences have a legitimate explanation, meaning that a difference does not necessarily constitute a VAT loss. But differences can also be the result of errors or fraud. The risk of VAT revenue losses is mainly related to the differences for which there is no legitimate explanation.

DKK 100 billion out of the annual average amount of differences of DKK 261 billion relating to EU purchases are particularly risky. The reason is that these differences have emerged, when Danish businesses underreported EU purchases in their VAT returns compared with the value of sales to the same businesses that the foreign businesses have filed with VIES. These differences indicate that the Danish businesses might have failed to report correct VAT on their EU purchases. Furthermore, the Danish businesses might have resold their EU purchases in Denmark without charging output VAT.

The Tax Agency has not, to a sufficient degree, looked into the risk of VAT revenue losses related to EU trade and the significance of the many and large differences for the VAT revenue. Fraud or error related to only a few percentages of the total differences entail a risk of very large VAT revenue losses.

Differences between VAT returns and VIES
The differences concern the value of trade ex VAT.

Differences in output VAT can emerge, if a Danish business has reported EU sales differently in its VAT return and in VIES.

Differences in input VAT can emerge, if the VAT return on EU purchases submitted by a Danish business deviates from what the foreign businesses have reported to VIES on their sales to the Danish business concerned.

The effort made by the Tax Agency to establish structural solutions to support correct reporting of EU trade by businesses, is worthy of criticism

The study found that the Tax Agency has failed to establish an input data validation process to reduce differences between EU trade reported by the businesses in their VAT returns and EU trade reported to VIES. Nor has the Tax Agency ensured that the design of the VAT return form supports correct reporting of EU trade.

The study showed that, in the period from 2010 to October 2020, the Tax Agency has not sent payment reminders to businesses with differences between EU trade reported by the businesses in their VAT returns and EU trade reported to VIES. Thus, the agency has failed to launch an initiative to support, systematically, that businesses comply with the legislative requirements for correct reporting of EU sales in the period from 2014 to 2020. Many businesses have particularly risky differences in EU trade, because they have reported higher EU sales in their VAT returns than to VIES. This type of differences made up between DKK 27 billion and DKK 53 billion per year in the period from 2014 to 2020. If these differences concern cases where no actual EU sales have taken place, but the businesses - by mistake perhaps - have reported their VAT liable sales in Denmark as VAT exempt EU sales, there is a risk of VAT revenue losses.

The Tax Agency's failure to act has had the consequence that the agency's and other EU member states' opportunities to check VAT payments in relation to EU trade have been limited, and, according to its own assessment, the agency has been unable to meet its obligations in relation to both the EU Directive on VAT and to the other EU member states.

The Tax Agency's ex-post control of businesses with EU trade is worthy of criticism

The study found that many businesses had differences, including very large differences, that had not been checked by the Tax Agency. On average, the agency has checked approx. 3 per cent of the businesses with EU trade.

The study also showed that the Tax Agency's checks of VAT returns against VIES, in the cases reviewed by Rigsrevisionen, has been inadequate. Rigsrevisionen has reviewed 71 completed VAT checks of businesses with differences. The agency has used VIES to determine the nature of the differences in only 7 per cent of the 71 cases. Several of the differences that have not been scrutinized by the agency concern amounts exceeding DKK 1 billion.

The study found that the guidelines of the Tax Agency are not adequately ensuring that the agency checks VAT returns against VIES in connection with ex-post control. Thus, the agency fails to identify and examine in more detail risky and material differences in relation to EU trade.

The Ministry of Taxation agrees that the effort in the area must be intensified, and the ministry has taken steps to establish structural solutions, that can help reduce the scale of differences. The Tax Authority also intends to step up its use of VIES in connection with ex-post control of large businesses trading in the EU.

Structural solution
The Tax Agency defines structural solutions as solutions designed to reduce or eliminate risk, error and fraud. According to the agency, structural solutions can take form of digitisation, processes or law amendments.

Input data validation
Input data validation is automated control of data input at the time of registration. Input data validation can include digital blocks, pop-up messages to the businesses or warnings of irregularities or illogical reports to the Tax Agency.

The EU regulation
The duties of the EU member states in relation to VIES and other administrative cooperation on combating fraud in the field of VAT has since 1993 been prescribed in regulations. The current regulation is no. 904/2010 of 7 October 2010.