

Grouping of Misconduct Types in Case of VAT Fraud

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The formation of the tax system is as old as the emergence of statehood, together with the intention of not paying taxes. The value added tax, i.e. VAT, is no difference. The European Communities decided to introduce VAT during the tax harmonisation process in 1973. The liberalised free flow of production factors between Member States has provided an opportunity for the increasingly complicated and complex methods of VAT fraud. The main objective of my study is to present a possible grouping of VAT frauds according to my own conceptual approach.

Keywords: VAT, fiscal fraud, organised VAT scams, billing chains, European Union

Introduction

The idea of value added tax (hereinafter: VAT) originates from the French tax administration employee, Maurice Lauré. It has been levied since 10 April 1954, starting with only the largest companies, gradually extending to all sectors of the economy.² In an effort of harmonisation of law, it was implemented in 1973 in the member states of the European Union (or rather European Communities, its predecessor at the time).³ Being eager to adopt the taxation principles of European countries, Hungary followed suit in 1988.⁴

Initial fraudulent attempts to evade VAT were quite simple. However, during the development of the integration of the European Union – after the accession in 2004, with Hungary on board and as an integral part – production factors, i.e. the free movement of products, services, capital and workforce gave rise to the emergence of more complex and sophisticated VAT evasion attempts.

The significance of combating VAT evasion is demonstrated by the fact that VAT, i.e. the direct tax on consumption forms one of the most important sources of income in most tax systems. (It is necessary to note that for example, in 2017, the VAT income of the Hungarian budget was HUF 3.525 billion, amounting to one fourth of the entire

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² Salo (2014) 130–131.

³ Magyar-Áhel (2012) 85.

⁴ Magyar-Áhel (2014) 10.

budget.) Additionally, the establishment of the percentage of VAT can also have a criminal law relevance, namely that high VAT content may increase the rate of grey economy, as economic actors – especially small and medium size businesses with relatively scarce financial resources – show increased willingness to forgo an invoice, thus evade VAT.⁵

In this paper – keeping the significance of combating VAT evasion in mind – I am attempting to separate VAT-related budget fraud (which is a crime) from VAT evasion (which constitutes a fraudulent conduct), and to present types of VAT evasion attempts published by other authors in the professional discourse. Of course, to understand VAT evasion schemes, it is necessary to take a closer look at the main characteristics of the working mechanism of VAT relevant from criminal law aspects.

However, an additional, but significant objective of this study is to create a classification system of budget fraud schemes regarding VAT along classification principles pointing out the criminal aspects of each scheme, based on the Act on Criminal Procedure.

Differentiating the Criminal Act of Budget Fraud from VAT Evasion and the Fraudulent Conduct of VAT Evasion

Considering that the objective of this writing is the classification of the attempts of budget fraud regarding VAT, first I need to differentiate budget fraud, as a criminal act that needs to be dealt with by the law enforcement authorities from a mere fraudulent conduct affecting VAT, which falls within the scope of the tax administration.

In order to proceed with the above, one has to be familiar with the legal principle of *nullum crimen sine lege*, in other words, no crime without law. This means that acts not declared by law as criminal acts are in fact not crimes. This applies to VAT evasions, too.

Point a) of subsection (1) of section 396 of the currently effective Hungarian penal code, i.e. Act C of 2012 on the Criminal Code is the provision to declare VAT evasion – amongst other unlawful acts causing financial harm to the budget – a criminal act of budget fraud. However, based on subsection (3) of section 462 of the above statute, budget fraud by VAT evasion is only a crime, if the financial harm caused by the fraud exceeds a hundred thousand forints. Budget fraud by VAT evasion, as a criminal act may be penalised within the framework of a criminal procedure by two to up to ten years of imprisonment, depending on the value of the evasion (i.e. the financial loss suffered by the budget) and the criminal conspiracy, or commercial characteristic of the fraud.

However, regarding the penalty of budget fraud by VAT evasion, I have to emphasise the currently prevailing notion that efficiency of combating economic crime cannot be increased by the years of imprisonment imposed. It can only be achieved by decreasing the lucrateness and profitability of this profit-oriented crime, i.e. by decreasing the possible proceeds of such criminal acts.⁶

⁵ Ercsey (2016) 170, 176.

⁶ Tóth (2015) 20.

If the financial loss suffered by the budget's VAT income does not exceed a hundred thousand forints or the elements of statutory definition are not fully satisfied, no VAT evasion is committed in the sense of criminal act. However, based on Act CL of 2017 on the Rules of Taxation, omission of tax payment can still be established in a tax administrative proceeding and sanctioned by a tax fine. Furthermore, tax administrative proceedings run parallel to a criminal procedure, one does not preclude the other.

Classification of Schemes of Budget Fraud by VAT Evasion

Balázs Gábor Fodor, PhD, student at the Faculty of Law of the Károli Gáspár University of the Reformed Church started his presentation at the conference entitled *Criminal Law Enforcement of the Budget* with quoting from Benjamin Franklin: "...in this world nothing can be said to be certain, except death and taxes." Then he went on with Gábor Tolnai's words: "The third is that people will make significant efforts to avoid the first two." If we immerse in studying the schemes of budget fraud by VAT evasion, we will quite soon agree with Gábor Tolnai and find that people come up with quite creative and complex constructions to avoid taxes.

The above quotes vividly demonstrate that due to their diversity, schemes of budget fraud by VAT evasion are also difficult to categorise. Each author does it his/her own way, along different categorisation criteria.

In this writing, I have highlighted three criteria I deemed to have criminal law aspects, namely: the working mechanism of VAT, the invoicing chains between the subject companies and the elements of statutory definition. The aspects I followed when choosing these criteria will be elaborated on in the chapter *Objectives and Methodology of Classification*. Below, I will present the schemes more or less matching the selected criteria, using the available professional discourse as a source.

However, to understand individual schemes, it is necessary to clarify the term VAT and a few relevant characteristics of its working mechanism (Figure 1). VAT is a several-phase net sales tax that is levied on businesses in every phase of manufacture and distribution, and the ultimate burden is borne by the end user, i.e. the consumer. Consequently, VAT is paid in every manufacturing and distribution phase and by every business.⁷ However, to avoid multiple taxation, businesses in each phase may deduct taxes already paid when purchasing the goods from the taxes payable upon sales. If this yields a positive value, they incur tax payment obligations, while if negative, they establish rights to a tax refund. Consequently, the burden of taxes is borne by consumers at the end of the supply chain, who buy the products or avail the services.

For cross-border manufacture or distribution phases, businesses' tax obligations and tax deduction rights are different. Act CXXVII of 2007 on Value Added Tax (hereinafter: VAT Act) distinguishes import of goods (when goods are imported to the territory of the European Community from a so called third country), from purchases

⁷ Faluvégi-Kállai (1987) 136.

from within the Community (when goods are imported from the member states of the European Community). The opposite of import is called export of goods or sales of goods within the Community. It is an important fact that for the purposes of the VAT Act, the European Community includes the member states of the European Union and all countries with the same legal status in terms of tax harmonisation.

For import of goods and for purchases from within the Community, the same tax rates are levied on products and services as on the goods with domestic origin. However, if statutory conditions exist, buyers may have the taxes levied on their purchases from within the Community deducted just like in case of domestic purchases. Export of goods and sales within the community is not subject to VAT, but VAT already paid after such transactions may be deducted.⁸ According to VAT Act, if imported goods are brought into the country for resale to another member state without taxes, i.e. with a so called tax free import of goods via an intra-Community transfer of goods, within the framework of the custom procedure encoded 42.00, importers are exempted from tax obligations, as VAT will be paid in the destination country.

At the above conference, Balázs Gábor Fodor also based his classification of VAT fraud schemes basically on the *working mechanism of VAT*, and has distinguished the following groups:

1. *Wilful omission of tax returns*: In this scheme, taxpayers hide their non-taxed transactions by a full or partial omission of tax returns towards the tax administration.
2. *Wilful acceptance of fictitious invoices*: Acceptance of invoices without an underlying transaction or invoices with false contents (for example, the invoice was issued by a person other than the originator indicated on the invoice) to wilfully evade taxes or to apply for a tax refund.
3. *Misrepresented tax exemption*: After a domestic gross purchase, perpetrators misrepresent tax-free sales within the Community, then have the VAT refunded. Subsequently, they fake having purchased the goods from another member state, and wilfully omit payment of VAT levied on their sales. This scheme is also called a carousel fraud.
4. *Hiding acquisitions from member states*: Acquisitions from the community where tax is levied are hidden by perpetrators, who sell the purchased goods unlawfully, without taxes later.⁹

⁸ Sztanó (2012) 141–142.

⁹ Fodor (2007) 92–94.

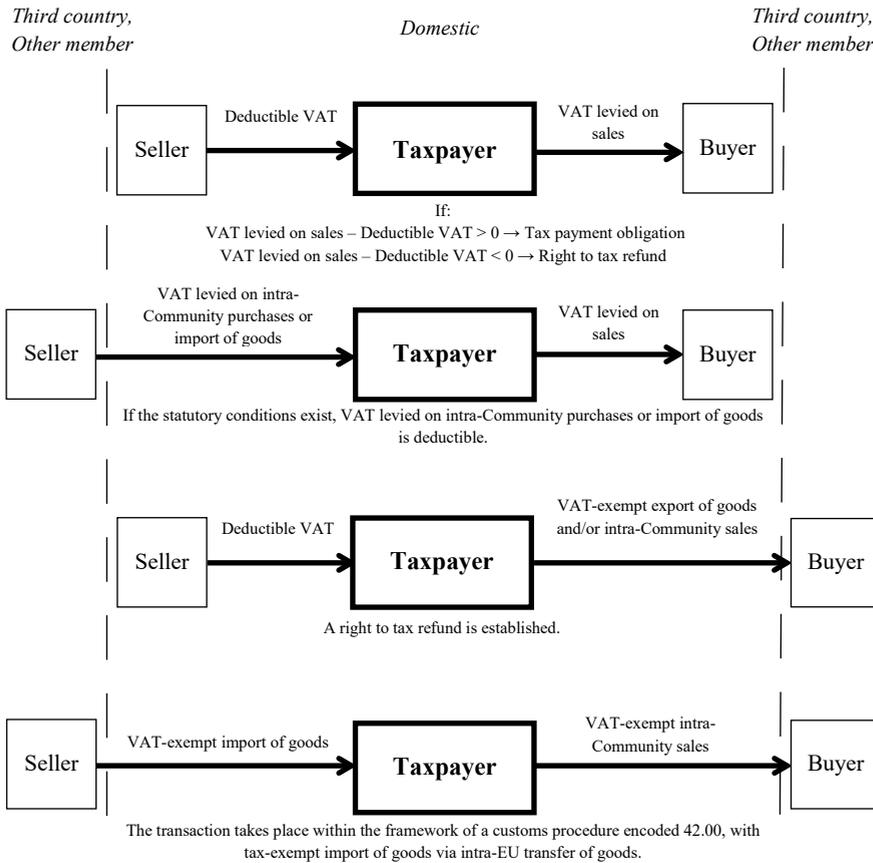


Figure 1. VAT obligations for domestic- and cross-border transactions

Source: Compiled by the author based on the VAT Act.

Borbála Sólyom, in her PhD thesis entitled *Combating Tax Fraud and Tax Evasion in the European Union, with Special Regards to the Jurisprudence of the European Court*, focused on the invoicing chains between the companies she examined, and, based on the results, she has distinguished:¹⁰

1. normal, general tax fraud, existing in domestic trade
2. normal, general cross-border tax fraud, and
3. fraud schemes involving missing traders

¹⁰ Sólyom (2015) 64–84.

Regarding normal and general schemes in the first two groups, the author lists a few examples, with the main common characteristic of a simple and less organised invoicing chain created by the perpetrators, regardless of the transaction's domestic or cross-border nature. In normal, general tax frauds, perpetrators falsify invoices to only one invoice down the invoicing chain (input, output or both). In these doctored invoices, they increase the deductible or decrease the payable VAT content of real or fictitious transactions with real or fictitious business partners. In other cases, they do not even bother filing their VAT returns, causing financial losses to the budget.

Unlike normal, general tax fraud cases, the objective of missing trader schemes is the misuse of opportunities opened up by cross-border trade.

In Chapter 4 of the textbook entitled *EU and the Specializations of Controlling*, Eszter Magyar-Áhel explores these organised missing trader VAT fraud schemes, including organised EU cross-border VAT frauds, reflecting on the VAT evasion schemes published and classified by the experts of the European Commission.¹¹

1. *Carousel fraud* (Figure 2): In this scheme, the first element of the domestic invoicing chain is a so called Missing Trader, who in fact is not engaged in any economic activities whatsoever. This player accepts invoices from companies incorporated in another member state (Conduit), which is invoiced further to the last element of the domestic invoicing chain (characteristically through other (Buffer) companies to make the invoicing chain more complex). This last element of the invoicing chain is the beneficiary of the chain. This element is also called Broker. Subsequently, the Broker issues an invoice to the Conduit, which is a company incorporated in a different member state. When the Missing Trader accepts the Conduit's invoice, the invoicing chain is closed. Missing Traders do not remit the VAT levied on sales to the budget. Characteristically, they do not even file such VAT returns, and authorities will not be able to reach them. The last elements of the domestic invoicing chain will claim tax deductions on invoices accepted directly or indirectly from Missing Traders, causing financial losses to the budget.

The most important characteristic of carousel fraud is that such invoicing circles do not necessarily reflect real economic transactions, the system is viable without market demand and actual sales, practically in laboratory circumstances, with the use of fictitious invoices only. If this fraudulent invoicing chain does not catch the authorities' attention, the only limit to the financial losses suffered by the budget is the perpetrators' mercy.

¹¹ Magyar-Áhel (2012) 85–99.

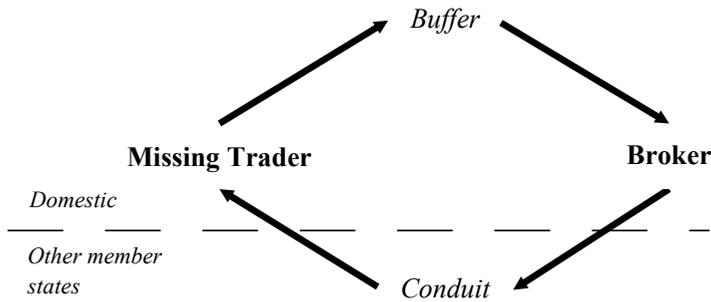


Figure 2. Carousal fraud

Source: Compiled by the author based on Magyar-Áhel (2012) 86.

- Another type of fraud is committed by involving an extra missing trader, in other words *Missing Trader Intra-Community Fraud* (MTIC) scheme (Figure 3), wherein a seller invoices the goods as intra-Community tax free sales of goods to a Missing Trader not engaged in any real economic activity whatsoever. The Missing Trader invoices the purchased product further, whether directly or through other companies to the buyer, who claims deduction of the VAT content of the invoice accepted from the Missing Trader, thus decreasing its payable VAT, even getting in the position to claim refunds. MTIC fraud can be realised by *fictitious domestic purchases* and/or *hidden domestic sales*.



Figure 3. Missing Trader Fraud

Source: Compiled by the author based on Magyar-Áhel (2012) 91.

3. *Misuse of customs procedure code 42.00*: In the so called customs procedure code 42.00, i.e. tax free import of goods with intra-Community transfer of goods, goods imported to the territory of the European Community from third countries are subjected to a customs procedure, however, this does not entail payment of VAT levied on imported goods. The statutory condition of VAT exemption regarding imported goods is that such goods are transported further to another member state of the European Union, where the importer will fulfil this VAT payment obligation. Considering that this system is not closed, it inherently offers opportunities for fraud. For example, goods can be subjected to a customs procedure on behalf of Missing Traders in an EU member state, and subsequently, the real importers sell the same goods on the black market, without paying the VAT levied on imported goods.
4. *Fictitious intra-Community or export sales*: While in the above misuse of customs procedure code 42.00, fraudulent conduct is aimed at the VAT levied on import of goods, in this case, fraudulent conduct is aimed at the opposite, namely tax free intra-Community or export sales in a way that the domestic seller misrepresents VAT exempt sales to another member state or third country, but in fact, the recipient of the sales is a domestic entity, without an invoice.

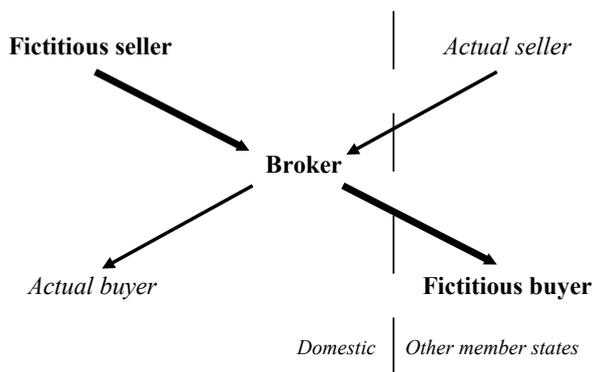


Figure 4. Cross-invoicing

Source: Compiled by the author based on Magyar-Áhel (2012) 94.

5. *Cross-invoicing fraud* (Figure 4): This scheme is a notch more complex than the previous ones. It is aimed at hiding transactions incurring VAT obligations, such as intra-Community purchase and domestic sales. In order to do this, perpetrators attempt to offset VAT obligations incurred by intra-Community purchase and domestic sales by domestic purchases and tax free intra-Community sales establishing rights to tax deduction. Another function of fictitious intra-Community sales is to channel fictitious goods accumulating in the fraud mechanism

out of the system. This scheme is often part of carousel or MTIC fraud chains. In such cases, Missing Traders attempt to reduce their tax obligations to zero by such cross-invoicing.

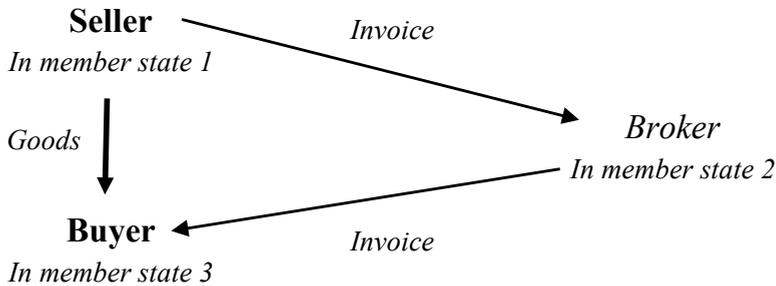


Figure 5. Triangular trade

Source: Compiled by the author based on Magyar-Áhel (2012) 96.

6. *Triangular trade fraud*: First of all, I have to note that triangular trade (Figure 5) is basically lawful. During this process, a seller incorporated in one member state sells goods to an intermediary incorporated in another member state, who then sells the goods further to a buyer incorporated in a third member state. Only those goods are delivered directly by the buyer to the seller. Fraudulent intentions emerge in a triangular trade, if either of the players is involved in a fraudulent sales chain. The purpose of this is to blur the invoicing chain, thus making it more difficult for authorities to unravel such crimes, as in triangular trade, the invoicing chain is different from the actual routing of the goods.

Other authors base their classification of budget fraud schemes on the statutory circumstantial elements. It is important that schemes established this way are significantly more general than the ones based on the historical state of affairs. Namely, based on the principle of *nullum crimen sine lege* mentioned earlier, if not all statutory circumstantial elements exist, we cannot talk about the criminal act of budget fraud. However, the economic environment and the conditions of taxes are inherently subject to a dynamic change, forcing schemes to become more complex and sophisticated over time, therefore, to prevent loopholes and frequent amendment of regulations, it is practical to keep legislation as general as possible to protect the budget.

Also, for VAT evasions, schemes appear in an especially abstract way in the effective statutory definition. One of the possible reasons beyond the ones detailed above is that to enhance efficiency of protection of the budget, the legislator merged a wide array of criminal acts (established by separate statutory definitions earlier) causing financial losses to the budget, both in revenues and expenditures (including the criminal act of

tax fraud by evasion of VAT or other taxes) under the term of budget fraud. Accordingly, the object protectable against this criminal act is the social interests associated with budget revenues.¹²

Hungary's effective penal code establishes the first basic case of budget fraud (which also includes VAT fraud) as follows:

“Any person who induces a person to hold or continue to hold a false belief, or suppresses known facts in connection with any budget payment obligation or with any funds paid or payable from the budget, or makes a false statement to this extent and thereby causes financial loss to one or more budgets, is guilty of misdemeanour...”

Based on the above statutory circumstances of budget fraud, (point a) of subsection (1) of section 396 of Act C of 2012 on the Criminal Code), Gábor Miklós Molnár classifies schemes of budget fraud as follows.¹³

1. *Misrepresentation*: Perpetrators represent false facts as true and correct, creating false impressions in the victim's mind.
2. *Condoning misrepresentation*: Perpetrators fail to correct or expressly confirm already existing false impressions that have been present regardless of their conduct.
3. *Making a false statement*: When discussing this scheme, first of all, we need to clarify the definition of “statement”. A statement is not a simple representation of facts or beliefs. A statement contains a declaration of the person making the statement about his/her intentions. It always has to be recorded in writing, in compliance with the statutory requirements regarding its content and format. In this sense, a tax return is also a statement, and if false, it satisfies the statutory definition of budget fraud.
4. *Suppressing true facts*: Suppressing true facts can only be construed against a specific obligation, if hiding such true facts can be linked to causing financial losses to the budget(s).

Taking the statutory definition in account, the above schemes committed to cause harm to the budget can only constitute to a criminal act, if such acts cause financial losses to at least one budget, and based on subsection (3) of section 462 of the above act, only, if this loss exceeds a hundred thousand forints.

It is important, that in consequent jurisprudences, for tax returns, including VAT returns, the first two schemes do not constitute to either misrepresentation, nor to condoning misrepresentation, because there is no passive victim. However, omission of payment of tax by false tax returns do constitute to a budget fraud, even if there is no natural person victim.

¹² Molnár (2011) 281–282.

¹³ Molnár (2013) 717–719.

Classification of Schemes of Budget Fraud by VAT Evasion Based on a Further Criteria System

In the previous chapter, we saw that due to their diversity, comprehensive classification of VAT fraud schemes is quite problematic, while certain schemes may fit into more than one pre-defined groups. An example of this is a fraud mechanism by fictitious intra-Community or export sales, which, under Borbála Sólyom's classification criteria, falls in the category of cross-border normal, general tax fraud, while Eszter Magyar-Áhel would classify it as an organised, cross-border EU VAT fraud. I could also mention the EU VAT evasion schemes in question as examples, which – as we will see below – are classified differently by different schools.

Objectives and Methodology of Classification

Based on the above, it has to be admitted that in the classification of VAT fraud schemes, we cannot avoid establishing a pre-defined, purpose-specific classification criteria system. *Below, I am attempting to create a classification system of budget fraud schemes regarding VAT along classification principles pointing out the criminal aspects of the investigation of each scheme under the statutory provisions.*

In creating these categories, I opted for the following classification criteria:

1. *working mechanism of VAT*
2. *invoicing chains between the subject companies*
3. *elements of statutory definition*

Above, I presented some schemes – the list is not exhaustive – more or less matching the selected criteria, using the available professional discourse as a source. Below, I am attempting to explore the bases for selection of the criteria and the groups of schemes I created along these criteria (Table 1).

Fraud schemes based on the working mechanism of VAT

In my opinion, relevance of the working mechanism of VAT as a priority criterion manifests in the fact that the statutory definition of the criminal act also including budget fraud by VAT evasion is only a framework disposition, filled with an actual content only by the VAT Act, at least with regards to the above criminal act. In connection with this, understanding the working mechanism of VAT is essential.

Taking the working mechanism of VAT into account is also paramount when establishing the financial losses suffered by the budget and caused by VAT evasion, as the referred criminal law definition is also based on this (in addition to perpetration in a criminal conspiracy and/or for commercial purposes). Though establishment of the

value of VAT evasion is a professional issue, however, when appointing a specialised advisor, when laying down the issues to be clarified or when evaluating expert opinions, along with the correct establishment of the criminal act of budget fraud, knowing the basis of it is still necessary.

Based on the working mechanism of VAT, as we saw it in *Figure 1*, the budget can suffer financial losses in the following ways:

1. Fraudulent increase of deductible VAT (for example, by wilfully accepting fictitious invoices).
2. *Omission of return of payable VAT or parts thereof.*

The above two fraud schemes are practically the same as the first two scheme groups defined by Balázs Gábor Fodor, however, considering the classification criteria laid in this writing, I would rather classify the two further schemes defined by him (i.e. misrepresented tax exemption or hiding domestic purchases) in one of the groups based on invoicing chains between companies.

VAT fraud schemes based on invoicing chains between subject companies

Going further into the details of invoicing chains between subject companies will lead us closer to the historical facts. Considering that the interest of perpetrators is to create chains as sophisticated and complex as possible to conceal their unlawful acts before the authorities, it is necessary to understand the main individual chain structures.

Based on the criminal characteristics of their investigation under the Criminal Procedure Act, invoicing chains between companies can be categorised as follows:

1. *cross-border, organised VAT fraud*
2. *domestic VAT fraud*

Borbála Sólyom, in the classification published in her PhD thesis entitled *Combating Tax Fraud and Tax Evasion in the European Union, with Special Regards to the Jurisprudence of the European Court* – in addition to domestic VAT fraud – she also mentioned cross-border normal, general tax fraud and missing trader fraud schemes. I did not separate the latter two, as missing trader fraud schemes also presume the existence of cross-border invoicing chains. Below I will demonstrate that these fraud constructions cannot be clearly separated.

In my opinion, in the categorisation of fraud schemes by their criminal characteristics and by the working mechanism of VAT, the most important criteria is whether the invoicing chains are of a cross-border or domestic nature. From this aspect, even the level of organisation of such invoicing chains is secondary, as cross-border chains require a higher level of organisation and structure than domestic ones.

Considering the fraud mechanisms published by Eszter Magyar-Áhel, cross-border, organised VAT fraud schemes should be categorised in the following groups:

1. *Carousel fraud*: The most important characteristic of carousel fraud is that such invoicing circles end where they start, and as such, they do not necessarily reflect real economic transactions, the system is viable without a market demand or actual sales.
2. *Missing Trader Intra-Community Fraud* (MTIC fraud): These only differ from the carousel fraud introduced above that it is induced by an actual market demand, and it is aimed at attaining the lowest possible consumer prices and the highest profit, from which end consumers also benefit, regardless of whether or not they are aware of the fraudulent characteristics of the invoicing chain. Some schools also classify MTIC frauds in the same group as carousel fraud, as both fraud mechanisms involve missing traders. However, taking into consideration that carousel fraud does not require an actual market demand, I would break down MTIC fraud schemes further, as follows:
 - *general MTIC fraud scheme*
 - *VAT refund fraud by fictitious domestic purchase*
 - *VAT refund fraud by concealed domestic sale*
3. *Fraud schemes other than carousel fraud or MTIC invoicing chains*: Fraud schemes falling in this category are classified by some schools as MTIC fraud, while others see it as separate fraud mechanisms. In my opinion, this latter aspect reflects the most the main characteristics of these fraud mechanisms setting them apart from the ones detailed previously. Namely, that carousel fraud is a completely fictitious invoicing chain ending where it starts, and aiming to cause losses to the budget. In an MTIC fraud, the invoicing chain is not a closed loop, and, apart from a few differences, it is largely equivalent to an arch of a carousel fraud, wherein, in addition to fictitious transactions, actual transactions induced by market demand are also present. The primary objective of such fraud schemes is decreasing sales prices.

Though the fraud mechanisms detailed below also involve both fictitious economic actors and actual transactions induced by market demand, the invoicing chain is not the same as the one in a typical carousel fraud or an arch thereof. These fraud schemes are the following:

- *misuse of customs procedure code 42.00*
- *fictitious intra-Community or export sales*
- *cross-invoicing fraud*
- *triangular trade fraud*

Another important fact is that the basis of triangular trade fraud and partly that of the cross-invoicing fraud open up further options for the creation of new categories, namely that triangular trade fraud in itself is not a fraud, only if it is linked to a carousel or MTIC chain. Also, a cross-invoicing fraud can be absorbed in the same chains, for example, when Missing Traders attempt to reduce their tax obligations to zero by such cross-invoicing. Therefore, cross invoicing is not necessarily an independent scheme.

When examining *domestic VAT evasion* cases, we find that perpetrators have less liberty than perpetrators of cross-border VAT evasions. Theoretically, the use of a Missing Trader or Buffer company is not ruled out, however, the invoicing chain is way more simple and clear. Perpetrators doctor invoices to only one invoice down the invoicing chain (input, output or both). Fraudulent acts largely take place by using the schemes detailed in connection with the working mechanism of VAT, i.e. acceptance of fictitious invoices of expenses or omission of return of payable VAT or parts thereof.

Classification of budget fraud schemes on the elements of statutory definition

In my opinion, elements of statutory definition are important criteria of classification of fraud schemes, because in investigations, the facts found during the proceeding have to be compared with such statutory definition elements before they move on to notification of charges. Based on the effective penal code, fraudulent behaviours are classified as follows:

1. *making a false statement (tax return)*
2. *concealment of true facts*

According to the statutory definition, budget fraud by VAT evasion can be committed by both misrepresentation and condoning misrepresentation, however, according to the jurisprudence, this is an empty set, therefore, I did not include these schemes in my classification.

Table 1. Classification of schemes of budget fraud by VAT evasion

Working mechanism of VAT	Invoicing chains between the subject companies	Elements of statutory definition
<ol style="list-style-type: none"> 1. Fraudulent increase of deductible VAT 2. Omission of return of payable VAT or parts thereof 	<ol style="list-style-type: none"> 1. Cross-border, organised VAT fraud: <ul style="list-style-type: none"> • carousel fraud MTIC fraud schemes: <ul style="list-style-type: none"> • general model of MTIC fraud scheme • VAT refund fraud by fictitious domestic purchase • VAT refund fraud by fictitious domestic sales Fraud schemes other than carousel fraud or MTIC invoicing chains: <ul style="list-style-type: none"> • misuse of customs procedure code 42.00 • fictitious intra-Community or export sales • cross-invoicing fraud • triangular trade fraud 2. Domestic VAT fraud 	<ol style="list-style-type: none"> 1. Making a false statement (tax return) 2. Concealment of true facts

Source: Compiled by the author.

Summary

In the selection of the categorisation criteria, I have considered the criminal characteristics of the investigation of budget fraud under the Criminal Procedure Act. Along these lines, I have selected three criteria: the working mechanism of VAT; the invoicing chains between subject companies; and the elements of statutory definition. In my opinion, the significance of working mechanism of VAT as a classification criterion lies in the fact that the framework statutory definition is only filled by an actual content by the VAT Act and that knowing the amount of the budget loss to establish the value of and/or evaluate the criminal act is necessary. Going further into the details of invoicing chains between subject companies will lead us closer to the historical facts, and it is necessary to know the statutory definition elements to be able to compare the two.

However, other criteria can also be used for the classification of schemes of budget fraud by VAT evasion. The methodology created by me differs from the ones published in the referred discourses in the choice of several dimensions, i.e. classification criteria, as opposed to only one.

Another important fact is that the EU system of value added tax (ratified in Hungary by the VAT Act) laying down the working mechanism of VAT, the schemes of the perpetrators and the statutory definitions of the penal codes change over time. Changing of economic environment and taxation conditions result in the change of VAT evasion schemes, giving rise to the emergence of increasingly sophisticated mechanisms. After

all, I still think that – at the time I am writing this paper – using the categorisation system based on the ‘three dimension’ detailed above works well in the classification of perpetration schemes emphasising their main criminal characteristics in the investigation of budget fraud cases by VAT evasion.

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