TAX FRAUD ON THE EU BUDGET AND MEASURES TAKEN BY THE COMMUNITY BODIES

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Abstract

Even if good financial management of EU funds is gradually improving throughout the EU, tax fraud affecting the EU budget remains a problem that always concerned bodies and member states alike. They coordinate their measures to protect the EU budget, to reduce the financial impact caused by tax fraud, but the total eradication of this phenomenon is impossible. However, community bodies have adopted many measures to prevent and combat this phenomenon.

Keywords: tax fraud, suspected fraud, financial impact, EU budget

JEL Classification: G28, H26

Tax fraud and it's financial impact on the EU budget

The European Union budget represents the effort of the Member States and their citizens for a social and economic development. In this regard, the Commission and Member States shall coordinate their measures to protect the budget and therefore illegal activities that affect them. Thus, Member States (which are responsible for control and management of 80% Community budget) are able to "effectively protected" the EU budget, the Commission having only a general supervisory role.Major reform efforts made in recent years by Member States and their efforts to transform their vision into reality (economic solidarity and social support, promoting research and technological development) lead to a better financial management of EU funds. Also, in this sense, community bodies provide statistics on the irregularities and cases of fraud and information of irregularities that affecting the EU budget.

Community legislation requires Member States to report suspicions of fraud and other irregularities detected that affecting Community financial interests. In this sense it is important to distinguish between fraud and other irregularities. An irregularity is any infringement of a Community provision by an economic operator who may or might harm the financial interests of the Communities [Regulation (EC, Euratom) no. 2988/95]. Fraud is an irregularity committed intentionally, which represents a criminal offense [Convention on protection of the European Communities' financial interests, OJ C 316, 27.11.1995].

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In 2007-2009 the situation per areas where Member States implement the budget, is described as follows:

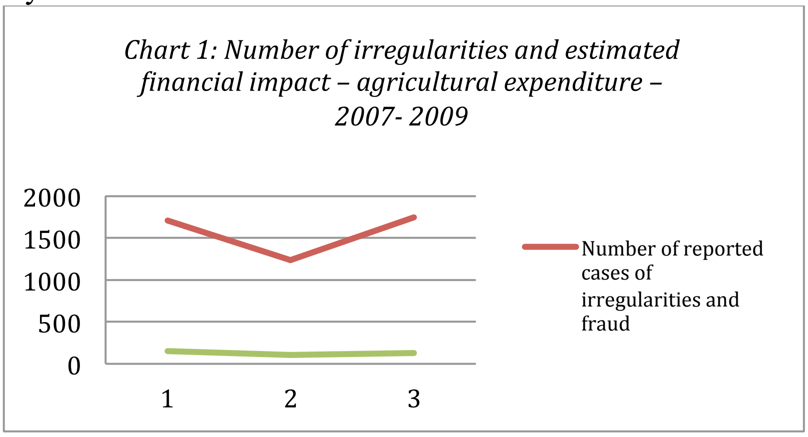
Area	Number of reported irregularities 2007[1]	Number of reported irregularities 2008[2]	Number of reported irregularities 2009	Total financial impact of such irregularities, including suspected fraud (millions of Euro) 2007[3]	Total financial impact of such irregularities, including suspected fraud (millions of Euro) 2008[4]	Total financial impact of such irregularities, including suspected fraud (millions of Euro) 2009	Assessed financial impact exclusively for suspected fraud (millions of Euro) 2007	Assessed financial impact exclusively for suspected fraud (millions of Euro) 2008	Assessed financial impact exclusively for suspected fraud (millions of Euro) 2009
Agriculture (FEOGA and FEADR)	1548	1133	1621	155	102,3	125	44,8 (~0,1% of allocated funds)	4 (0,01% of allocated funds)	13,3 (0,03% of allocated funds)
Structural funds and Cohesion Fund	3756	4007	4931	804	585,2	1 223	141 (~0,31% of allocated funds)	57 (~0,11% of allocated funds)	109 (~0,23% of allocated funds)
Pre-accession funds	332	523	706	32	61	117	5 (~0,38 % of allocated funds)	13 (~0,9% of allocated funds)	57 (~0,38% of allocated funds)
Direct expenditure	411	932	705	33	34,7	27,5	18,1 (~0,17% of allocated funds)	3,2 (~0,03% of allocated funds)	1,5 (~0,01% of allocated funds)
Total expenditure	6047	6595	7963	1 024	783,2	1492,5	208,9 (~0,22% din of expenditure in all four areas)	77,2 (~ 0,07% of expenditure in all four areas)	180,8 (0,13% of expenditure in all four areas)
Own resources[5]	6097	5344	4648	401	351	343	130,78 (~0,81% of total value of own resources5[6])	75 (~0,46% din of total value of own resources5[7])	99 (~0,68% of total value of own resources5)

Source: Commission's Report to the European Commission and Council. "Protection of the Communities' financial interests – Fight against fraud – Annual Report 2008 and 2009"

[1] For certain areas, the statistics has been updated following the 2007 report.
[2] For certain areas, the statistics has been updated following the 2008 report.
[3] Idem 1
[4] Idem 2
[5] Customs duties and farming tax
[6] This percent is calculated based on own traditional assessment in the 2008 general budget and not based on accounting records.
[7] This percent is calculated based on own traditional assessment in the 2008 general budget and not based on accounting records.

Agricultural expenditure (European Agricultural Guarantee Fund and the European Agricultural Fund for Rural Development)

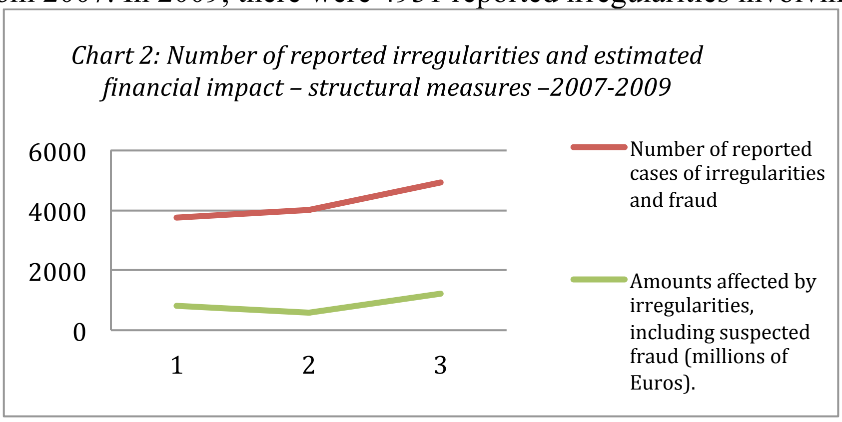
Irregularities reported for agricultural spending was up from 2008, their proportion in 2009 was 43%. Of these, 20% of them are suspected fraud, registering a downward trend. Financial impact was 13.3 million, down considerably from 2007 when the estimate was 44.8 million.



The main reason for this increase is the implementation of IMS (management system is a system of reporting irregularities based on the Internet) that allowed a greater number of users to process communications, thereby having a direct impact on the number of cases communicated. Spain announced the largest number of cases (404) and Italy announced the highest amount affected by irregularities (54 million).

Structural Funds and the Cohesion Fund

If the Structural Funds and Cohesion Fund increased the number of irregularities reported by 6.7% in 2008 compared to the previous year, while their financial impact decreased by 27%. Suspected fraud represented 7.4% of cases of irregularities communicated with an estimated financial impact of 57 million, down from 2007. In 2009, there were 4931 reported irregularities involving a total



of 1.22 billion. The financial irregularities and related values increased compared to 2008. The increase was significant both in terms of irregularities (23%) and in the amounts affected by irregularities (109%).

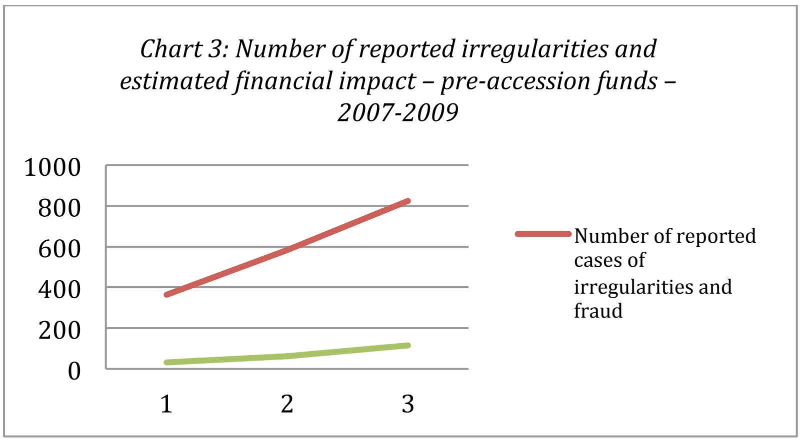
The highest rates of irregularities concern the European Regional Development Fund (ERDF). For him, the most plausible explanation is that the fund finances projects of higher value and therefore irregularities tend to have a higher value. Also, regarding the rate of suspected fraud FEDER remains the most affected fund (0.29%).

Pre-accession funds

As regards pre-accession funds (PHARE, SAPARD and ISPA - including, in 2008, CARDS, Transition Facility and Pre-accession assistance for Turkey), was an increase in the number of irregularities reported (an increase of 58% compared 2007) and in terms of financial impact (an increase of approximately 5.4%). Suspected fraud represented approximately 21.7% of the irregularities reported in 2008, with a financial impact estimated at 13 million eurosor approximately 0.94% of total annual budget.

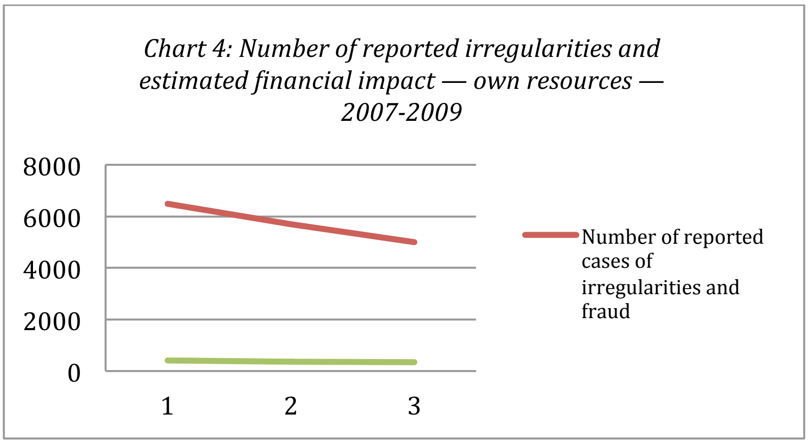
In 2009, authorities of 14 countries rapporteur release 706 cases of irregularities with a value of 117 million affected. There is a 35% increase in the number of cases proving that the number of irregularities detected in the pre-accession assistance does not decrease, but migrate to a smaller group of countries, namely EU-2 countries. Irregularities in Bulgaria and Romania account for 81% and 93% of the amount affected by irregularities reported in 2009. However, increasing trend applies only for Bulgaria, with a 134% increase in the number of cases. Consequently, the trends are influenced largely by the methods of reporting these countries and thus the objective analysis is limited.

EU irregular amounts continue to grow and thus to accumulate about the whole programming period, while allocations remain fixed and the payments decrease gradually. Therefore, the rate of irregularities and suspected fraud rate shows an upward trend (Chart 3).



Own resources

As regards own resources, the number of cases of irregularities in 2009 was 23% lower than in 2008 (4648 cases in 2009 compared with 6075 in 2008), while the estimated value is also the 8.5% lower (from 375 million in 2008 to 343 million in 2009). The number of communications from the ten new Member States increased continuously from the date of their accession in 2004 until 2007. In 2008, this ceased to grow, and 2009 show 2% fewer reported cases compared to 2008, although own resources increased by 20% from 2008 to 2009. Suspected fraud accounted for approximately 19% of all cases of irregularities with a financial impact estimated at about 99 million.



Main legislative and administrative measures adopted by the European Union in 2007-2008 to protect its financial interests.

The Community fosters cooperation with third countries and international organizations by means of international agreements and administrative arrangements to protect its financial interests and combating fraud and any illegal activities.

Intersector legislative developments

As regards bilateral agreements, in December 2008, the Commission presented a proposal (COM (2008) 839 final) for a Council Decision concerning the signing, on behalf of the Community, of a cooperation agreement between the European Community and its Member States, on one hand, and the Principality of Liechtenstein, on the other hand, to combat fraud and any other illegal activities affecting their financial interests.

The proposal also covers the evasion of direct taxes, which is not considered a criminal offense in Liechtenstein. Under this agreement, the parties are compelled to provide mutual assistance in cases of fraudulent conduct contrary to the law on direct taxes.

Negotiations to conclude an agreement with Liechtenstein had been preceded by an anti-fraud cooperation agreement between Switzerland and the

European Community. The agreement covers indirect taxes (VAT and excise duties) and customs offenses, corruption and money laundering.

With regard to multilateral agreements, the European Community ratified the UN Convention against Corruption (UNCAC). It addresses mainly preventive measures in the private and public sectors and the establishment of anti-corruption bodies, and transparency and accountability in public finance issues. Furthermore, the Community with OLAF tried to close contacts and where possible, to conclude administrative arrangements of cooperation with the services from countries benefiting from EU funds to improve the management and control of public funds.

The Community in the process of ratification of instruments for the protection of financial interests (PIF) adopted the Second Protocol to the Convention on the protection of financial interests, which entered into force on May 19, 2009. It was ratified by all countries except the Czech Republic, Hungary, Malta and Estonia. To implement the above mentioned instruments Slovenia amended the Criminal Code, including an article on the criminalization of fraud against the European Communities, which had not been previously defined as offence in the Slovenian legislation.

Progress in the customs sector

Measures were taken in the customs sector, as well. European Commission through the European Anti-Fraud Office (OLAF) organized operation "Diabolo II." This joint customs operation led to the seizure of more than 65 million counterfeit cigarettes and other 369 000 counterfeit items (shoes, toys, photographic cameras , headphones, hats, caps, gloves, bags, etc..) representing over 20 different trademarks. This resulted also conduct international investigations in other criminal activities. The success of this joint operation emphasizes the importance of maintaining close cooperation between all partners to combat global trade in counterfeit goods and protection of legitimate trade with original products.

The new legislative provisions extend the current exchange of information on suspected fraud to the systematic communication of business information and establish a database for the customs files' identification (FIDE), covering investigation files and helping to coordinate Member States' controls to detect suspicious shipments of goods and vehicles and to collect information in a "European registry data".

Smuggling of cigarettes annually causes significant losses both in national budgets and the EU budget. Thus, the European Commission has concluded agreements with two major manufacturers of tobacco, which provide for payment of 400 million dollars for Japan Tobacco International and U.S. $ 1,250 million for Philip Morris International. The Commission also wants to create a framework to legislate obligations such as tracking and detection of counterfeit tobacco.

The European Union through the European Commission adopted administrative measures to prevent fraud. One of them is getting a positive assurance statement, which involves the adoption of an action plan to address "gaps" existing at that time in the Commission's control structures. It should be reminded that the improvement of the financial management in the Union must be supported by strict monitoring of control within the Commission and Member States.

As regards the control of compliance and accuracy of operations involving the Community's financial interests[1], Member States should observe the controls performed by the European Commission which envisage: compliance of administrative practices with Community rules, existence of justificatory documents and, implicitly, their compliance with the Community's budget.

These controls are carried out in one of the three situations: to detect serious or transnational irregularities that may involve economic operators which operate in several Member States or, to detect irregularities, when a Member State requires strengthening checks and controls, or at the request of the Member State concerned. They may also consider: records and documents (invoices, bank statements, pay slips), data stored on computers, budgetary and accounting documents, etc.

Information from such controls is reported to the competent authorities of the State where the control was carried out. It can be used by the Community institutions only in order to protect the financial interests of the Community.

To protect the financial interests of the community, Member States have legislative and institutional initiatives. Thus, several Member States have adopted or amended their national legislation on the management of EU funds, to ensure greater transparency and greater financial control. Also, regarding the prevention of tax evasion, several states adopted different measures: the United Kingdom established the National Strategic Fraud Authority (NFSA), Malta adopted a national strategy to combat fraud and corruption aimed at creating a regulatory, institutional and operational framework; the Czech Republic adopted a national strategy to protect the financial interests of the European Union and an associated Action Plan; Romania, Hungary, Italy and Estonia enacted laws and regulations to combat VAT fraud and to improve the operations' coordination by the competent national authorities in this field; Greece adopted a law on prevention and suppression of money laundering and terrorist financing; Cyprus replaced all the legislation between 1996-2004 with the recently adopted law on combating money laundering; Latvia amended its Criminal Code relating to establishing liability for intentional spread of false information or data on the status of the Latvian financial system.

Following these steps, at the end of 2008, Member States reported a series of legislative and administrative progress. For example: the United Kingdom

[1] Regulation (Euratom, EC) no. 2185/96 of the Council on controls and verifications made by the Commission in order to protect the financial interests of the European Community against fraud and other violations

registered a 9.09% of cases classified as fraud from those communicated, France 39.55% Greece 100%, while Latvia 0%.

Studies in developed countries have shown that the application of the most drastic measures have not only a reparatory role, but also a preventative one to deter such acts. EU Member States are not at the same level of development. However, by proper application of sanctions and without discrimination, as well as by making the facts found public, the situation might change.

Another measure adopted by the Community to prevent tax evasion is the Directive 77/799/EEC on the exchange of information between competent authorities of the Member States, which allows a correct evaluation of direct taxation. This information exchange can be done: on demand, automatically, periodically, without prior request, spontaneously.

As noticeable, each government is "required" to adopt firm measures to reduce tax evasion and implicitly to increase budgetary revenues. However, actions undertaken in this respect are often "sensationalist" and approach a particular moment. We believe that to achieve sustainable results, actions should be carried out within an overall tax strategy, supported by most political parties, to ensure continuity.

Conclusions

Tax fraud affects society as a whole, by impacting on revenues, but also through the practice of unfair competition and business environment's distortion. To ensure equality of citizens before funds and maintaining a healthy business environment, where competition is fair, EU bodies lead a dynamic and ongoing struggle to identify and reduce tax fraud.

All Member States are invited by Community bodies to speed up efforts to strengthen national criminal legislation for the protection of the Community's financial interests. This should be strengthened as it is "suffering" from a certain inability to capture all states of the economy. This lack is characteristic to all tax systems, more or less because, as a rule, the economy is "moving" faster than the legislature.

Even when impact studies, analysis and programs are designed to try to ensure legislative consistency and stability, consider that a first step would be to implement a social civism to assist taxpayers to understand the impact of the fraud phenomenon both in their country and at the Union's level. This does not only affect (the establishment of) revenues, but especially in times of economic crisis, it can affect economic stability.

Total eradication of tax fraud is impossible, but major reform efforts made in recent years by all Member States and EU bodies have brought more clarity.

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