- Consultation response -

VAT fraud – A persisting threat to gas, electricity and emissions trading

Need for a prolongation of existing derogation and an extension to all Member States

Brussels, 31 May 2017 | The VAT fraud in energy and emissions trading continues to pose a serious threat to European Exchequers and energy and emissions markets alike. The existing preventive mechanisms, like the derogations enabling Member States to implement a domestic reverse charge mechanism on gas, electricity and emissions transactions between taxable persons and taxable dealers as resellers, need to be continued and further extended. Active action must be taken by the European Commission, the Council of the EU and the relevant bodies at Member State level to protect energy and emissions trading from a repetition of large scale VAT fraud in Europe. In this context, Europex calls for:

- A prolongation of the existing derogation;
- An extension to all Member States;
- The explicit mentioning of Guarantees of Origin in the derogation.

The necessity to keep the derogations in place and to invite all Member States to implement them domestically should also be mentioned in the overall assessment report that the European Commission will present to the European Parliament and the Council before 31 January 2018.

1. Background

VAT fraud, also known as Carousel Fraud or Missing Trader Intra-Community Fraud (MTIC), constitutes a critical threat to energy and emissions trading in Europe. Prominently in 2009, carousel fraud took place in emissions trading under the EU ETS. Highly specialised criminal organisations entered the European emissions market, and within a period of a few weeks, the European Exchequers were defrauded of several billions of euros.

Besides the financial loss for the affected Member States, the emissions market almost completely collapsed with severe consequences to the functioning of the EU ETS and the energy markets in Europe. The main element in re-establishing trust in the markets and preventing further fraud in emissions trading has been the introduction of domestic reverse charge mechanisms on emissions transactions in a large majority of EU Member States.

Similar events have been observed in gas and electricity trading after 2009 with several hundred million euros of fraud in some of the bigger cases. In reaction, in 2013 under the Irish Presidency of the Council of the EU, the 28 Member States introduced a VAT derogation allowing for the introduction of domestic reverse charge mechanisms also on gas and electricity transactions in case of deliveries to a reseller. Ever since many Member States have made use of this derogation, effectively protecting their markets but at the same time increasing the pressure on the still unprotected markets.

Although the risk of VAT fraud in energy trading in the EU is not diminishing over time under the current VAT set-up, the 2013 derogation contains a sunset clause, automatically ending the provision after five years, if no active action is taken. This would mean that all existing domestic reverse charge mechanisms on gas and electricity transactions in the EU would have to stop, if the Council did not decide on a prolongation of the mechanism.

2. Prolongation of the existing derogation

The 2013 amendment to the 2006 VAT Directive allowing for the implementation of domestic reverse charge on gas and electricity transactions was published on 22 July 2013 and entered into force 20 days thereafter. The derogation, however, is limited in time and will run out next year on 31 December 2018, if no decision is taken to prolong it.

The risk and techniques of VAT fraud in energy and emissions trading are well-known – both to the tax authorities and to highly sophisticated criminal networks. Hence, it is of utmost importance to keep the existing derogation in place and this well beyond 2018. Should the derogation suddenly end, this would be perceived as an open invitation by fraudsters to set up new carousels and to reengage in VAT fraud at a large scale.

As in all other sectors, fraudsters are attracted to VAT fraud because it generates large profits with a relatively low risk of prosecution. Gas and electricity markets are particularly interesting as there is a significant trading activity with big trading volumes. In addition, the technical requirements for trading electricity and gas are minimal and there are no or very low transportation / shipping costs.

In this context, it should be considered to either replace the sunset clause with a permanent solution, by e.g. deleting the timely limitation, or to at least extent any future sunset clause to ten or more years.

3. Extension to all Member States

The necessary renewal of the derogation should also be used to call upon all Member States who have not yet implemented a domestic reverse charge mechanism on gas and electricity transactions to finally do so. It is important to ensure persistency in the prevention of VAT fraud in energy trading in all Member States and in Europe and to close possible loopholes.

Importantly, whenever a Member State is protected, its markets can still be used in fraud carousels as long as not all Member States apply domestic reverse charge. This in turn puts more pressure on the unprotected markets and exposes them to an even higher risk. The fraudsters and their techniques remain and they will use all opportunities to pursue their criminal activities, if they are not stopped from it by applying preventive tax measures.

4. Explicit mentioning of Guarantees of Origin in the derogation

Guarantees of Origin (GOs) based on the Renewable Energy Directive have a strong resemblance to EU Emission Allowances (EUAs) in the way they are structured and traded. This means that they are potentially exposed to the same risk of VAT fraud as EUAs.

With the amendment introduced by the 2013 derogation, Art. 199a of the amended 2006 VAT Directive now refers to "supplies of gas and electricity to a taxable dealer as defined in Article 38(2)" and "supplies of gas and electricity certificates". Given that Guarantees of Origin directly relate to the way electricity is produced, four Member States, namely Austria, Czech Republic, Ireland and Romania, have already explicitly extended the application of their domestic reverse charge mechanisms to GO transactions.

However, many Member States making use of the 2013 derogation currently only cover gas and electricity transactions but not Guarantees of Origin. This should be changed in the context of the prolongation of the derogation in order to achieve a higher level of consistency and most importantly to prevent VAT fraud in GO markets.

About

Europex is a not-for-profit association of European energy exchanges with currently 27 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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