False and Fictitious *INVOICES*

IOTA Report for Tax Administrations

Intra-European Organisation of Tax Administrations
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Intra-European Organisation of Tax Administrations (IOTA)

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PREFACE

IOTA, as one of the major international organisations working in the field of tax administration, commits itself, besides its other activities, to issuing publications on selected topics to inform interested tax officials from IOTA Member tax administrations and other readers working in or dealing with tax administration issues.

To address this issue, the IOTA Area Group "Treatment of Specific Industries – Construction" decided to form a Task Team with the purpose of studying and reporting on false/fictitious invoices. A questionnaire was sent to all IOTA Members in June 2008 to obtain details on how they handled the problem. Based on the replies from the 23 Member tax administrations who responded the Task Team compiled information on the different practices and methods.

The basic idea was not to gather detailed information on procedures and legislation from every country, but to present a comprehensive overview showing how tax administrations (can) act concerning false/fictitious invoices, and which tools/audits they can use to detect and tackle them.

Therefore, this report does not aim to be a good practice guide, but rather it seeks to educate the reader on the subject and give them an overview of possible measures that could be used. Any proposals from readers for amendments or the inclusion of additional information that will increase the value of the document would be appreciated and should be sent to the IOTA Technical Advisory Committee (e-mail: TechnicalActivities@iota.hu).

During the development of the material used in this publication, input was provided by the Area Group members from the majority of IOTA tax administrations[1], who supported the efforts to collect experiences in the field of false and fictitious invoices. We would like to thank them all and more specifically the Task Team members who compiled this report: **Malgorzata Brzoza** (Poland), **François-Xavier Besnard-Mangin** (France), **Tuomo Karvonen** (Finland), **Victoria Moraleda Garcia** (Spain), **Morten Mørch Sørensen** (Denmark), **Mike Pope** (UK), **Kathleen Redmond** (Ireland), **Tor Sandby** (Norway), **Marco van der Waal** (the Netherlands) and **Bojana Znidarsic** (Slovenia).

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[1] Austria, Azerbaijan, Belgium, Croatia, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, the Netherlands, Norway, Poland, Portugal, Romania, Serbia, Slovenia, Spain, Sweden and the former Yugoslav Republic of Macedonia.

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1. EXECUTIVE SUMMARY

The IOTA Area Group Treatment of Specific Industries – Construction; formed a Task Team to study and report on false/fictitious invoices. A questionnaire was issued to all IOTA Members to obtain information regarding the use and handling of false/fictitious invoices in the Member tax administrations.

The report contains the different practices and methods regarding this subject from the 23 completed questionnaires.

The report does not aim to be a good practice guide but it seeks to educate the reader on this subject and give an overview of possible measures that could be used to tackle false/fictitious invoices.

The Task Team devised definitions which identified the differences between a false and fictitious invoice. These definitions were agreed by most tax administrations. It is important to differentiate between the two types of invoices because different penalties apply depending on the type of invoice in some countries.

There is very little statistical information available on false and fictitious invoices in the construction industry but the Task Team obtained statistics from Finland which suggests that false and fictitious invoices are more likely to be found in companies with a turnover between EUR 100,000 and EUR 3,000,000.

Detection is carried out by a number of methods including data analysis of different databases using a variety of audit tools and software as well as site visits.

A lot of useful indicators of false/fictitious invoices were established including the appearance of an invoice, information contained within it and method of payment of invoices.

When detected it is important to gather information and cross check this information from a number of sources, for example cross border and forensic departments.

Most countries do not have legislation relating specifically to false or fictitious invoices but it is normal practice to prosecute or attempt to prosecute.

Many tax administrations educate tax officials by way of specific seminars, websites and international collaboration.

A list of initiatives to combat false and fictitious invoices was drawn up. Nine detailed case studies and six examples of false and fictitious invoices are included in the report.

The conclusions are set out at Section 9 of the report but the main points are:

- The problem of false/fictitious invoices exists in all Member tax administrations;

- These invoices exist in a lot of industries but it is a major problem in the construction industry;
- The Task Team established that the detection of and the way of tackling false/fictitious invoices is very different in all the Member tax administrations, as is the follow up action of penalties and prosecution. This is because legislation and organisation of tax administrations vary from country to country;
- The use of false/fictitious invoices is becoming more sophisticated and more difficult to detect;
- International co-operation between the tax administrations is highly recommended.
- The Task Team found a range of usable indicators and identified some good practice which can be found in the case studies (Section 11).

2. INTRODUCTION

The Task Team "False and Fictitious Invoices" was established in September 2007 in order to obtain a better knowledge of the use of false and fictitious invoices to evade tax and of the different measures adopted by tax administrations to tackle this issue. For this purpose, the Task Team sent a questionnaire to all Members of IOTA and collected their responses.

2.1. Aim of the report

The Task Team aimed to produce an information booklet on false/fictitious invoices in the construction industry in order to provide an overview for tax auditors and other tax officials on this subject.

The overall objective of this comparative study was to identify the different methods used by auditors to detect and prevent tax frauds occurring due to the use of false/fictitious invoices.

The report covers the following aspects:
- Definition of false and fictitious invoices;
- General observations, reasons and implications of false and fictitious invoices;
- Detection methods and indicators;
- Tackling false/fictitious invoices and the consequences of using these invoices;
- Taxpayers education;
- Initiatives to combat false and fictitious invoices;
- Case studies from various countries.

2.2. Task Team working methods

The Task Team organised its work on two levels:
- Task Team meetings to discuss the main points of the analysis;
- For detailed analysis and specific subtopics; tasks were shared and each participant of the Task Team was responsible for their allocated topics.

The Task Team members carried out an analysis of the documents received from members of IOTA Area Group Treatment of Specific Industry - Construction (TSIC). The general questionnaire was answered by 23 IOTA Members.

2.3. Reading guide (caveat)

The report is based on answers to questionnaires and discussions held during Task Team meetings.

The focus of IOTA publications is always in the area of administration itself and does not cover policy issues: IOTA Good Practice Guides, Reports, Booklets or Comparative Studies are not intended to prescribe a solution to a specific problem, but rather to provide an overview on the different approaches adopted by the various tax administrations in addressing and tackling those issues. It is up to the individual tax administration to draw their own conclusions from the publication and to make their decisions based on their own domestic situation.

The guide can be read on different levels:

- The report without the annexes, offers you a complete view of the subject at summary level;
- The report and annexes offer you the possibility to access all information in a comprehensive way.

3. DEFINITION

3.1. False/fictitious invoices

A false invoice is, in the first instance, a false document. Most countries have a definition of a false document in their criminal legislation.

In this way, we can define a false invoice as "an invoice on which incorrect information has been put intentionally".

The incorrect information could be about:
- The nature of the transaction carried out;
- The amount on the invoice;
- Company details;
- Customer details.

Some countries make a distinction between two kinds of false invoices. This distinction is made to differentiate between the uses that the false invoices are put to.

For the purpose of this report the following are the definitions of false and fictitious invoices that the Task Team has devised:

A fictitious invoice is an invoice where the transaction did not take place and the main purpose is to extract money from the business possibly for funds for the directors. A fictitious invoice could also simply be used to reduce the VAT liability in countries where no reverse charge system is in operation. This would include invoices from "missing traders".

A false invoice is an invoice where a transaction took place but it was not the transaction that is on the invoice. An example of this is where the false invoice is for the supply of goods whereas the money allegedly paid for the goods is actually used to pay the wages of workers who are not on the payroll.

Most countries agree with these definitions.

In **France**, false invoices are categorised as either false (convenience) invoices or fictitious invoices. A false invoice is where the transaction has taken place but was not performed by the company whose name appears on the invoice. A fictitious invoice, on the other hand, is an invoice where the transaction on the invoice did not take place and the invoice was only used to extract money from the business. The tax penalties differ between false and fictitious invoices. In relation to false invoices, the penalty applies to the supplier and user of the invoices while it only applies to the supplier where the invoice is deemed to be fictitious.

In **Hungary**, the Ministry of Finance has issued a policy on false/fictitious invoices. It defines false and fictitious invoices as "invoices that fulfil the legal requirements but have significant content deficiencies and includes false information regarding the transaction or the participants". An indication of a fictitious invoice could be if the transaction between the participants on the invoice did not take place at all or the contract between the participants is bogus. An indication of a false invoice could be if the real economic event is not the same as the transaction outlined on the invoice. Generally, if the issuer of the invoice is not tax registered or the registration was based on false or stolen documents, there is a case of false/fictitious invoices.

In **Italy** there is a different definition:
- Objectively non-existent: A transaction which is non-existent in the absolute sense. A VAT deduction is not allowed because the supply of goods or the services has not taken place.
- Subjectively non-existent: A transaction between other participants than those who appear on the invoice or the acquisition for goods or services, illegally, with participants other than the company that had issued the invoice. The tax consequences are also that a deduction of VAT is not allowed.

In countries where they differentiate between the invoices, the definitions are generally in the legislation along with penalties that apply.

In a number of countries different penalties apply to the different types of invoices. Some have tax penalties while others have criminal penalties.

3.2. Tax treatment of false/fictitious invoices

The tax treatments may also differ for the various categories.

In some countries a deduction is allowed in corporate (company) tax for a false invoice but not for a fictitious invoice. The reason for this is that a business transaction of some nature has taken place but the actual nature of the transaction on the invoice is incorrect.

4. GENERAL OBSERVATIONS

False and fictitious invoices are not confined to any one particular country. Audits have been carried out in a number of countries and false and fictitious invoices have been detected.

These invoices are not confined to the construction sector. They have also been used in other sectors and in the field of carousel fraud.

False and fictitious invoices can be obtained in a number of ways. Nowadays it is very easy to produce invoices that appear genuine with new generation printers and personal computers. Invoices can be purchased on the Internet. Companies that want to buy invoices and those which sell invoices get in touch either through a mutual acquaintance or through word of mouth.

4.1. Statistical information

There is very little statistical information available on false and fictitious invoices in the construction industry. However, information has been obtained from both Finland and Poland.

A project has been ongoing in Finland to tackle the black economy in the construction industry. An analysis of the data gathered (August 2009), following on from the audits conducted, suggests that false and fictitious invoices are more likely to be found in companies with a turnover of between EUR 100,000 and EUR 3,000,000. Companies with a turnover in excess of this amount would appear to pose less of a risk in Finland.

According to statistics from Finland:

- 54.6% of audited companies had a turnover between EUR 100,000 – EUR 3,000,000;
- This 54.6% produced:
    - 89.15% of the value of false/fictitious invoices;
    - 86.5% of false/fictitious invoices found;
    - 68.91% of the companies who were found with false/fictitious invoices had a turnover between EUR 100,000 and EUR 3,000,000.

The full analysis is attached in Section 10.

An analysis of the information obtained from Poland (September, 2009) is available as separate file.

This statistical analysis is contained in 3 different worksheets, as follows:

- Worksheet 1 - information about the number and outcome of audits undertaken in the construction sector;
- Worksheet 2 - supplementary information to Worksheet 1;
- Worksheet 3 - information about the number and outcome of checks undertaken and information exchanged in this area.

4.2. Reasons and implications of false and fictitious invoices

The reasons why false and fictitious invoices are used are often the same in different countries.

False and fictitious invoices are used to take money out of the company in order to:

- Pay workers (illegal immigrants or otherwise) who are not on the official payroll;
- Pay hidden dividends to the manager or other connected persons.

Sometimes these invoices are used to:

- Finance criminal or corrupt activities;
- Hide the illegal origin of goods.

The tax implications of using false and fictitious invoices are often the same in the different countries. They can reduce tax payments by:

- Reducing corporate tax by increasing deductible expenses;
- Obtaining a VAT refund;
- Decreasing the VAT payable by increasing the input credits;
- Altering the VAT rate applicable;
- Paying wages that have not been subjected to payroll taxes or social contributions.

It is interesting to see that even in countries with the reverse charge system of accounting for VAT[2], there could be a VAT implication. False and fictitious invoices can be used to change the nature of the transaction so as to make VAT applicable on the transaction and in so doing introduce the possibility of a “missing trader” fraud.

[2] EU Directive Article 199. Reverse charge is where the receiver of the supply accounts for the VAT. In operation in Austria, Belgium, Germany, Hungary, Ireland, Italy, the Netherlands, Portugal and Sweden.

5. DETECTION OF FALSE AND FICTITIOUS INVOICES

5.1. Data analysis

The following are indicators that may assist in identifying companies (construction or other), which may issue, receive and/or use false and/or fictitious invoices:

- High input credits for VAT to reduce the VAT payable to nil or to a minimal amount;
- Level of expenses not in line with industry norms;
- Small number of employees, or no employees at all;
- Fluctuation in the number of employees;
- Large amounts paid for temporary employees;
- Lots of foreign workers with low wages;
- Low wages in general;
- Significant taxable turnover in comparison to the number of employees working in the company;
- The company also has no assets or only has a small amount of assets in order to perform the business of the company;
- Proportion of sales and acquisitions is equal and therefore no taxable income;
- Low profit margin compared to industry norm;
- Noticeable changes in business activity;
- Atypical transactions: the type and amount of transactions is not typical for the declared business activity of the company;
- Discrepancies between declared data;
- Transactions with non-compliant companies;
- Companies with no premises (letter box companies) or companies registered in apartments of the officials of the company;
- High percentage of subcontracting;
- Newly established companies.

5.2. Databases, tools and software

It is possible to use information from a variety of sources to assist in identifying companies, which may issue, receive and/or use false and/or fictitious invoices. These sources include:

- Internal databases;
- Database for foreign letterbox companies;

Germany
ISI is an internal database containing information about foreign letterbox companies collected by the Federal Central Tax Office.

- Database for non-compliant companies;

Lithuania
MOKSI/"Black list" in Lithuania is a database containing information of companies that have:
- Committed tax law infringements;
- Failed to obey the tax administrations instructions;
- Engaged with fraudulent traders; or
- Are missing traders.

- Database for information from tax returns, tax audits, social contributions returns etc.;
- External databases and registers;
- Other authorities including police, customs and administration in charge of social contributions;
- Trade register;
- Real estate register;
- Vehicle register;
- Population register;
- Fictive enterprise register (**Latvia**);
- VIES (allows to check the validity of companies behind the invoices);
- EUROCANET - European Carousel Network (only certain countries are participating in this forum);
- Company websites;
- Official newspaper;
- Information from previous audits;
- Information from other taxpayers;
- Information from the banks;
- Demands for invoices;

Azerbaijan
The Ministry of Taxes of the Republic of Azerbaijan identifies the demand for invoices and orders invoices from printing houses that are licensed to manufacture invoice forms. These forms are sold to taxpayers by regional financial departments in the area where the taxpayer carries on its business activity. Information is provided monthly by these regional financial departments to the Ministry of Finance on the invoices sold, date of sale, serial numbers of the invoices, name of the buyer and also information on returned, unused, damaged or spoiled invoices. This information is then fed into a database and crosschecked with information provided in tax returns. Any discrepancies may be checked by special controls.

- Confidential calls (**Lithuania**);
- Detection of inactive companies;

Romania
An inactive company is a company that does not declare its headquarters or subsidiaries, or the tax administration observes that it has no business activity. For the period the company is declared inactive, it does not have the legal right to issue fiscal invoices. The fiscal authorities may disregard transactions made by or with an inactive company. The tax administration may also refuse a VAT refund requested by another company based on a transaction with an inactive company. The names of inactive companies are published in a

special list in the Romanian Official Gazette and on the website of the Ministry of Finance. An inactive company can become active again if the reason for the inactivity no longer exists.

- Risk analysis tools, e.g. OASIS, SYNFONIE (**France**);
- Chamber of commerce;
- Information from architects (**Spain**);
- The right of inquiry involving making a visit to a taxpayer to check the authenticity of an invoice (**France** and **Slovenia**);
- ACL - a software programme that enables the auditor to extract data from a company's computerised accounting system;
- The MT-database from **Slovenia** contains information on missing trader companies discovered during audits, receivers of the invoices, value of the invoices and period of issuing of false/fictitious invoices.

Spain has initiated visits to subcontractors who have recently commenced business to establish whether a genuine trade is being carried on. After the visit the tax administration makes a report if they suspect that the company could be a potential false invoice issuer. This information is included in the tax administration database to be used in subsequent tax audits.

The **Slovenian** tax administration and other countries have also developed a software sub-program known as "Taxpayer Profile". This program is fed with all important information on taxpayers or their owners, shareholders, legal workers, etc. Tax inspectors are able to get the specific information for any particular taxpayer and its partners and identify the business partners or specific transactions that should be audited.

5.3. Site visits

Site visits are a very good tool to get a general picture of the activities of the companies working on that particular construction site, but they are not a means to detecting companies who probably use false and fictitious invoices. Not all tax administrations have the authority to undertake site visits and some administrations can only do so in conjunction with other relevant authorities.

It is important to do preparatory work prior to a site visit to establish a profile on all companies known to be working on a particular construction site. This enables the administration to act immediately on any tax irregularities that may be identified during the visit.

During site visits tax authorities are able to check if certain companies really exist and which company is really carrying out the work. During the visits it is also possible to:

- Talk with employees;
- Collect the names of the subcontractors and check their data from the tax administrations databases;
- Check the working hours and records of the workers on the site;
- Check the contracting documents, contracts, etc.;
- Raise awareness of the tax administration.

It was also identified that additional benefits arising from site visits can be to establish:

- Who are the employers?
- How many employees are working on that site?
- How are wages paid and from who?
- Are there illegal workers working on that site?
- Are wages paid without being subject to tax?
- Does a certain company have enough employees, equipment and material to do the work that was contracted?
- Is the service the same as mentioned in the site records?
- Is the company using its own plant and machinery?

Business records are the best way to identify such companies that use false and fictitious invoices. However, the company's books and records including the accounting documentation are not normally kept on the construction site and therefore it is not possible to look for invoices. Usually, when the tax audit commences the invoice has already been issued and the construction site may no longer exist.

5.4. Indicators of false and fictitious invoices

The following physical indicators have been identified by various tax administrations that may suggest that an invoice is a false or fictitious invoice.

The **appearance** of the invoice:

- Style of layout;
- The type of paper used;
- Lack of or unusual fold marks on the invoice;
- The quality and type of printing of the invoice having regard to the company size;
- The invoices normally used by the genuine supplier/subcontractor are different in layout.

The **information** contained on the invoice:

- Lack of specific information or incorrect or old information used, i.e. incorrect address or telephone number;
- The address used is a post office box number or does not exist;
- No invoice number;
- Round sum figures;
- Invoices are not itemised or contain only basic details regarding the nature of the transaction, e.g. "labour only" or "for work agreed";
- The VAT number used does not correspond to the company name;
- The VAT number used is for a company that no longer exists or the number has ceased.

Many tax administrations crosscheck the suppliers' invoices with other information as this also assists in identifying potential false or fictitious invoices.

In some administrations this is done by simultaneous audits on the companies involved to verify the authenticity of the transactions. Some of these checks undertaken include:

1. Checking the tax history of the company supplying the invoice:
    - Are they paying their taxes?
    - Is the VAT on sales correct (for countries without the VAT Reverse Charge System) having regard to the purchase invoices in the other company?
2. Checking all available internal and external sources to build up a profile of the supplier:
    - How long has the company existed?
    - What is the normal business of the company?
3. The address and registered office of the supplier company:
    - Is the company actually known at these addresses?
    - Do these addresses exist?
4. A background check on the people involved with both companies:
    - Have they been involved with other companies where similar problems were uncovered?
    - Have they been involved in other companies with tax problems?

   The people representing the supplier company may only be "fronting" the company on behalf of other people. The person purports to represent the company but in fact plays no active part in the management or otherwise of the company (Straw Man, Goalkeeper, Firmant, etc.) This is common in many countries.

   It has also been identified that the people engaged in this type of activity are usually involved in numerous companies supplying and using false/fictitious invoices.
5. Payment of invoice:
    - Cash payments are usually considered suspicious;
    - Payments may be made to a private bank account;
    - Return cheques show the payment was made to a third party;
    - The payment is lodged into the supplier/subcontractor's bank account and is followed by a large withdrawal usually in cash. This amount is normally for the majority of the invoice amount less the supplier's share;
    - The payment may be made prior to receipt of the invoice.
6. Backup documentation to support the transaction:
    - There are normally no written contracts or tenders between the parties;
    - Delivery notes and order forms to support the invoice are not available;
    - The company may also have no credit control account for the supplier.
7. An analysis of the number of invoices issued, the dates of the invoices and their frequency.
8. The address of the supplier compared to the trader:
    - Is this in line with normal business supplies?
    - Is the supplier a significant distance from the receiving company?

9. Has the supplier the capacity to deliver on the contract:
   - The amount on the invoices may be high in comparison to the size of the company.
   - Has the company the necessary assets to carry out the contract?
10. Other indicators identified that may assist in the detection of false or fictitious invoices include:
    - The directors or representatives of the company using the false and/or fictitious invoices are only able to provide vague information on how they came to do business with the supplier. They also are usually unable to provide contact names or telephone numbers;
    - The company often does not comply with their obligations under the relevant company tax legislation (e.g. default on their obligation to submit annual returns, etc.);
    - The trader may change supplier but the new supplier is, in reality, the same company under a different name.

Some tax administrations also use databases to assist them in detecting fraud.

Professional judgement is crucial when determining whether an invoice is potentially false or fictitious.

6. MEANS AND METHODS TO TACKLE FALSE AND FICTITIOUS INVOICES

When a company is suspected of dealing with false and/or fictitious invoices some tax administrations commence a notified audit or a "raid". Sometimes this action is in cooperation with the police. This may lead, in many cases, to a criminal prosecution.

6.1. False/fictitious invoices when detected

When a false or fictitious invoice is discovered during an audit it is necessary to confirm the validity of the invoice and all documentation supporting it. The supplier and purchaser documentation is usually crosschecked.

When it is proven that the invoices are false or fictitious the audit is stopped in some administrations and a report is compiled and the case referred to the police. In some other tax administrations the investigation/audit continues while the prosecution commences as a separate procedure.

6.2. Gathering information

In looking to gather the information to prove that an invoice is false or fictitious, tax administrations will initially review all the various indicators that an invoice is possibly false or fictitious and decide what is the best way to proceed. A lot will depend on the strength of these various indicators in deciding what specific follow up action is taken to gather further information.

The following may be considered:

- Is there an invoice to correspond with the transaction?
- Were the transactions undertaken by the issuer of the invoice (keep in mind the new rules relating to self-billing and the invoicing for third parties – VAT Reverse Charge System)?
- Were the invoiced transactions really intended for the holder of the invoice?
- Does the issuer of the invoice really and physically exist?
- Does the receiver of the invoice really and physically exist?
- Is there a direct link between the invoiced transaction and the transaction, which the holder/receiver covers by an invoice?
- Is the issuer materially and financially able to carry out those supplies and services?
- Was there a real debt between the issuer and the receiver?
- Was the debt cleared as shown in the accounting?
- Have discrepancies been noted among the various operators between customers' accounts and suppliers' accounts?
- Have debts and payments been properly recorded?

The first step usually is to check the information, which is held in the tax administration's databases or paper files. At this stage readily available third party information can be checked in telephone books or on the Internet.

Regarding VAT fraud, there is a special form SCAC (Standing Committee of Administrative Cooperation) that facilitates the electronic exchange of information on VAT between the competent administration authorities of individual EU Member States through a standard questionnaire. Information is provided by EU Member States tax administrations using EUROCANET (European Carousel Network) and VIES (VAT Information Exchanges System).

There is also cross-border mutual assistance and exchanges through competent authorities in relation to other taxes.

There are other important ways of gathering information:

- Cross-checking with suppliers and other third party research and investigations;
- By extending inspections to other taxpayers and chain audits; auditing the issuers of the invoices;
- Site visits sometimes with the police and labour and construction inspectorate where it is possible to interview employees and physically check for the supplies of goods and equipment.

6.3. Other agencies and organisations

In many countries the police and tax administrations co-operate in tackling false and fictitious invoices. Other government organisations e.g. customs and labour inspectorate can also provide useful information.

6.4. Forensic departments

Forensic departments have been established in some countries, which gather information regarding suspicious transactions, and to provide evidence to support criminal investigations.

In the **Netherlands**, the forensic department is involved, in some cases, in physically analysing the invoice to determine whether it is a false document.

Croatia has access to the Police Forensic Department and this is used for particular cases.

A number of countries have IT experts, or access to IT experts, who can interrogate computer hard drives.

6.5. Prosecution and outcome

The prosecution procedures vary considerably in the different countries.

Most countries do not have legislation relating specifically to false or fictitious invoices. However, some do have criminal legislation dealing with the problem and others have a specific section in their VAT legislation dealing with these types of invoice.

Most countries have at some stage taken a criminal prosecution case regarding the use of false and/or fictitious invoices. In specific circumstances a civil prosecution could be undertaken. For example, the victim of a crime (e.g. a company who has been defrauded by its own employees) can use civil law to claim for damages.

It is normal practice to prosecute, or attempt to prosecute offenders. In some countries the decision to prosecute rests with the police. However, the decision to proceed with a prosecution case often depends on the degree of the fraud.

Prosecutions are normally handed over to the public attorney for further criminal investigation. In some jurisdictions there is a fiscal police under the authority of the tax administration.

In most countries the tax investigation/audit continues as well as the criminal prosecution, but they are not run in parallel to each other. The tax audit will normally result in a monetary fine while the judiciary will impose a penalty for the criminal prosecution.

6.6. Transition from audit to criminal investigation

Following the discovery of alleged false or fictitious invoices, the case is usually handed over to criminal investigators (or police or fiscal police).

In some countries the tax audit ceases while in others it continues to its conclusion. The timing of the transfer of the case to the criminal investigators also varies considerably. The main point is that; when evidence of a fraud is uncovered the matter becomes a criminal case.

6.7. Burden of proof

The burden of proof varies considerably in the different jurisdictions but usually lies with the tax administration or criminal investigator to prove. Therefore, it is necessary to check the level that is required for your own country.

It is worth remembering that, "*You are innocent until proven guilty*".

6.8. Penalties

The penalties imposed are normally set out in the tax legislation and vary considerably from country to country. These can include monetary fines, recovery of assets, repayment of tax claimed, or imprisonment.

There have been some very successful outcomes. Penalties of up to five years imprisonment have been handed out to offenders in a number of countries.

6.9. Education of tax officials

Many tax administrations have organised specific seminars to raise awareness of false and fictitious invoices and on how they can be tackled. In some tax administrations it is incorporated in the normal training programme.

Representatives from other specialised agencies e.g. public prosecutor's office, criminal police, labour inspectorate, construction inspectors, office for money laundering prevention, etc. also participate, on occasions, in these training programmes.

A number of tax administrations have a forum on their Intranet where tax officials can discuss issues and share information and knowledge.

Organisations like IOTA and OECD and initiatives such as Fiscalis allow for the sharing of knowledge and information on a European wide basis in relation to issues such as financial criminal activities, financial fraud and tax evasion.

Denmark, Finland, Norway and Sweden have a network for exchanging experiences and information in the area of false and fictitious invoices. This network was created in November 2008.

Some tax administrations have also compiled instruction manuals and good practice guides to educate tax auditors and tax officials on false and fictitious invoices.

6.10. Publicity

In most countries they do not publish or disclose information about penalties imposed based on false invoices; as the legislation prevents them from doing so.

However, publication of penalties or audit findings may be allowed in some countries under certain conditions.

In Ireland publication of tax defaulters is catered for in the tax legislation provided the audit settlement satisfies certain criteria.

7. INITIATIVES TO COMBAT FALSE AND FISCTITIOUS INVOICES

The following initiatives are being considered by various IOTA Member administrations or have already been introduced to combat false and/or fictitious invoices:

7.1. Initiatives

- Development of risk analysis systems (i.e. a data mining model) to assist in the detection of fraud through the use of false or fictitious invoices (various countries including **Belgium**).
- National construction projects to tackle risks quickly and consistently (various countries including **Slovenia**).
- Introduction in **Poland** of the “Plan of Tax Discipline” based on the main tax risk areas. This plan identifies how audits should be selected and provides guidance on how to lead and to address specific issues of interest during an audit. This information was based on problems identified and experiences gained during audits.
- Introduction of the Reverse Charge System of accounting for VAT.
- The MT-database was established in **Slovenia**. This contains information on missing trader companies discovered during audits, those traders receiving invoices, the value of the invoice and period during which false/fictitious invoices were issued.
- Introduction of a Single VAT Deposit Account in **Azerbaijan** in 2008. This is the first tax administration in the world to introduce this initiative and has resulted in an increase in VAT receipts of 74.7% above the 2007 figure. It is an automated process where taxpayers transfer the VAT amount from their bank account to the VAT deposit account by showing the sellers TIN (Tax Identification Number). The amounts per TIN are reflected on the sub-accounts of those taxpayers. From their VAT sub-account the taxpayer can pay their tax liabilities.
- Preventative controls. These are deterrent controls introduced in **Italy** to discourage tax evasion and are carried out before the deadline for the submission of tax returns. They are short visits to taxpayers to verify certain information to be included in the returns, checking for the existence of workers not on the payroll (for future enquiries relating to social security) and, amongst other things, for checking invoices and receipts. These checks, which are primarily for VAT purposes, give rise to fines and sanctions for any breaches found. The taxpayer also has the opportunity to correct the tax return to be submitted.
- “Targeted Access” controls have also been introduced in **Italy**. These are checks carried out after the submission of the tax returns (as distinct from preventative controls which take place prior to the submission of the tax return) and are a way of establishing whether a more in depth tax audit is required.
- Creation of fraud detection cells in **Belgium**. One to two persons have been appointed in each of the 10 local directorates to gather information received from inspectors and auditors relating to tax frauds whose impact extends

beyond the local area. This information is then passed on to a central unit who determine which tax frauds must be tackled.

- Joint and several liability[3]. This has been introduced in a number of countries and is being considered in **Norway**.
- Introduction of a new procedure in **France** (fiscal flagrante delicto): to enable the tax administration to react quickly when a fraud is uncovered in a letterbox company. The procedure, which only applies to a period where a return submission date has not passed, involves swift action against a company (e.g. on the bank account), where fictitious invoices are found or where the company has issued them. This procedure does not require the permission of a judge and can result in a penalty of up to EUR 20,000. It can also result in an audit covering a period of 6 years rather than the normal 3-year period.

7.2. Measures

- Unannounced visits/checks (various countries including **Spain**, **Romania** and **Germany**);
- Effective sanctions, including imprisonment and confiscation of assets in **FYR Macedonia**;
- Joint actions involving police, customs, tax auditors and labour inspectors (various countries including **Denmark** and **France**);
- Establishment of specialised teams for carousel fraud in **the Netherlands**;
- Crosschecking of bi-annual returns regarding invoices issued and received in **Romania** (audits are then undertaken on the riskiest cases identified);
- Interrogation of financial networks (e.g. linking connected parties) in various countries including **Latvia**;
- Reorganisation of the unit responsible for the detection of criminal and tax frauds in **Croatia**;
- Highlighting of specific legislative measures in **Portugal** to collect the correct tax due or tax improperly reclaimed;
- Introduction of identity cards for all persons engaged on a construction site in **Norway**;
- Amendment of the relevant legislation is currently underway in **Croatia**;
- Exchange of information between:
  - Various authorities regarding illegal employment, illicit work, unlawful social benefits, reimbursement of social benefits, temporary employment and immigrant workers from other countries,
  - Tax authority and fiscal police;

  This occurs in a number of countries including **Germany**.

7.3. Education

- Education of tax auditors in the **Netherlands**;

[3] Example: company A is the main contractor and has to use company B as a subcontractor. Under certain circumstances company A may be responsible for company B's payment of payroll withholding tax.

- Education of the construction industry regarding the use of illegal workers in **Sweden**, which includes co-operation with companies to provide information regarding their use of potential subcontractors.

8. EXAMPLES OF FALSE/FICTITIOUS INVOICES

The following section provides examples of false/fictitious invoices from **Denmark** and **the Netherlands**.

Additionally, a number of case studies have been drawn from real cases and are attached at Appendix B (Section 11). The case studies come from **Denmark**, **Finland**, **France**, **the Netherlands**, **Norway**, **Poland**, **Slovenia** and **Spain**.

These studies are anonymous and simplified for the purposes of this report and are only included to show how false and fictitious invoices are used.

A comparison of the studies identifies that the underlying schemes are very similar, which shows us that fraud with false and fictitious invoices is common across all borders.

An explanation has been provided to explain why the invoices are false/fictitious.

8.1. Example: Denmark

Four invoices, copies attached, were sent to the tax administration from a man who claimed that he had bought articles to produce electronic solutions for sale in the construction industry. These invoices were used to support his VAT refund claim.

At first glance everything appeared in order. The invoices were from 4 different suppliers and the items purchased could be used in the production of electronic solutions. The suppliers were well known large foreign companies.

A couple of things caught our attention:

- The man was elderly, almost 70 years old and retired;
- There was no evidence of any income from the sale of electronic solutions;
- Something about the invoices gave the feeling that it was a potential fraud.

As you can see on the invoices there is a black line across the page just beneath the boxes that are blacked out to hide the supplier names. This black line is on every invoice despite the fact that they were issued by 4 different suppliers.

Our suspicions led to a cross check of the suppliers and each had no knowledge of the invoices.

A search warrant was obtained. Several invoices were found which were ready to be used.

It came to light that there was a small group of retired people that had found a new way of earning money. The problem for this group was that all the invoices were generated from the same computer and despite the care taking in completing the information on the invoices the fraud was revealed by the printer error.

All the people in the "Retirement Club" were charged with falsifying documents and with VAT fraud.

[redacted]

Bilag 2 a

[redacted]

[redacted], den 28.09.2006

Faktura. A.0004321

Automatik.

1 stk CP 62 xx I "Economy" built-in Panel-Pcs. +
1 stk CP 66 xx, CP 69 xx1 Economy
built - in Control Panel.

Indbygget- styresystem

leveret - 1o % ----------------------------	kr. 85.65o,-
+ 25 % moms	kr. 21.412,5o
	kr.107.062,50

betaling netto kontant.

KOPI

Bilag 4

[redacted]

[redacted]

[redacted] 1 september 2006

Faktura nr. 0004432

Stk:	Produkt/type:	
50	Fiberforstaerker NPN Timer, stk netto kr. 684,00 TYPE E 3 x NAIL 2 M	kr. 34.200,00
50	Diffus coaxial fiber M/6 300 mm. stk netto kr 300,00	kr 15.000,00
		Kr. 49.200,00
	25 % moms	Kr 12.300,00
		Kr 61.500,00

Betingelser:

KOPI

kontrol 3/10 ok

[redacted]

Betalt 20 sep 06
Nr D. B 00001466

[redacted]

[redacted]

Bilag 2 a

[redacted]

[redacted], den 28.09.2006

Faktura. A.ooo4321

Automatik.

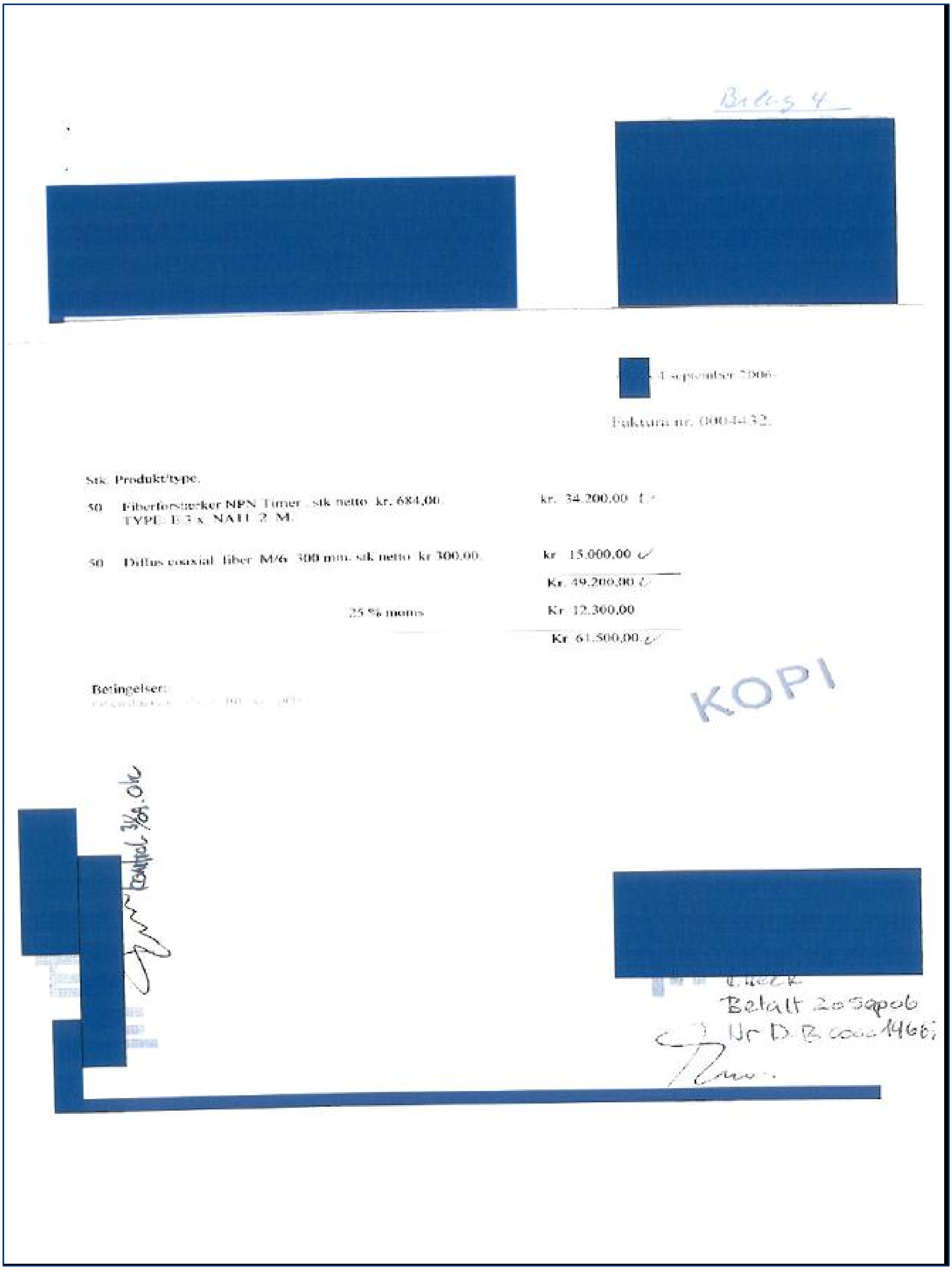
1 stk CP 62 xx I "Economy" built-in Panel-Pcs. +
1 stk CP 66 xx, CP 69 xx1 Economy
built - in Control Panel.

Indbygget- styresystem

leveret - lo % ----------------------------	kr. 85.65o,-
+ 25 % moms	kr. 21.412,5o
	kr.107.062,50

betaling netto kontant.

KOPI



Bilag 4

[redacted]

[redacted]

[redacted] 4 september 2006

Faktura nr. 0004432.

Stk. Produkt/type.

50	Fiberforstærker NPN Timer . stk netto kr. 684,00. TYPE: E 3 x NA11 2 M.	kr. 34.200,00
50	Diffus coaxial fiber M/6 300 mm. stk netto kr 300,00.	kr 15.000,00
		Kr. 49.200,00
	25 % moms	Kr 12.300,00
		Kr 61.500,00

Betingelser:
[illegible]

KOPI

[redacted]

kontrol 3/9 08. ok

[redacted]

Betalt 20 Sep 06
Nr D.B 0000 1466;

8.2. Example: the Netherlands

The following invoices relate to Case Study 9 – see Appendix B (Section 11), the Netherlands (B) dealing with the VAT reverse charge system.

One invoice shows VAT being charged and the other has the VAT reversed. The figures are different from the case study but the principle is the same.

Belastingdienst

KADO

Bouwbedrijf

Rabobank [redacted]
K.v.K. n[redacted] Den[redacted]
BTW NL[redacted]B01

BIJLAGE Nr.
D/204
[redacted]
FIOD-ECD

Faktuurnr. 030976

[redacted]

BEHANDELD 10 NOV. 2003

Zoetermeer, 21 oktober 2003

Uw projekt; [redacted]

p134010

Hierbij belasten wij uw rekening voor herstelwerkzaamheden i.v.m. schade.
E.e.a. zoals besproken met uw projektleider.

Betaald per bank 12 NOV. 2003

Aanneemsom	€ 134.000,--
BTW 19%	€ 25.460,--
Totaal te voldoen	€ 159.460,--

C 1105860

Showroom : [redacted]

Belastingdienst

Belastingdienst

D/113 3B
[redacted]
FIOD-ECD

KADO

Bouwbedrijf

Rabobank nr. [redacted]

K.v.K. [redacted] Den [redacted]

BTW NL [redacted]

Faktuurnr. 030976

[redacted]

Zoetermeer, 21 oktober 2003

Uw projekt; [redacted]

Hierbij belasten wij uw rekening voor herstelwerkzaamheden i.v.m. schade.
E.e.a. zoals besproken met uw projektleider.

Aanneemsom	€ 159.460,--
BTW verlegd	€ 0,--
Totaal te voldoen	€ 159.460,--

Showroom : [redacted]

9. CONCLUSIONS

After gathering all the answers from the questionnaires and making our report we came to the following conclusions:

- The Task Team worked out a definition of a false and a fictitious invoice that all tax administrations, in the main, agreed with;
- In this report there is a difference between definitions of false invoices and fictitious invoices; there is no need to differentiate between these two types of invoices in all tax administrations;
- The problem with false and fictitious invoices exists in all Member administrations;
- False/fictitious invoices exist in a lot of industries, but it is a major problem in the construction industry;
- We have established that the detection of and the way of tackling false/fictitious invoices is very different in all the Member administrations;
- This is also the same for the follow up action, when false/fictitious invoices are found, e.g. penalties, prosecution and burden of proof, etc.;
- The Task Team has found a range of usable indicators and identified a number of good practices;
- The answers to the questionnaires provided some very good examples and case studies;
- There are few statistics available, but there is one from Finland which demonstrates that most false/fictitious invoices were found in businesses with a turnover between EUR 100,000 and EUR 3,000,000 (see Appendix A in Section 10);
- The work revealed differences between both legislation and the organisation of administrations in the different countries; that is why this report is not a good practice guide to solving the problem of false or fictitious invoices, but rather an aid to providing an overview of the issues facing all administrations;
- False and fictitious invoices are, in the first instance, a false document everywhere; and the basic aim to use such invoices is the same in all countries;
- The use of false and fictitious invoices is becoming more sophisticated and more difficult to detect;
- The biggest problems are to prove that the invoice is false or fictitious and in getting the correct taxes afterwards;
- International co-operation between tax administrations is highly recommended;
- Reverse charge systems could be a solution, but it does not solve the whole problem with false and fictitious invoices;
- We would recommend our report is widely circulated in all IOTA tax administrations and that it would be useful for the Members to collect statistics on the numbers of false/fictitious invoices identified and any tax adjustments that follow.

10. APPENDIX A. STATISTICS FROM FINLAND

Turnover	Audited companies	Audits %	Invoices €	Euro %	Invoices	Invoices %	Average (€ / inv.)	Companies with FFI	FFI %	Audits %
<=0 or no information	108	9.85%	762,061.92	2.25%	142	3.02%	5,366.63 €	6	8.11%	5.55%
> 0 and <10 000	49	4.47%	112,112.06	0.33%	22	0.47%	5,096.00 €	2	2.70%	4.08%
>= 10 00 and < 50 000	128	11.67%	1,229,880.12	3.64%	331	7.04%	3,715.65 €	9	12.16%	7.03%
>= 50 000 and < 100 000	72	6.56%	91,655.00	0.27%	2	0.04%	45,827.50 €	1	1.35%	1.38%
>= 100 000 and < 500 000	251	22.88%	14,837,102.77	43.90%	2031	43.21%	7,305.32 €	31	41.89%	12.35%
>= 500 000 and < 1 000 000	129	11.76%	1,796,486.73	5.32%	274	5.83%	6,556.52 €	7	9.46%	5.42%
>= 1 000 000 and < 2 000 000	164	14.95%	6,510,420.97	19.26%	1546	32.89%	4,211.14 €	10	13.51%	6.09%
>= 2 000 000 and < 3 000 000	56	5.10%	6,986,992.87	20.67%	202	4.30%	34,589.07 €	3	4.05%	5.35%
>= 3 000 000 and < 4 000 000	32	2.92%	1,427,975.66	4.23%	107	2.28%	13,345.57 €	1	1.35%	3.12%
>= 4 000 000 and < 5 000 000	17	1.55%	0.00	0.00%	0	0.00%	0.00 €	0	0.00%	0.00%
>= 5 000 000 and < 10 000 000	52	4.74%	0.00	0.00%	0	0.00%	0.00 €	0	0.00%	0.00%
>= 10 000 000 and < 20 000 000	20	1.82%	38,964.73	0.12%	39	0.83%	999.10 €	3	4.05%	15.00%
>= 20 000 000 and < 30 000 000	10	0.91%	3,757.24	0.01%	4	0.09%	939.31 €	1	1.35%	10.00%
>= 30 000 000 and < 40 000 000	4	0.36%	0.00	0.00%	0	0.00%	0.00 €	0	0.00%	0.00%
>= 40 000 000	5	0.46%	0.00	0.00%	0	0.00%	0.00 €	0	0.00%	0.00%
Totals	**1,097**	**100%**	**33,797,410.07**	**100%**	**4700**	**100%**	**7,190.94 €**	**74**	**100%**	**6.75%**

11. APPENDIX B. CASE STUDIES

11.1. Case study 1- Finland

11.1.1. Introduction

During a drug investigation the police established that people involved in the drugs trade were also involved in a tax fraud. On the basis of this, a tax audit was commenced on construction company C.

11.1.2. Background

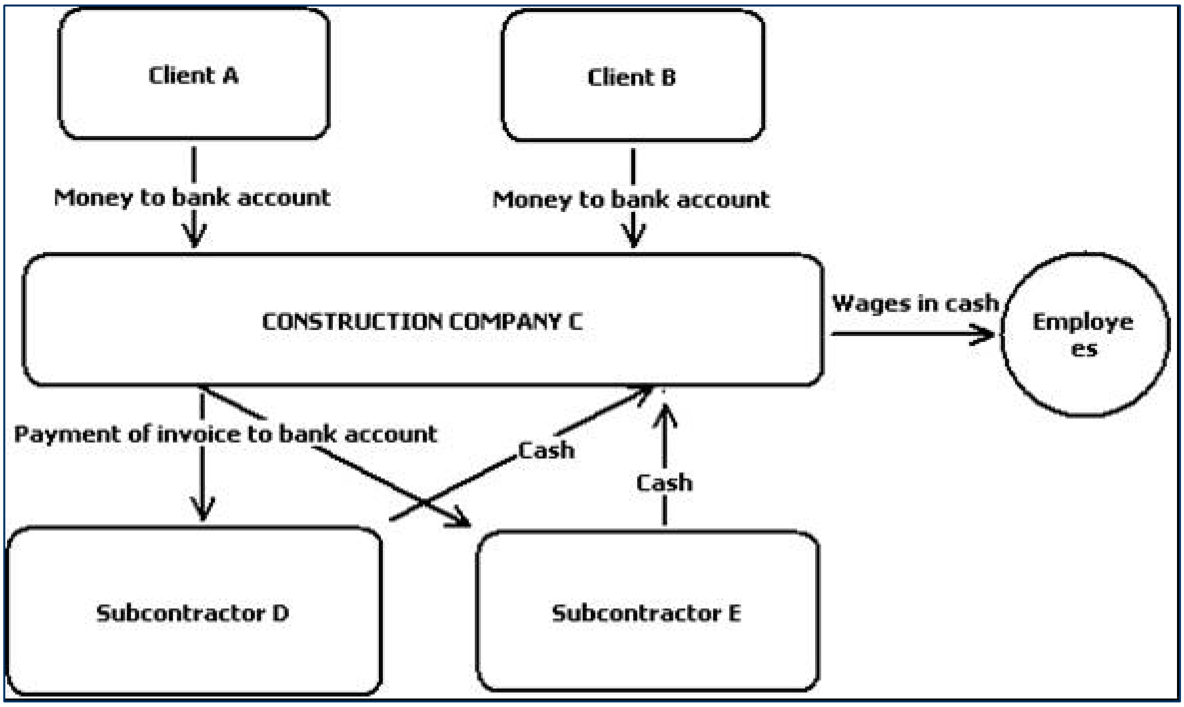
Company C was established in 2005 and the tax audit commenced in May 2008. Income tax return forms had been received. Monthly VAT returns had been received but the tax amount payable was very low. The annual employer payroll report on wages had not been received.

The bookkeeping records included journals, general ledger, income statement and a balance sheet. The bookkeeping was done by an external accountant. There were no wage costs in the records. However, a list of workers and hours worked was obtained from the clients of the company. Company C had workers who were being paid illegal payments. Therefore, company C needed false invoices in its records to account for illegal payments to its employees.

11.1.3. Scheme: step-by-step

Company C received payments from clients A and B (see diagram on the next page). Company C paid its workers wages on which no taxes were accounted for. Fictitious invoices were received from subcontractors D and E. According to the invoices subcontractors D and E (Straw Men) provided a service to company C. In fact, subcontractors D and E did not provide any services to company C and their only use was to provide fictitious invoices to company C.

Payments were made to subcontractors D and E. The money was then withdrawn from D and E's bank accounts and repaid in cash to company C. This money was then used to pay the employees of company C. A small amount of money was retained by subcontractors D and E.



Clients A and B did not know any of the subcontractors of company C. If this business had been real, it is likely that A and B would have known the subcontractors used by company C. Neither of the clients, A and B, had anything to do with subcontractors D and E. This is one indication of the use of false subcontractors.

Subcontractors D and E had no real activity. They did not submit any income tax returns at all and their VAT returns were false. All the money was being withdrawn from their bank accounts in cash. The companies had no employees and the persons involved in these companies had previous convictions for tax fraud.

11.1.4. Activities

Tax auditors conducted a tax audit on company C in co-operation with the police Financial Crime Investigation Unit. The police had seized the bookkeeping records and the audit was being carried out at a police station.

11.1.5. Conclusion

It was determined that the subcontractor costs were not deductible in calculating income tax and VAT. Some wage costs were allowed because some actual construction work did take place. An important decision was made that the money retained by subcontractors D and E were not deductible in company C's taxation but was taxable income in D's and E's taxation.

The task risk posed by this type of scheme could be minimised by the introduction of the reverse charge system in the construction industry in Finland.

11.2. Case study 2 - Norway

11.2.1. Introduction

According to Norwegian law, banks are liable to report suspicious transactions to the National Police Authority for Financial Criminal Affairs (NPA). In this case company C's bank considered the cash withdrawals as suspicious and, accordingly, reported the transaction to the NPA. The NPA forwarded the information to the local police authority where company C was located.

Based on the information from the NPA the tax region in which company C is located, jointly reported the case with the police. The joint investigation with the police was founded on the provision of fraud in the Penal Code.

11.2.2. Background

Company A was a subcontractor to company B and company C was a subcontractor to company B. All companies were registered entities. Company A carried out both regular and irregular activity. Company A submitted VAT and tax returns in due time for its regular activity and all taxes were paid on time as well. It looked perfectly reliable.

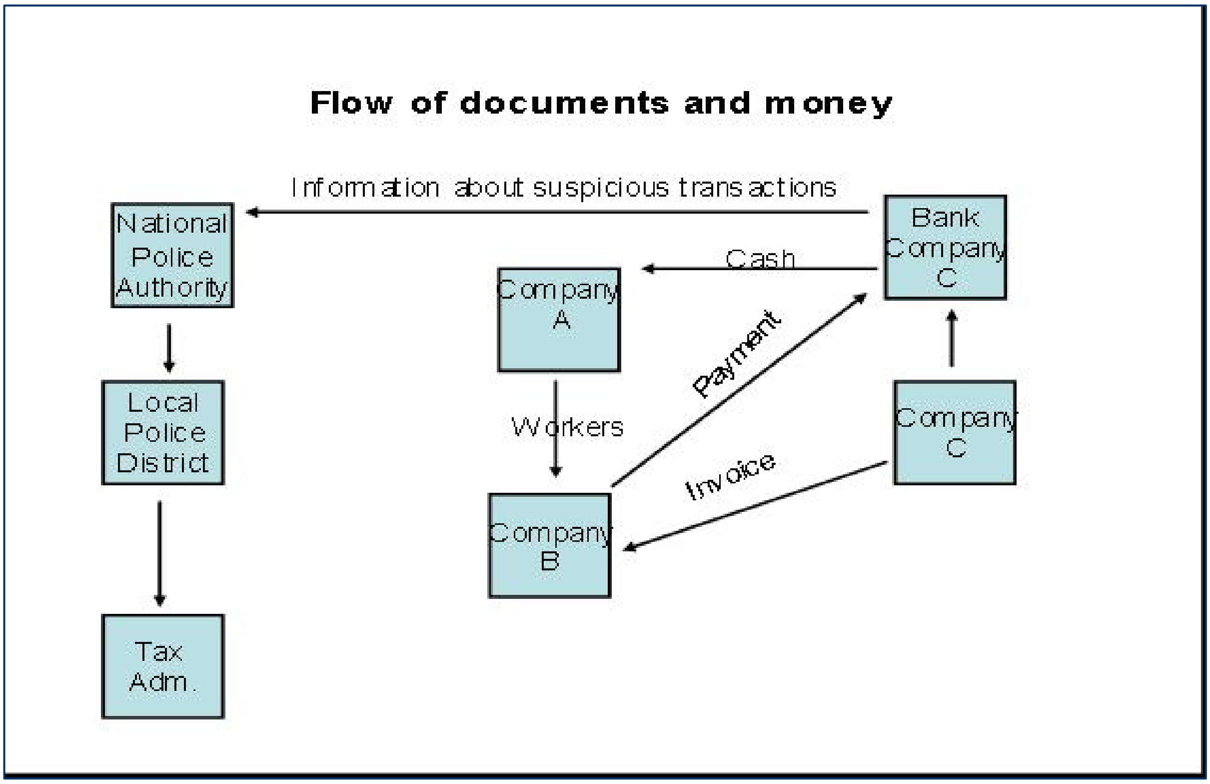
There was no activity in company C, but the company produced false VAT returns and tax returns on which only a very small amount of tax was payable. These amounts were also paid on time and the company looked perfectly reliable as well. Both company A and C had received a so called "Tax Certificate" which is issued to companies who fulfil their obligations to the tax authorities. It is usual that companies use this "Tax Certificate" when advertising for business.

11.2.3. Scheme: step-by-step

Company C entered into a contract with company B, but company A carried out the work with its workers, who were mainly foreigners (see diagram on the next page).

Company C sent invoices to company B inclusive of 25% VAT for the work carried out by company A's workers. Company B paid the invoice to company C's bank account. Within a very short period of time company C withdrew the money from its bank account – less 10% - and paid this cash to the manager of company A. The manager of company A used this cash to pay his workers. No payroll taxes were paid by company A.

The 10% retained was company C's profit. In this particular case this irregular activity amounted to approximately NOK 20 million inclusive of 25% VAT (approx EUR 2.5 million) over a two- year period.



11.2.4. Activities

The tax audit on company C started as a joint operation between the police and the tax authorities.

Based on information obtained from company C both the police and the tax authorities in the region in which company A was located were contacted. A joint operation between the tax and police authorities was carried out on company A. At the same time an unannounced audit commenced on company B.

11.2.5. Conclusions

- The only purpose of company C was to issue invoices. The company submitted false VAT returns for very small amounts, which represented about 1.5% of the total turnover, just to look reliable. The state lost a considerable amount of VAT.
- Company C is now a missing trader.
- The two people managing company C and the manager of company A have been reported to the police and may face criminal prosecution.
- Payments of large amounts of cash are always suspicious.
- Tax certificates are not 100% reliable.
- Cooperation with the police was crucial.
- The importance of high levels of skill and resources required (i.e. IT, audit skills, etc.) to undertake such audits. It was, for example, necessary to extract information from computers and mobile phones.

11.3. Case study 3 - Poland

11.3.1. Introduction

A VAT audit was carried out on company A relating to the period January to November 2007. During the audit suspicious invoices were identified which were issued by company B. Company B was a subcontractor of company A.

11.3.2. Background

Company B started as a subcontractor of company A in March 2007 following an agreement between the two parties dated 1 March 2007. A tax audit commenced on company B in November 2007.

Monthly VAT returns had been received from company B but no VAT had been paid. At the outset of the audit the VAT arrears amounted to over PLN 1,500,000 (about EUR 375,000).

The annual employer payroll report on wages had not been received. Company B had not registered for payroll taxes.

The bookkeeping records were very poor. There were no wage costs in the bookkeeping.

11.3.3. Scheme: step-by-step

Company B did not provide any services to company A, as its only purpose was to provide false invoices. Company B issued invoices to a number of different companies. Generally, these invoices were for large amounts and related to building and transport services. Company B had no employees and did not have the capacity to supply the services as outlined on the invoices. Company B did, however, declare the VAT due on the sales but did not pay the liabilities due.

Payments were made to company B from company A. It was established from the documentation that payments were made before the agreement was signed and some just shortly afterwards.

Company A claimed VAT input credits on the basis of the invoices received from company B.

Based on the evidence collected during the audit it was established that company A had a number of false invoices issued from company B. Both companies produced different agreements and invoices to authenticate their “business activities”.

The tax office determined, based on the information available, that the workers were employees of company A.

11.3.4. Activities

The tax administration failed to secure the tax arrears. It was difficult to find the right company address, but with the help of the Fiscal Intelligence Office[4] it was possible to commence a tax audit.

The audit was conducted by tax auditors from the Fiscal Audit Office. Site visits were conducted and some evidence was obtained; including documents, invoices, agreements, payment lists and evidence of payments. Statements were also obtained from employees from other companies, the construction supervisor and other subcontractors.

Statements received from company A and company B were inconsistent with each other.

Examples of these inconsistencies include:

- Company B was contracted to carry out the entire work with their own materials. However, the statement from company A indicated that they purchased the materials.
- According to company B's statement, the services were already provided prior to the signing of the agreement between company A and company B and some payments were received in advance of this date and some payments just shortly after.
- Company B issued invoices for services already rendered which coincided with the date of the agreement between both parties.

11.3.5. Conclusion

As a result of the audit, tax liabilities for both companies, totalling PLN 133,035 (EUR 33,260), were identified.

11.4. Case study 4 - France

11.4.1. Introduction

The administration in charge of the social contributions in France made an unannounced visit to a building site and found workers who were not on the company's payroll (illegal workers). This information, including the names of the construction company involved, was passed on to the tax administration.

A few weeks later, a tax audit commenced on this construction company.

[4] This office is part of the Fiscal Audit Office. The role of this office includes the detection and audit of undeclared economic activities, as well as income unaccounted for in disclosed sources of revenue, and the audit of sources of income to fund property procurement.

11.4.2. Background

During the course of the tax audit, the auditor identified that the company engaged several subcontractors.

The auditor noticed that these subcontractors were very similar:

- They paid very little tax or no tax at all. Some of the subcontractors had not submitted any tax returns while others had submitted returns showing no tax liability.
- They were located in different letterbox companies.
- They were short-lived companies.
- The invoices did not contain the correct details.
- They were paid by a number of small cheques, e.g. an invoice of EUR 10,000 was paid by 5 cheques of EUR 2,000 each.

11.4.3. Activities

The auditor was able to obtain copies of the relevant cheques directly from the bank because of a "right of communication" that exists in France.

The cheques were not made out to the subcontractors but were either made out to the manager of the construction company or an unknown person. In one instance a cheque had been made payable to a prepaid phone card company.

Because of the information obtained it was decided to take protective measures.

11.4.4. Conclusion

The following was the outcome:

1. Payments made to unknown persons.

   The tax administration determined that these persons were illegal workers. Based on this position, the tax administration accepted that the services on the invoices actually took place. These types of invoices are called "false invoices" or "connivance invoices" in France.

   The VAT deduction reclaimed on the invoices was not allowed. However, the total amount paid to the illegal workers (inclusive of VAT) was deductible from the company's tax on profits. A penalty amounting to 50% of the total amount of the invoice was levied on the company.

   If the tax administration is successful in locating these illegal workers, an income tax assessment will be raised on the individuals concerned. However, they are usually very difficult to trace.
2. Payments to the manager or to a person connected to the family.

   The tax administration considered that these invoices were fictitious on the basis that no work had actually taken place and the payment obtained was similar to a hidden dividend.

   The VAT on these invoices was not deductible for either VAT purposes or as a deduction when computing tax on company profits. However, income tax assessments were raised on the individuals that received any payments.

3. Payments to the prepaid phone card company.
It was not established whether the payment made was used to purchase phone cards (as possibility a benefit in kind to the illegal workers) or if it was a way to obtain cash (these type of companies usually have a large cash supply).
It was reckoned that the money was used to pay illegal workers in some manner and on that basis it was determined that this invoice was a "false invoice" or "connivance invoice".
4. Criminal Conclusions.
The tax administration had the following options:
- Prosecute the manager for tax fraud. A special committee (independent from the tax administration) decides if the fraud is serious enough to register a complaint against the manager.
- Prosecute the manager for using false documentation in order to obtain a VAT deduction. The tax administration can register a complaint against the manager directly (no need to ask the opinion of the special committee) because it is an ordinary crime.

In this case, it was decided to prosecute the manager for tax fraud as the amount involved exceeded EUR 200,000.

11.5. Case study 5 – Denmark

11.5.1. Introduction

Following the receipt of anonymous information, the Danish tax administration suspected that a company who supplied temporary workers to the construction sector was involved in serious tax fraud. On the basis of this information, a tax audit was commenced on company A.

11.5.2. Background

Company A was an employment agency, which provided temporary workers to mainly large building companies. An examination of the company's VAT returns gave credibility to the anonymous information received.

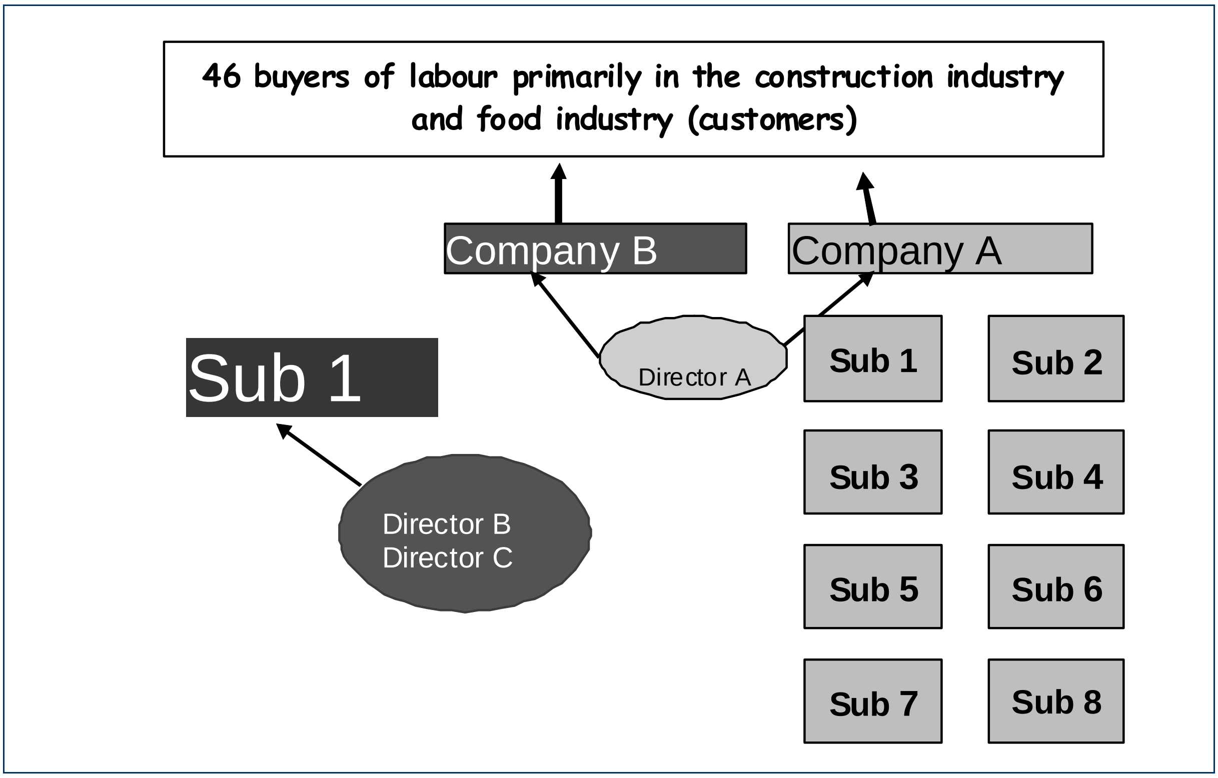
The tax office's investigation identified that the company that we were interested in, was actually two separate entities, company A and company B. However, company A and B acted as if they were one single entity. The director of company A was also a director of company B. Company A engaged 8 subcontractors and company B engaged only one subcontractor.

The audit focused on obtaining information on the subcontractors engaged by companies A and B. An external accountant did the bookkeeping. There were no wage costs in the bookkeeping in company A or company B. The only payments made were to the subcontractors engaged.

Company A and its subcontractors appeared to be reputable. The subcontractors concerned were registered and were paying employment taxes and VAT.

In contrast, company B's subcontractor had workers who were being paid wages without the deduction of the requisite taxes (illegal payments). The cash for these payments was extracted from the company by the inclusion of false invoices in the company's records.

11.5.3. Scheme: step-by-step



Company A and company B provided temporary workers to several different companies (customers). The customer did not know which company it was dealing with, because both companies used the same name and invoices.

Company A is a respectable company and pays VAT and employment taxes.

Company B had only one subcontractor. From the outset, specially selected workers where asked if they wanted to be engaged as a subcontractor of company A and therefore pay all the necessary taxes or be engaged as a subcontractor of company B and get paid by illegal payments.

11.5.4. Activities

The offices of company A and B were searched by the police and the tax authorities. Simultaneously, teams of police and tax officials visited a number of construction sites where the companies were known to be working.

During the search of the offices, a computer was found which contained details of the workers engaged by company B. Considerable documentation was seized and copies of the computer files were made.

A big investigation then took place, which involved reviewing all the documentation seized including the invoices; and identifying the workers named in the computer files. This involved a tremendous amount of work as the invoices looked very genuine. However, a comparison with the real invoices and a cross check of information identified that almost all of the invoices were false.

The director of company A and B (director A in diagram) was arrested along with the director of subcontractor 1 (Sub 1 in diagram). The tax administration assisted the police with the interviews of the directors and the workers.

An investigation was also conducted on company B by the tax auditors in conjunction with the Police Financial Crime Investigation Unit. The police had seized the records and the investigation was carried out at a police station.

11.5.5. Conclusion

Because of the very close connections between subcontractor (Sub 1) and company B, it was assumed that director B and C were Straw Men for company B.

Therefore, it was possible to transfer all transactions made in subcontractor 1 (Sub 1) to company B. This is called "liability breakthrough". This was because subcontractor 1 (Sub 1) had gone bankrupt and all its money had been placed in Company B. This decision was confirmed by the Court.

A number of workers were fined for receiving illegal money and fraudulently claiming public benefits.

This example has been simplified for the purposes of this report. It is an unusual example as it is difficult to obtain a decision of "liability breakthrough". In this particular case, the false invoices proved to be very strong evidence.

11.6. Case study 6 - Slovenia

11.6.1. Introduction

There is a shortage of workers in the Slovenia. Because of this, a number of Slovenian companies hire workers from other countries, including EU Member States and other third countries like Bosnia and Herzegovina, Montenegro, Croatia, Ukraine and the former Yugoslav Republic of Macedonia.

11.6.2. Background

In the Slovene Tax Procedure Act there is a specific provision for non-residents, under which they must submit their tax returns to the competent tax authority to allow them to assess the amount of tax due on the income received. This must be done within seven days of payment of the income.

11.6.3. Scheme: step-by-step

Company A is a Slovenian construction company which had a number of construction contracts in Slovenia during the past two years. It, therefore, required a significant number of employees.

Company B, a smaller construction firm resident in a non-EU country (third country), did not have a permanent establishment in Slovenia. The employees of company B were non-resident in Slovenia.

Company B had 100 employees working on construction sites belonging to company A. They worked for 10 months under the direct supervision and control of three company A employees.

Company A paid company B an amount equal to the remuneration, social contributions and other employment benefits of those 100 foreign workers for the period in question, together with a 5% commission. Company B paid monthly salaries to their employees and paid their social contributions in their resident country (country of origin).

11.6.4. Activities

A tax audit was conducted on company A regarding tax on personal income (payroll tax) because there were significant expenses in company A's tax returns.

During the tax audit it was established that company B had issued false invoices to company A for 120 employees instead of 100 workers who actually worked on the construction sites.

Two major problems were detected. The first involved false invoices issued by company B and the second problem related to the taxation of foreign employees.

According to the current regulations in Slovenia, foreign employees who are working in Slovenia and who receive salaries from a foreign employer are responsible for submitting monthly tax returns to the Slovene tax authorities themselves. On the basis of the return submitted by the individual employees, the tax authority issues a decision on the amount of tax due on the income within 15 days of the return being submitted.

In this case, the employees of company B were required to declare their income received from abroad to the competent tax office in their own countries. However, the foreign employees of company B were unaware of their obligations under Slovenian law.

Company A was not allowed to deduct the expenses for 120 employees but only for 100 employees who actually worked there.

11.6.5. Conclusion

It was estimated that over EUR 200,000 of payroll taxes and social contributions were due from the foreign workers. The Slovenian company, company A, were made to pay this liability.

The false invoicing of 20 workers, issued by company B, was included in the corporation tax return of company A. Those expenses were not allowed by the tax authority and the case has been handed over for criminal investigation.

11.7. Case study 7 - Spain

11.7.1. Introduction

In this case we found inappropriate deductions and expenses in corporation tax and VAT returns relating to work that had not been performed.

The audit was undertaken in Madrid where the receiver of the invoices, company A, was established. The invoices were issued by companies B, C, D and E, that were situated in a different part of Spain.

11.7.2. Background

The tax authority, responsible for company A, coordinated the audit on all companies involved in the fraud.

Auditors, responsible for companies B, C, D and E (issuers of the false/fictitious invoices) prepared reports in which they demonstrated that these companies did not provide any construction services apart from issuing invoices to company A.

There was absolutely no sign of any construction activity in companies B, C, D and E. They did not have the necessary capacity to provide the services reflected on the invoices issued to company A.

11.7.3. Scheme: step-by-step

After analysing the reports prepared by the auditors who conducted the audits on companies B, C, D and E, the tax authority commenced an audit on company A.

The audit identified that all the invoices issued by companies B, C, D and E were included in company A's records. Company A had taken VAT deductions and corporation tax deductions on the basis of the invoices from companies B, C, D and E.

The tax authority decided to disallow the expenses and VAT deductions taken on the basis of these invoices.

11.7.4. Activities

The tax authority asked company A for the contracts signed with companies B, C, D and E. There were no contracts or any other documents at all. Companies B, C, D and E explained that offers were sent by fax and confirmed by telephone calls.

None of the companies could provide supporting documentation, e.g. receipts for material purchased, workers payroll and expenses, etc. to justify the contract with company A. The bank accounts supported this, as there was no evidence of any payments being made.

Payments were made by cheque by company A to companies B, C, D and E. The bank accounts of companies B, C, D and E showed payments received from company A. However, the money was immediately withdrawn from these bank accounts.

All the invoices were similar. They appeared the same. The content, amount, and date issued were more or less the same and they were signed by the same person.

11.7.5. Conclusion

Company A had no right to claim the deductions from these invoices in their corporation tax and VAT returns.

Company A's audit liability exceeded EUR 120,000. As they did not pay this liability their case was referred for criminal prosecution.

11.8. Case study 8 – the Netherlands (A)

11.8.1. Introduction

During a tax audit the auditor uncovered false invoices for generating (black) money; or to get money for private expenses.

11.8.2. Background

False invoices were detected during a VAT audit. The audit took place at both the accountant's office (known as intermediary in the Netherlands) and also at the company's premises.

Three large invoices created a VAT refund in the October/December VAT return for that year. These invoices were from the same supplier. The director of the company was unable to provide the name of the contact person of the supplier.

This gave the auditor reason to undertake further investigations on these invoices and tax returns.

11.8.3. Scheme: step-by-step, and activities

The auditor undertook further research to find out what was possibly wrong or odd with these invoices. The auditor identified that:

- These invoices were for larger amounts in comparison to other invoices in the company records. These three invoices totalled EUR 425,000;
- The normal amount of orders was in the region of EUR 10,000;
- The dates of the three invoices were unusual;
- The numbers allocated to the orders/purchase invoices for these three transactions was not in line with the other orders/purchase invoices in the company;
- The description of the service provided on the invoice was ridiculous;
- The supplier was different to the normal supplier; the supplier in this case was the subcontractor;
- The three big invoices were in a short period of two months;
- The director of the company could provide no explanation regarding the description on the invoices and was unable to provide a name of the contact person in the supplier.

11.8.4. Conclusion

The auditor obtained proof that the three invoices were false/fictitious invoices.

The tax consequences of these invoices included:

- A false VAT claim for EUR 80,000;
- Total costs of EUR 425,000 taken as a deduction for corporation tax purposes. This resulted in a loss of EUR 127,500 in corporation tax (EUR 425,000 at 30%).

The director of the company had the possibility to spend the EUR 425,000 withdrawn from the company for his own personal benefit.

What can we do to correct this problem?

- A correction (adjustment) of the VAT deduction of EUR 80,000 taken;
- A correction of the costs for corporation tax showing an additional EUR 425,000 profit; this gave rise to additional corporation tax of EUR127,000;
- A correction of personal income tax for private expenses - distribution of profits;
- A penalty of 50% was applied as it was considered that this was done on purpose.

How can we detect this problem?

- We must pay attention during an audit in order to identify odd or irregular invoices and/or figures;
- Conduct audits on third parties, where necessary and possible, in order to cross check information.

11.9. Case study 9 - the Netherlands (B)

11.9.1. Introduction

This involved false invoices by using the reverse charge VAT system.

11.9.2. Background

The false invoices were detected during different VAT audits of different companies within a six month period. It occurred in circumstances where it was not absolutely certain that the use of the reverse charge system was required. It was necessary to conduct an audit on both the supplier and the receiver of the invoices, to determine whether the invoices were the same.

11.9.3. Scheme: step-by-step, and activities

Company A undertook work for company B.

The agreed price was EUR 100,000 plus EUR 20,000 VAT, making a total amount of EUR 120,000. Company A wrote up an invoice to this effect and forwarded it to company B. Company B claimed a VAT deduction of EUR 20,000 in their VAT returns on the basis of the invoice from company A.

However, company A also wrote up an invoice for EUR 120,000 with VAT reversed and put this invoice in its records. Company A, therefore, did not pay the VAT on sales of EUR 20,000 relating to the invoice issued to company B.

As it was not totally clear that the transaction between company A and B was subject to the VAT reverse charge system, the tax administration did not react immediately to this invoice during the audits.

Company A had to pay corporation tax (rate of 25%) on the EUR 20,000 but there was still a profit for the company (75% profit after tax).

There are two invoices in company A's records – one with VAT and one without VAT (VAT was reversed). The total amount of the two invoices was the same (EUR 120,000).

Company B used the invoice with VAT and took a VAT deduction of EUR 20,000 in their VAT returns. Company A, on the other hand, used the invoice with the VAT reversed and did not pay the VAT due on the transaction. Company A made an additional profit of EUR 20,000 less the corporation tax. The profit was EUR 15,000.

11.9.4. Conclusion

The fiscal consequences were:

- Loss of VAT of EUR 20,000 as company B took a VAT deduction for this amount but company A did not pay over this amount;

- Company A paid an additional EUR 5,000 corporation tax on the additional profit of EUR 20,000.

This transaction therefore gave company A an overall profit of EUR 15,000 (EUR 20,000 less EUR 5,000).

How do we correct this problem?

- Company A had to pay the EUR 20,000 VAT due along with a penalty of 50%. The supplier is obliged to pay VAT under the tax law (false reversed charge put on the invoice);
- If the correction is made on the receiver of the invoice we may have to deal with the 6th EU VAT Directive (neutrality principle).

How do/can we detect this problem?

- At first there must be knowledge of the VAT reversed charge system; where the VAT reverse charge system applies and particularly knowledge of grey areas where it may or may not be required.
- Identifying "strange" total amounts on invoices with VAT reversed could be a possibility. In the construction industry (subcontracting) it is normal to agree a round sum price between parties without VAT. If VAT is included in the total amount this gives rise to a "strange" total amount.
- Special attention to subcontractors that do not use the reverse charge system for VAT, as they are obliged to use it most of the time.
- If most of the invoices of a company are subject to the reverse charge, pay close attention to the invoices with VAT.