

Subcontractors in the Construction Industry

GENERAL ISSUES - COUNTERMEASURES

IOTA Report for Tax Administrations



Intra-European Organisation of Tax Administrations

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**SUBCONTRACTORS IN
THE CONSTRUCTION INDUSTRY:
GENERAL ISSUES -
COUNTERMEASURES**

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Intra-European Organisation of Tax Administrations (IOTA)



Budapest 2010

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 aspect, the IOTA Area Group “Treatment of Specific Industries - Construction” decided to form a Task Team with the purpose of studying and reporting on subcontractors in the construction industry, general issues and countermeasures. A questionnaire was sent to all IOTA Member tax administrations to obtain details on how they handled the problem. Based on the replies from the 24 Members 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 Member, but to present a comprehensive overview of issues related to subcontractors and possible countermeasures implemented by tax administrations.

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 administrations¹, 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: Eduart Gjokutaj (Albania), Georg Wlachojanis (Austria), Eddy Struyven (Belgium), Veselin Trifonov (Bulgaria), Jaroslav Matejcek (Czech Republic), Susanne Kurz (Germany), Steffen Scholze (Germany), Peppino Crea (Italy) and Eva Persson (Sweden).

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¹ Albania, Austria, Azerbaijan, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Finland, France, FYR Macedonia, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Netherlands, Norway, Poland, Romania, Serbia, Slovakia and Sweden.

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1. INTRODUCTION

The Task Team “Subcontractors in the Construction Industry: General Issues - Countermeasures” was established in September 2007 in order to obtain a better knowledge of the issues arising from subcontractors and their activities in the construction industry and of the different measures adopted by tax administrations to tackle them.

For this purpose, the Task Team sent a questionnaire to all Members of IOTA and collected their responses.

1.1. Aim of the report

The Task Team aimed to produce an information booklet on subcontractors’ issues, countermeasures 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 get a better knowledge of fraud/tax evasion schemes in the construction industry (focused on the subcontractor’s problem) and study of existing and suggested legislative and administrative countermeasures.

The report covers the following aspects:

- Fraud schemes involving subcontractors;
- Detection by site - visits;
- Subcontractors detection methods;
- Legislative countermeasures;
- Administrative countermeasures;
- International administrative cooperation;
- Determination of the place of supply of services for construction works.

1.2. 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 Industries - Construction”. The general questionnaire was answered by 24 IOTA Members.

1.3. 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 related materials, offers you a complete view of the subject at summary level;
- The report and related materials offer you the possibility to access all information in a comprehensive way.

2. SUMMARY

This report aims to give an overview of the common fraud schemes with subcontractors in construction industry. It is described how they work, what impact they have on the economy and which administrative responses were adopted by the auditor in the field and by the tax administration as a whole.

This report also shows the possible ways of detection of fraudulent schemes and describes the wide range of legislative and administrative countermeasures introduced to combat against tax avoidance and fraud. To avoid an overlap with the Task Team “Audit Methodologies in the Construction Sector” and the Task Team “False and Fictitious Invoices”, this report is not go in to detail about specific audit procedures or about the impact of the use of false and/or fictitious invoices. In this respect the Task Team refers the reader to the reports of the other Task Teams of this Area Group on specific industries.

The report is largely based upon the responses to a questionnaire which was sent to the tax administrations participating in this Area Group. All responding administrations have identified different problems with subcontractors in the construction industry. In many cases problems are similar, but there are also some remarkable differences, often depending whether reverse charge or a tax withholding system is in use.

Among the tax authorities of IOTA Member countries, one can notice a balance between pre-selections of construction sites and random selection for observation/supervision of the subjects to be checked.

One of the main ways to detect construction activities, and especially fraudulent activities of a subcontractor, is (besides site observations or visits) the practice of analysing the data (digital and on paper) that is in the possession of the tax administration.

In many cases implementing administrative countermeasures may be necessary when a specific legal measure is taken to tackle fraud schemes in the construction industry. The two main legal countermeasures which are widely promoted to cope with fiscal problems within the construction industry are the introduction of:

- A reverse charge system, which moves the liability of VAT to the principal instead of the subcontractor;
- A tax withholding system, combined with a legal obligation for registration for domestic and/or foreign subcontractors.

Since the fiscal behaviour of subcontractors - especially in an international context - represents a clear and obvious risk for fraud or other fiscal misbehaviour, it is natural that the authorities of the European tax administrations continuously make efforts to develop, intensify and vary their administrative countermeasures. One of the most common means in this respect are the pre- and post registration audits operated by various tax administrations. These audits become more effective when combined with specific registration procedures for foreign subcontractors and/or a

tax withholding system or even, though more rarely applied, the joint and several liability of the main contractor.

Another important part of the report is dealing with the possibilities of international cooperation. The last part of this report is dedicated to the new VAT regulations for the EU Member States concerning the determination of the place of supply of services linked to construction work. Both parts are not based upon the feedback of the questionnaire, but are a reflection of the existing and future regulations in this field.

As previously mentioned the Task Team's goal it is not to find the best way of dealing with the range of problems caused by subcontractors. This report should be an aid to finding the right mix of measures.

3. FRAUD SCHEMES WITH SUBCONTRACTORS

3.1. Introduction

All responding tax administrations have identified problems with subcontractors in the construction industry. In many cases problems are similar but there are also some remarkable differences, often depending whether a reverse charge or withholding tax system is used or not. Some tax administrations have answered that there is no difference between cases detected during audits within the construction industry, involving subcontractors and typical fraud cases in other industries. The problems that have been identified are described below. Examples given by different tax administrations have in most cases been discovered during an audit. In the first part a description of typical fraud cases is given; followed by comment on the abuse against the reverse charge system and the withholding tax system.

3.2. Typical fraud with subcontractors in the construction industry

The main typical fraud with the subcontractors is very simple: short lived subcontractors who do not declare their taxes. Another typical fraud perpetrated by subcontractors is the overcharging of the building work. The subcontractor gives the surplus, in cash, to the manager of the main company, this cash being used either to pay illegal workers or the manager keeps it.

A major building project requires the employment of a large number of construction workers. The records of most companies are frequently inadequate for this situation -many employees are not shown nor are the amounts of their salaries or expenses. The companies have not correctly reported the number of employees and are paying them off-record in cash. Also, the company declares a higher input tax figure on its VAT returns, and is requiring a VAT refund. The general finding is that companies are issuing fictitious documents with invoiced services that have never been undertaken. Many submitted documents appeared to be fraudulent.

An example given by the Italian tax administration showed that during a check at a construction company, documents were found relating to the subcontracting companies but no employee of this company was present on the site. Subsequent investigations revealed that the owners of the subcontracting firms were in fact simple workers, employees of the contractor, who did not know they were meant to be owners of this company. The contractors themselves created false invoices and fictitious costs through this false company.

There are cases in practice where the subcontractor invoices to the contractor for the work carried out, and then the contractor omits to invoice the investor for a longer period of time.

The most frequent fraud is:

- Making out an invoice for non-performed services;

- Creation of an invoice by an entity not authorised to issue invoices or by a non-existent entity;
- Making a sale without issuing an invoices (the sale would not show on the tax return) or making out an invoice for services with amounts that do not correspond to the actual costs;
- Showing a large income without employing any workers or having any equipment;
- Making input tax deductions for the renovation and modernization of a dwelling or residential building on the basis of "handled" VAT invoices in collusion with builders' merchants.

The main problems:

- In a subcontracting chain one company is refunding VAT but the other has not paid this VAT;
- Use of false/fictitious invoices;
- Payment of "black" wages.

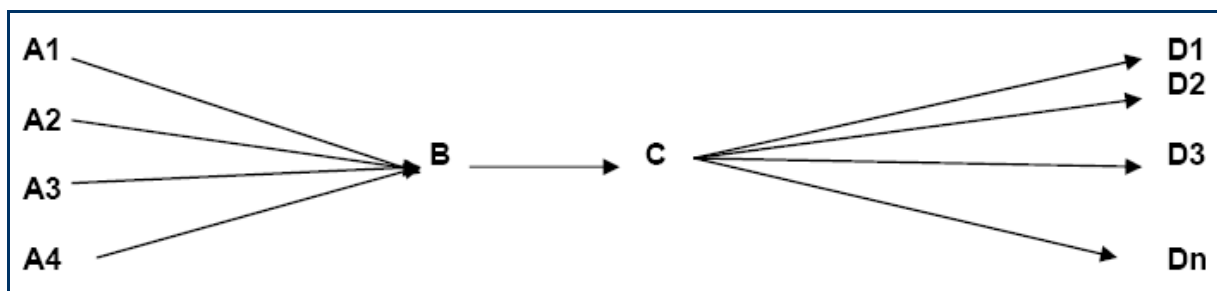
These schemes are very difficult to detect without co-operation from the police. In almost every case their co-operation is needed.

The audit actions typically consist in: meeting with the police, raiding the construction site or/and the premises of the company or/and to homes of the people involved, audit of the bookkeeping, police interrogations, and bank enquiries.

3.3. Examples of fraud cases

3.3.1. Case 1

False invoices and illicit workers.



A1 - taxpayer - individual, does not cooperate or communicate with the local tax office, did not complete tax returns for VAT.

A2 - taxpayer - individual, filed their tax returns for VAT, does not communicate with the local tax office, without phone contact.

A3 - taxpayer - individual, filed their tax returns for VAT, communicates with the local tax office, but does not submit invoices, documents, taxpayer only declares that the work was undertaken by illicit workers.

A4 - taxpayer - individual, submits invoices to the local tax office, but does not fill in the tax returns for VAT, he/she declares that the work was carried out by illicit workers.

B - taxpayer - individual, completed their tax returns for VAT - deducted VAT for general site excavation - invoices from A1, A2, A3, A4; prepared the invoice without carrying out the work (general site excavation) for C (the amount of the output tax is more than the deducted input tax).

C - taxpayer, filled out the tax returns for VAT - deducted tax - invoices from B, prepared invoices for big building companies (D1, D2, D3, Dn) - the amount of tax on the invoices is huge.

A1, A2, A3, A4, B - fictitious works.

C - real works, but also use of illicit workers.

3.3.2. Case 2

In order to avoid paying tax, a general contractor will set up a chain of subcontractors that would invoice the completion of given construction services, which, in fact, had never been supplied.

An investor of the construction site will usually contract for the completion thereof a company that would be the main contractor for all construction works and activities. This company is responsible for all contracted works on the construction at the site; using its own resources or by reassigning any particular activities to third parties. Where the general (main) contractor provided construction services using its own workers a problem would arise for it: coping with the significant expenses for paying the labour force of hired construction workers, plus social security contributions that should be paid to the State for tax and social security contributions due on their income.

Expenditure on labour hired by the company forms a large proportion of the construction costs. However, the company will not be eligible to reclaim VAT on these payments in the same way as it can on building materials that are purchased or machinery is rented, etc. Furthermore, when a service to a commissioning entity is to be invoiced, the general contractor will normally face a significant VAT liability payable to the State budget. In order to avoid paying the tax, the main contractor will normally set up a chain of subcontractors that would invoice the completion of given construction services, that, in fact, had never been provided.

An example of this is: the general contractor hired (without employment contracts) a construction team laying outer heat insulation on a building during construction. Workers are usually paid significant sums of money in return for the work; however, not having agreed employment contracts, no social security contributions or taxes on their income were paid. At the same time, a fictitious contract was entered into with another subcontract company, assigning it to perform the same

heat insulation of the building. In order to make things difficult for tax authorities' subsequent monitoring it is quite often that such a subcontractor would then assign the work to a second subcontractor, etc. The end of such a chain is formed by a company, which will either accrue tax and never pay it (such a company may not be found at the declared address or its owner is a person having low social status, etc.) or clear the accrued tax by claiming input tax against the supply of other fictitious services (advertising, marketing, sale of vouchers with prepaid minutes for mobile phones, etc.) supplied by third parties. And, finally, the general contractor will, quite against the law, gain a benefit from both the non-payment of taxes and social security contributions to the State budget for workers hired without employment contracts and by unlawfully claiming a VAT credit based on fictitious invoices issued by subcontractors, who never made any supplies to the general contractor.

3.3.3. Case 3

Examples of different ways that a subcontractor reduces the tax base.

Subcontractors tend to reduce the tax base in following manners:

- They accept fictitious purchase invoices (for non actual cost);
- They avoid invoicing for work performed (outgoing invoices);
- They invoice for a smaller quantity of work than was actually performed;
- They do not record (post) a proportion of work performed to their business books;
- When work is performed by subcontractors, the payment is made in cash with no record in the business books;
- They carry out additional work to that shown in the contract and invoice additional work that they never performed;
- They show additional costs associated with fictitious complaints about work they performed;
- They do not conform to construction standards; using less quantities than standard;
- Materials and goods of a quality lower than standard (planned) are used;
- Work is performed by unregistered workers ("black labour market") with no payment of stipulated taxes or contributions.

3.3.4. Case 4

Uses of false invoices and the companies that issue these invoices.

A company that makes use of illicit workers (the company appears to be a subcontractor) can have these distinguishing features:

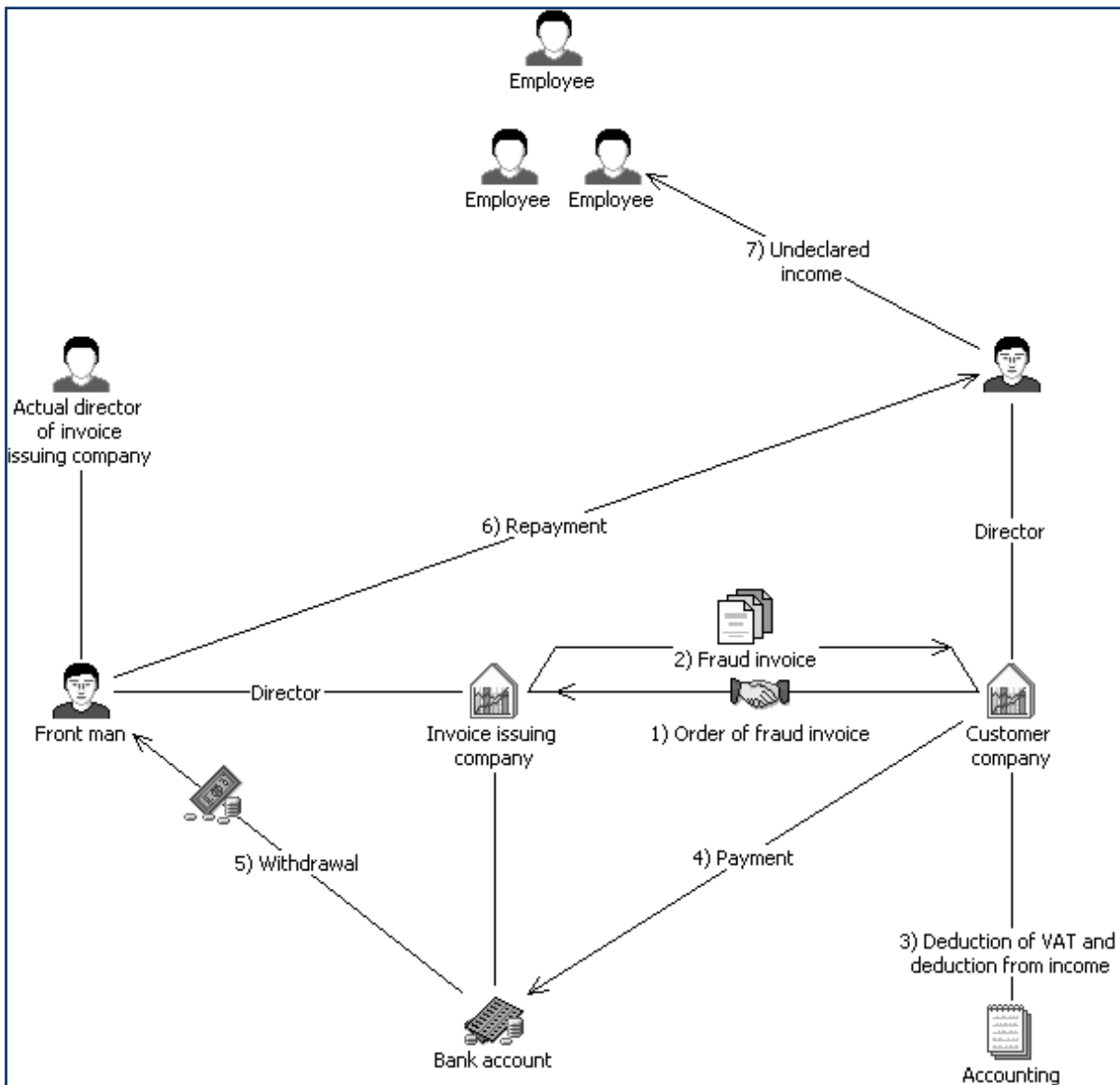
- The members of the board are not the real representatives of the company; their commission consists in the signing of documents; they are only the representatives on paper, though not in reality;
- They often have a very low income or no income at all;
- The members of the board change frequently and the persons who holds this position only has it a short time;

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- The company has a short lifetime and often goes bankrupt;
- The company does not show any VAT due, or if it does the amount due is very low;
- The company does not show any wages paid, or if it does, the amount of wages is very low and less than a normal company would pay;
- Invoices received are often paid in cash or direct to a bank account, short time for due delay.

The only/main genuine activity of the company is the production of invoices. The picture below describes the approach.



All this is often set up by the person behind everything who in reality remains the owner of the customer company. The customer company partly uses illicit workers and in order to be able to deduct the cost for these workers, the company will purchase false invoices. The company that produces the invoices very often is going bankrupt. It does not have any bookkeeping records and very often it is not possible

to get in contact with any responsible person for the company. The telephone is not answered and the address is very often a post office box.

The customer company uses one or several subcontractors in this kind of scheme. Often the invoices are false and it is quite common that the company that produces the invoices has not even done the work.

The *modus operandi* is as follows: the company orders the false invoice from the subcontractor; this invoice is received and paid on the subcontractors' bank account. Sometimes this happens in cash but usually, a bank account is used. The same day or next day the subcontractor withdraws nearly all the money from the bank in cash. He refunds the money back to the customer company or to the director of this company who then uses the money to pay the illicit workers or withhold the money to enrich themselves. To detect the company that uses false invoices, the investigator should follow the money.

3.3.5. Case 5

Use of subcontractors

A contractor makes contact with a subcontractor asking for labour. The subcontractor has sub-subcontractors that can do the work. The sub-subcontractors are fraudsters, and make no VAT or other returns.

The sub-subcontractor's employees are often illegal workers, i.e. underpaid workers from new eastern EU countries, seekers of asylum or receivers of unemployment benefits. All the payments to the workers are made in cash, and are therefore hard to track.

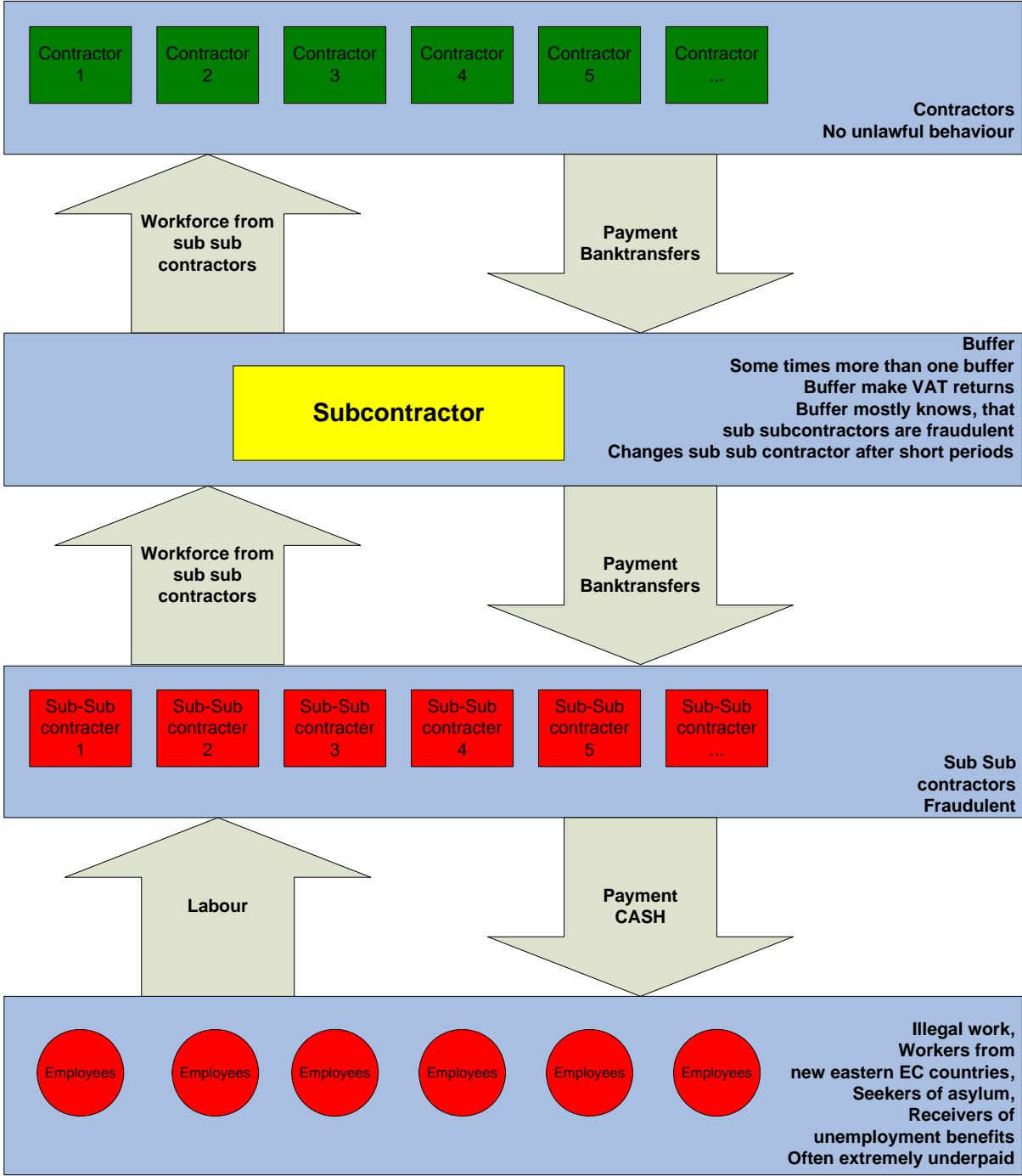
The subcontractor is often aware of the fraudulent behaviour by the sub-subcontractors he/she employs.

The audit usually begins with the subcontractor, where its sub-subcontractors are to be examined. By comparing the VAT written out to the subcontractor and the VAT returns, indications can be found whether the sub-subcontractor is a fraudster.

When the audit reveals sub-subcontractors being fraudsters, the tax administration gets into contact with the sub-subcontractor. In many cases it indicates that the manager of the sub-subcontractor is able to control a company.

If it is proved that the sub-subcontractor is related to the subcontractors company, and the head of the sub-subcontractor is a straw man, the VAT adjustment is sent to the subcontractor. Then joint and several liabilities between the subcontractor and sub-subcontractor should apply.

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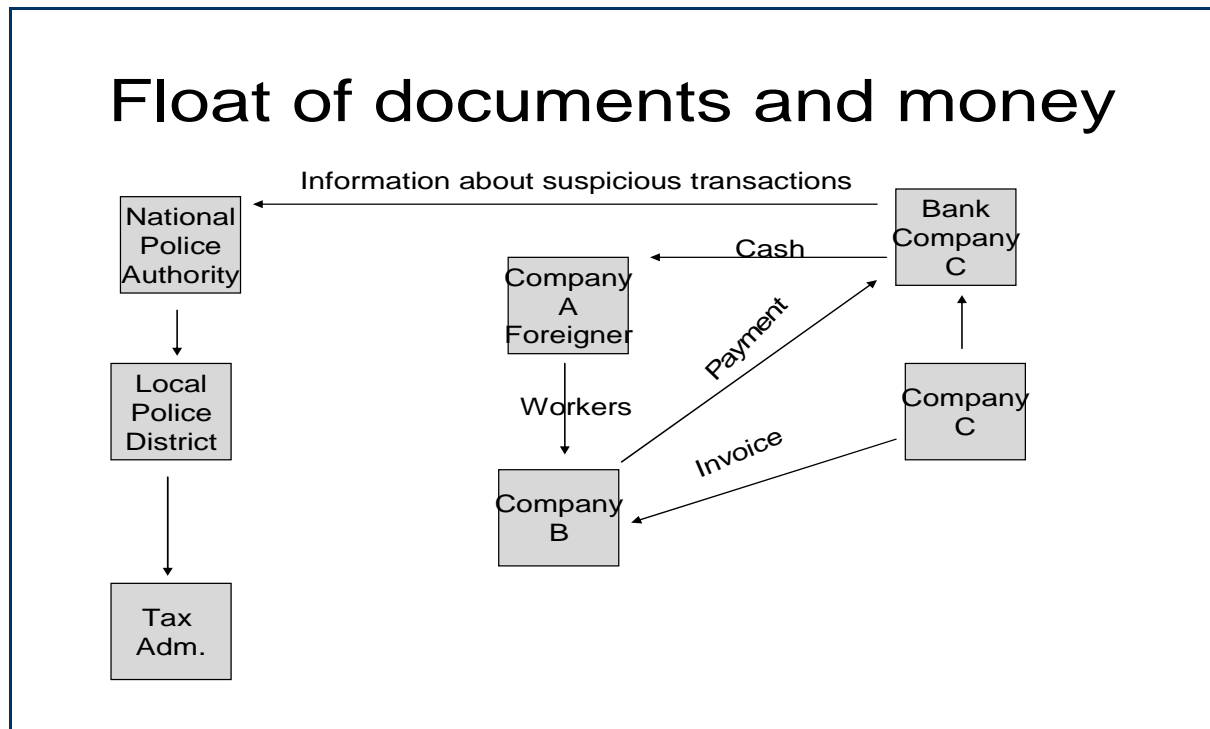


3.3.6. Case 6

Use of both "black" and "white" labour

Company A is a sub-subcontractor. It negotiates contracts together with company C, with company B. Company A uses both registered and unregistered ("black") labour. Company A pays tax and payroll withholding tax for its "white" activity and looks therefore "reliable". Company C sends invoices to company B (25% VAT incl.) for the work carried out by company A. Company B pays the invoice to company C's bank account. Company C withdraws immediately the different payments made to

its bank account and pays cash to company A minus 10% which is C's profit. Company A finally pays its "white" and "black" labour with this money.

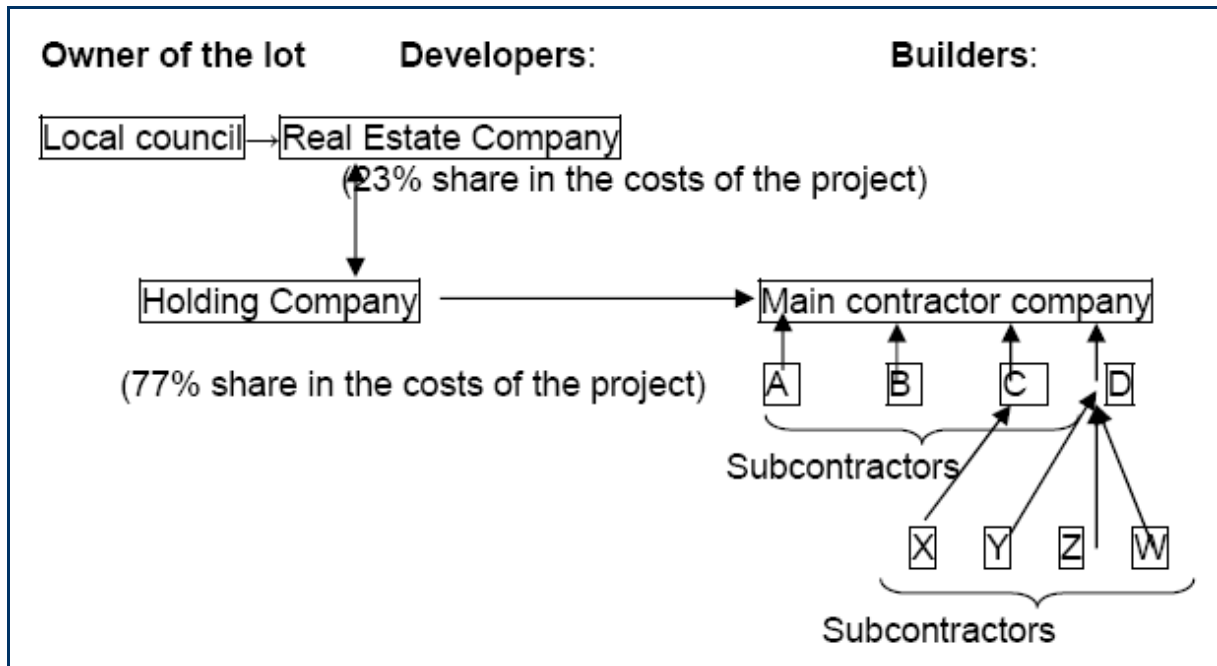


3.3.7. Case 7

Use of subcontractor's invoices where no work has been performed, by companies trying to legitimise the cost of work carried out illegally, plus the wages of non-registered employees and the cost of illicit material purchases.

A real estate company and a holding company jointly participate in a project, the capital was funded partly by their own resources, partly by investment loans. The lot was given by the local government. Authorization procedures, planning and administrative actions were arranged by the holding company. A main contractor company was appointed by the holding company to undertake the construction work.

During the audit the ownership relations between the developers and the main contractor were examined and it was found that this relationship did not meet the definition of associated enterprises as defined by the law (because the share of the main contractor company in the holding company did not exceed 50% in the relevant period).



At the beginning of the audit the inspection found that the main contractor company, who undertook the whole construction work, did the job not only with its own staff and assets but also by using several subcontractors. Invoices issued by the subcontractors could be found in the books of the main contractor.

The enquiry identified the major subcontractors based on their invoices found in the main contractor's records. These subcontractors were audited by using data and information from the tax administration's database. The initial finding was that one of the subcontractors did not fulfil their obligation of filing tax returns in the relevant period, and another one was inspected before and this previous tax audit had revealed undeclared tax.

In order to investigate any unlawful actions of the main contractor, no errors, discrepancies or circumstances that would suggest that the tax authority had any suspicion of fraud was declared during the initial audit. The construction was carried out by the main contractor using its own resources and by using subcontractors. The developers verified regularly the partial work done according to the schedule, and the invoices issued on the basis of these actions were paid. The bank financed the building by loans, checking the progress of the project by the use of its own independent technological expert. Finding undeclared tax was not expected at the main contractor.

Subcontractor A did not meet the obligation of filing tax returns.

Subcontractor C issued invoices to the main contractor. Subcontractor C appointed subcontractor X to carry out the work that was undertaken by subcontractor C originally, because its average number of employees was only three in the audited period. According to the documents of subcontractor C the work performed by subcontractor X was billed by subcontractor C to the main contractor.

On the starting day of the subcontractor X's audit, the enterprise's representative stated that the car he was to use to go to the tax administration building had been stolen along with the fiscal documents. He proved his statement with police documents. At this point the investigation procedure stopped as it was impossible for the tax administration to gather more information on other subcontractors based on non traceable cash payments.

Subcontractor D did not have any employees at all, so he used other subcontractors (subcontractor Y, subcontractor Z and subcontractor W) to execute the works, and deducted VAT based on the invoices received from them. The tax authority started investigations with subcontractor Y, subcontractor Z and subcontractor W. It was not possible for the investigators to make further enquiries because the subcontractors were not available, they were not operating from their registered premises, their names were false and just used to issue invoices, or they had no tax-related documents. Subcontractor D was found to not have any certified documents for allowable VAT deductions.

The developer and the main contractor operated legally, but the subcontractors and further subcontractors in the subcontractor-chain worked unlawfully. It is a common situation that the documents either disappear or are stolen or destroyed which stops any investigation and makes the clarification of the whole transaction more difficult or impossible. It may be that there was no subcontractor's chain in reality, but taxpayers fake VAT invoices in their tax records in order to avoid the burden of a large tax bill (taxpayers try to reduce their tax liability to a minimum). It is also typical of these companies that they have no assets and any penalties charged will never be paid to the budget.

Using subcontractor's invoices when no work was carried out by them is a way these companies try to legalize the cost of black work, the wages of non-registered employees and the cost of undeclared material purchases.

It is not possible for the tax administration to state that no work was carried out, because the building stands, but it cannot be proved who and with how many workers did the work.

3.3.8. Case 8

Frauds concerning the reverse charge system - for further information see Chapter 6.2

Example of cases

Case 8.1

Delivery of goods or services - Is reverse charge applicable?

A subcontractor raised an invoice with VAT on to his client, C, the main contractor and builder.

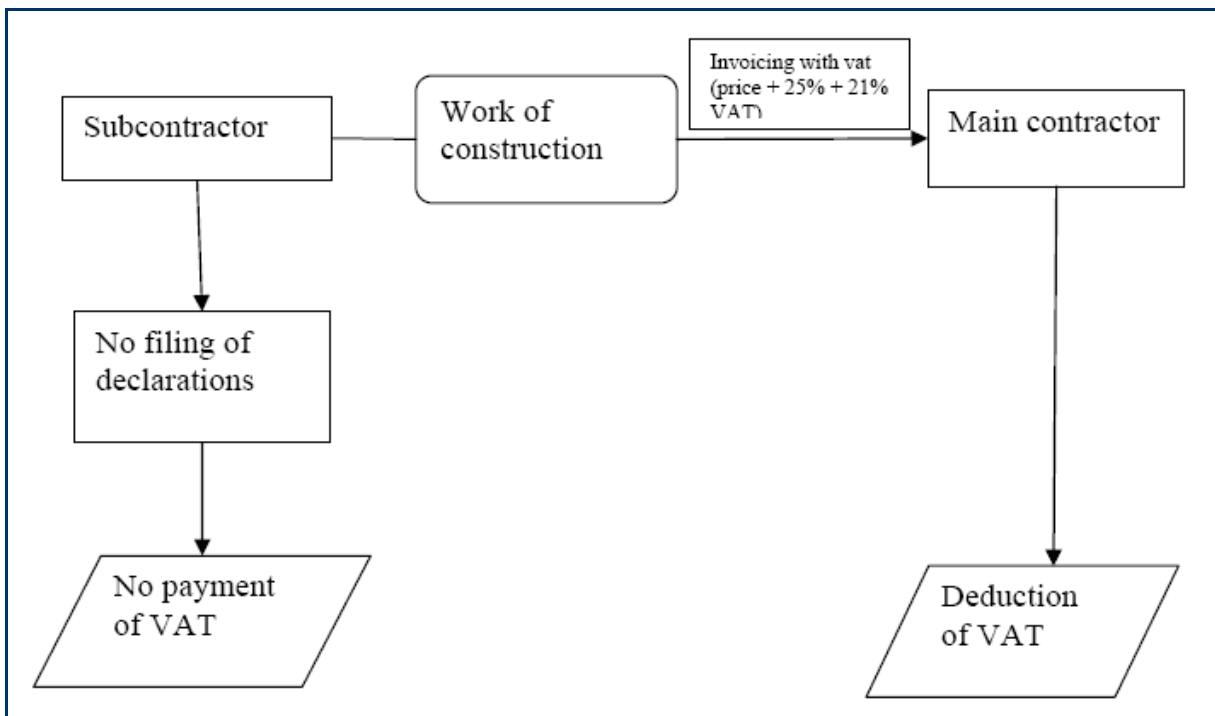
The client, C, deducted the VAT, while the subcontractor, did not file any declaration, so no output VAT was collected.

The description on the invoice referred only to a delivery of goods, which would mean that a reverse charge was not applicable.

However, the tax agents noticed during an onsite visit, that the subcontractor was installing the materials in a way that had to be considered as construction work. Consequently, a reverse charge would be applicable.

During the investigation, the tax agents managed to get a confession from the subcontractor, who stated that the fraud was committed in association with the main contractor. The amount of the invoice was increased by 25%.

The profit made because of the VAT fraud, was split between the subcontractor and the main contractor.



Because the subcontractor prepared invoices with VAT on despite carrying out construction work, and did not file declarations, the fraud scheme was obvious.

Case 8.2

The supplier issues invoices with VAT to the client but keeps an invoice without VAT in his own records.

A subcontractor issues an invoice with VAT on to his client: turnover - EUR 100, VAT - EUR 20. He/she sends this invoice to his/her client.

In his/her own set of business records he/she keeps a second and different invoice: turnover - EUR 120, VAT - diverted. The client pays the total of EUR 120 and that amount is booked in his/her ledger. On his/her VAT return he/she files a turnover of EUR 120 with the VAT diverted, paying no VAT. The client deducts EUR 20 VAT on his/her tax return.

With this fraud scheme the tax administration will raise the profit of this taxpayer. He/she gains an extra EUR 20 as a profit. He/she will pay corporate income tax on this extra profit, but in the end he/she will benefit.

3.3.9. Case 9

Frauds concerning the withholding tax system - for further information see Chapter 6.3

Typical fraud cases involve the subcontractors' abuse of the withholding tax deduction scheme for payments made to subcontractors in the construction industry. Under this scheme the contractor must deduct 35% on gross payments made to subcontractors when certain legally defined operations have taken place. The contractor then pays the deducted amounts on a monthly basis. The subcontractor can claim a refund of the 35% tax withheld from revenue. A system is also in place to allow for exemptions to this 35% deduction.

The fraud typically involves a request from the contractor for a "relevant payments card" for a subcontractor. This card allows the contractor to pay the subcontractor in full i.e. without the need to deduct the tax.

1. Applications for the relevant payments cards were made by the contractor without the knowledge of the subcontractor. Bogus invoices were used to support the alleged payments made to the subcontractors. Payments were made either by cash, by a cheque made out to cash or went into a bank account unrelated to the subcontractor.
2. The contractor engaged the subcontractor and a relevant payments card was obtained. *Bona fide* payments were made to the subcontractor and the records included valid invoices from the subcontractor. Further payments, which were purported to be to the subcontractor, were also made and bogus invoices put into the company records to support these payments. These payments were usually by cash or by cheques made out to cash.

The scheme was detected by cross checking the subcontractor invoices in the records with the subcontractor's VAT returns.

4. DETECTION BY SITE VISITS

4.1. Introduction

In this Chapter the subject is the observation and selection of construction sites to be put under surveillance by the tax administration. At this stage of the investigation the advance planning of the audit work is important. Good results in terms of recovery of tax revenue will depend very much on this stage.

Among the IOTA Member tax administrations one can notice a balance between pre-selection of construction sites and random selection for observation/supervision of the subjects to be checked. Some tax administrations have special teams to perform periodical inspections.

An interesting way of proceeding seems to be the selection on the basis of invitations to tender for the building of a new large construction project. Another way is to focus on the final stage of the construction project, because it is more likely in terms of increased risks for illicit work.

Some administrations make their selections of controls with risk analysis instruments.

Some administrations use custom services in order to operate controls against illegal work.

4.2. Site visits

When a visit to the construction worksite is made, the first important step is to identify workers.

Information is requested directly from the individual worker and in some cases, the employee may be asked to fill in a questionnaire. Some tax administrations (the Netherlands) have prepared questionnaires in a number of languages to help workers of other nationalities. Questionnaires include a number of questions such as: citizenship, residence permit, work permit, date of hiring, salary, date of payment of wages, hours of work.

Typically, this type of control allows for the discovery of illegal workers and also of non-compliant subcontractors. Another important purpose of site visits is to monitor the enforcement of legislation on social security as well as the payment of social contributions.

Checks for professional qualifications are not done by the tax administration. This is in some countries a task of the inspectorate general of labour; otherwise this information must be provided by the principal contractor.

4.3. Selection of site visits

There are standard procedures by tax administrations regarding the selection of site visits using risk analysis. This wide mix of factors of intelligence and risk analysis can be summarized as follows:

- Examination of the profit and loss statements, tax returns and budgets;
- Irregularities in tax returns;
- The taxpayer's behaviour in the past;
- Taxpayers who require large VAT refunds.

The figures used are a series of financial and economic indices (liquidity, profitability, efficiency, and solvency) that are processed as if it was an internal audit, but aimed at extracting lists of likely tax evaders.

Examples of "risk criteria" are:

- Big construction sites compared with a small number of people employed to perform the work;
- The comparison between the cost structure and profitability.

This information is usually "official information" in possession of the tax administration. Some administrations also have additional information that can be obtained from the Internet or from newspapers or information received from individuals. In some countries the "research and analysis" office, using special software to analyse the information on the Internet, cleans this information from the "noise" (not useful information) and makes it available to the verifier. This improves the quality of investigation.

In some countries (e.g. the Netherlands) the large size companies are selected by offices, created for this type of control.

It may happen that for high value construction projects, the general contractor should inform its own tax administration.

Another element that could initiate an audit is the presence of foreign companies and foreign workers.

In many tax administrations joint planning is carried out with other authorities.

More specific for construction industry are the targeted controls for detecting the chains of subcontractors. Some authorities are using special software to perform their selections.

4.4. Results and experiences

The results of visits to construction sites are used as a starting point for subsequent control of subcontractors. If there is any evidence of evasion of social security contributions, this information is sent to the relevant organisations responsible for more intensive controls.

An advantage provided by these controls is the accumulation of data and information that gives a better understanding of the construction industry. In this way the tax administration can better understand the mechanisms of fraud.

Some tax administrations already have groups of experts in the field of construction; others are considering setting up specific groups to that end. Some administrations' experiences revealed that the involvement of experts from different areas of the construction sector, even if it took more time and appeared to cost more, ultimately brought better results.

If irregularities are found during the inspections, the companies that are involved are penalized in various ways, usually with fines, with the suspension of their tax number, or even the temporary suspension of the yard.

These penalties have a major deterrent effect upon taxpayers.

One particular tax administration (the Netherlands) suggested the following way of proceeding during site visits:

“With the experience of auditing a project instead of a taxpayer, we formed a project team to monitor the biggest building projects. The advantages are that we work in the present and that we can actually see what is happening. We can detect risks at once and act on those risks. We work in close co-operation with the main contractor to cover up those risks. The on the spot observation could be the start or the final piece of the supervision. It is also used to make agreements with the main contractor on supervision and registration of employees on the building site. In case a main contractor does not want to co-operate with us, we use the on the spot observation to enforce co-operation. If necessary, we will use this tool every week, until they co-operate. It is used in that case as a repressive audit tool. We do not see any disadvantages at this moment.”

4.5. Collaboration with other administrations

All tax administrations reviewed have indicated a close collaboration between different government agencies, police, labour inspectorates, immigration offices, ministries of interior, ministries of labour, tax police, customs, etc. This collaboration is reflected in the establishment of joint groups for verification in which each member controls the documentation of their specialism. Cooperation is not limited to site visit observations but also to the exchange of information. In some cases, interpreters are used during the visits to get better information from foreign workers.

5. SUBCONTRACTOR DETECTION METHODS

5.1. Introduction

One of the main ways to detect fraudulent activities of a subcontractor, is (besides the site observations or visits) the practice of analysing data (digital and on paper) in the possession of the tax administration.

There exists a wide variety of sources and types of information and in the way the information is stored and used by the tax analysts. Thus, this part of the inquiry is closely related to the problem of risk analysis.

When attempting to establish the tax liability of a taxpayer who is operating in the construction industry, the tax administration, as well as the individual auditor, will be required to make the best use of all sources of information available. These sources of information will either prompt the commencement of an audit or will assist the auditor in computing the tax liability. Information can be received from several sources, internal and external, some of which are listed below.

Part two of this Chapter details an inquiry into the existing and planned initiatives for the use and exploitation of tools/software and other programs on the data from these sources. This could be helpful and lead to new ideas and initiatives for many tax administrations.

Finally, this Chapter deals with the use of specific guidelines, indicators, etc. in order to audit non-compliant taxpayers and especially principals and subcontractors in the construction industry. The aim is the detection or recognition of false and fictitious invoices or the use of particular fraudulent schemes (domestic and international) during the audit.

5.2. Internal and external sources of information

Classified into internal and external sources of information, relevant and useful information remains as follows:

- Data acquired from the tax police;
- Data from state authorities are used;
- VAT data;
- Data extracted from the VIES system;
- Data obtained from the international exchange of information;
- Data from income tax and corporate tax returns;
- Data from suppliers and clients/customers.

The different types of data have been grouped and summarised according to their sources along with a comprehensive explanation as to their value.

5.2.1. Types of internal sources

From different tax regimes

All taxes tend to interact to a greater or lesser extent. The tax officer auditing a company for VAT purpose should realise the impact of employment taxes on the turnover for VAT purposes and of the effect of VAT on the published profits for income tax payments. The cost of other tax payments is usually a deductible expense when calculating the income tax liability of the business. However, when deducting the tax payment this deduction must equal the actual payment of the tax, e.g. the deduction for one tax regime must equal the payment for the other. A typical example of the mismatch between tax declarations is where the turnover declared for income tax purposes does not equal the turnover declared for VAT purposes.

In the field of VAT we can specify the following list of indicators that can be useful in the detection process of non-compliant taxpayers (principals and subcontractors in the construction industry):

- Amount of credit notes on outgoing transactions in comparison to all the positive outgoing transactions;
- Amount of received credit notes in comparison to the total turnover;
- Amount of investments;
- Difference between paid VAT and deducted VAT;
- Difference between VAT on purchases according to the customers accounts of the taxpayer and the amount of net VAT on the sales according to declaration (some countries having liabilities that impose declaration of these data by the taxpayers);
- Difference between national acquisitions and the amount reported by the suppliers (some countries having liabilities that impose declaration of these data by the taxpayers);
- Proportion of the purchases of commercial goods and services versus the total turnover (gross benefit margin);
- Difference between the net Intra-Community acquisition of goods on the declaration and in the VIES system;
- VAT due against the lowest rate in comparison to the total turnover;
- VAT due against the normal rate in comparison to the total turnover;
- Difference between the base of the list of customers and the total turnover;
- Proportional turnover in the last trimester or month in comparison to the total turnover;
- VAT on the list of customers in comparison to the difference between the base on the list of customers and transactions where VAT due by the other person of the contract (checks on domestic reverse charge application (some countries having liabilities that impose declaration of these data by the taxpayers));
- VAT due against the normal rate and VAT due by the other person of the contract in comparison to the acquisitions with reverse charge mechanism.

Specific references from other tax offices

Other tax offices may send routine transaction verification requests based on the premise that one person's sale is another person's purchase. In addition an audit carried out on a business in one tax district will often generate a suspicion about the customers or suppliers of that business which in turn will generate a specific reference.

Ratio analysis

Virtually all businesses operate in a sector that has certain characteristics. These characteristics usually form the basis for commercial or governmental analysis of key ratios and trends. Examination of the key sector trends and comparison to the business under review may reveal unexpected variances that will call for further enquiry and explanation.

The auditor should carry out specific ratio analysis of the business under audit to search for anomalies both when carrying out the pre-visit inspection and during the authorised audit programme. The industries liable to payment of VAT on their sales are classified into groups of industries under the Standard Industrial Classification Code. Each classification has certain characteristics in the business operations, from which a picture of the average business can be built up.

Direct observation

Direct observation of the business premises can reveal unexplained economic activity that may lead to fruitful areas of inquiry. For instance, observed deliveries from manufacturing premises may be matched to dispatch notes and invoices (establishing the completeness of records that are used to compile financial statements).

Another aspect of direct observation is to evaluate the lifestyle of the directors/owners of the company under audit. A reconciliation of the cost of the observed lifestyle with the declared profits may reveal understatement, especially in owner-managed companies.

Annual accounts and management accounts

A business limited in liability must publish annual accounts which must be lodged with the authorities. Matter of public record, the annual accounts are prepared by the management and audited by a reputable firm of accountants they can be an invaluable source of information for items such as sales, purchases, additions and disposals of assets, and expenditure items.

Most management, when not directly involved in the running of a business on a day-to-day basis (small businesses for example) will require reports of the activities of the various parts of a business. These reports can be extremely revealing, especially if prepared in isolation from the system that prepares official accounts and tax returns.

Example from Hungary on the use of internal sources of information is presented below:

- In case of a “fictitious company” the tax authority launches the procedure for tax number suspension; finally the tax number is deleted from registration. The relevant data is published on the tax office website and is available for everybody to see.
- The tax authority publishes quarterly the list of those, whose outstanding tax liability exceeds, for instance, EUR 400,000 in case of companies, and EUR 40,000 in case of individuals. This is a useful piece of information for other taxpayers who may enter into a business contact with these tax debtors.

It is obvious that not every tax administration will have the legal possibility to implement the measures as described above. This example from Hungary only aims at showing how internal sources can be used as a deterrent.

5.2.2. Types of external sources

Informers' letters

It is not unusual for the tax authority to use information received from informers but this information should be treated carefully. As a general rule, specific attributable information should be treated as reliable and action should be taken to verify the information given. Un-attributable or vague information should be treated as unreliable and the reference left on the taxpayer's file to be dealt with at the next routine audit.

Supplier and customer businesses

Direct enquiries of suppliers and customers may reveal differences in declared and actual transactions.

Gathering information about subcontractors during interviews with main contractors is a source that may help to analyse the supplier chain for construction work. The contracts between the main contractor and the subcontractor have to be checked and also the list of people working that day on the site. Based on those lists, the inspectors can check ID documents.

The purpose of checking is to know the person as a taxpayer. Based on the outcome of those checks tax administrations can select companies for audit purpose.

Media and Internet

Sales, acquisitions and other important information are reported in areas such as the financial and fiscal press, trade and tax magazines, statistical bulletins, websites on Internet, search engines, etc. This can be a valuable source of information when building up the background of the company. Tax administrations use specific software for the collection a variety of economic and non-economic data which is available on the Internet.

Non tax-related records

Other records, unconnected or only loosely connected with financial statements can be used to obtain ratios that can then be used to check the accuracy and completeness of tax declarations, which are originally based on the financial records of the company.

The auditor should use his/her judgement to select interrelated areas of the business then:

- Calculate the effect of one ratio against the other;
- Compute an expectancy based on the calculation;
- Assess the expectancy against the actual reported figures;
- Make enquiries to establish the reasons for any variance;
- Adjust the expectancy utilising the reasons given; and
- Continue to establish the reasons for any variances from the adjusted expectancy.

Exchange of information with third parties as a useful external source of information

Exchange of information with third parties, institutions or organizations is of vital importance to the accuracy of establishing tax obligations. In this context, it is of primary importance to use information from domestic and foreign institutions, associations, organisations, similar organisations from other countries, third parties, etc., which, under the terms of signed agreements, among others, also have obligations to exchange information.

Exchange of Information is taking place with:

- Customs authorities;
- Treasury branches
- Territory plan administration;
- Real estate registration offices;
- Constructors association;
- Authorities that administers vehicles register;
- Authorities that administers population register;
- Authorities in charge of the social and work inspection.

Other external sources are:

- Commercial banks that are required to report suspicious bank transactions to the police; tax inspectors also receive reports from the police based on the information from banks;
- Different records & information from other authorities (state/communal) which are involved with labour, crime, and construction, eg.; unemployment records, etc.;
- Confidential calls;
- Information provided by the general public.

5.2.3. Example of using both internal and external sources for tax purposes

The National Revenue Agency (NRA - Bulgaria) makes the selection of taxable persons manually, i.e. the so-called active selection is used. In the process of selecting those persons who provide construction services, the following sources of information are used:

1. NRA's databases:

- Annual tax returns and financial statements;
- Monthly returns under the VAT Act and sales and purchases ledgers;
- Returns under the social security legislation (i.e. registered employment contracts of personnel, security income returns submitted by personnel, and due social security contributions);
- Statements containing results from completed audits;
- Results from inspections carried out at construction sites (identified violations);
- List of businesses with a record of fraud (where participation in fraud schemes was identified);

2. External sources of information:

- Register of persons undertaking construction activities (supported and maintained by the trade organisation, i.e. the Construction Chamber);
- Authorisations issued by local municipal administrations to carry out construction work;
- Register of persons carrying out construction supervision (maintained by the Directorate for National Construction Supervision);
- Estate transfer transactions: from the registers of the Registry Agency at the Ministry of Justice;
- Advertisements of estate sales: from websites of sale and brokerage estate agencies.

5.3. Organisation of the data processing

All involved administrations use internal data gathered from their processing systems to identify potential fraudulent subcontractors. Their risk analysis system gathers information from all tax returns together with data from external sources. At this point none of the processes are specific to the construction industry. In some tax administrations managing the construction industries activities is based on creating and maintaining a database of suspected risky principal contractors and their subcontractors.

Some tax administrations created a platform where issues and trends can be identified. They also use local information from various sources as previously mentioned.

Datamining as a risk analysis tool is used to select companies to be audited: the criteria used for the purpose of assessing the risk in the construction sector mainly comes from data on the VAT returns. The objective is to detect fraudulent taxpayers, including subcontractors active in the construction industry. Tax administrations may use internal databases or third party databases to source information. This information/data is compared and processed using models based on the risk analyses.

Some tax administrations also apply a special reporting tool in order to allow local tax offices to select visits using their own initiative. Pre-selection consists of the

use of all available data from VAT files, corporate tax and/or income tax returns (IT selection).

The IT tools used by some tax administrations are sometimes available on the open market in the field of risk analysis, such as “SPSS Clementine” (Belgium), “Answer Tree” (Sweden), “SAS Miner” (Norway), etc.

Other types of software are internal developments made by the IT services of certain tax administrations, such as “ESKORT” (Finland), “MOKSI” (Finland).

The automatic or semi-automatic selection of taxpayers that operates in the construction industry is made at a centralised or regional level.

5.3.1. Examples of the use of databases

One specific responding country (Germany) uses a database called “ZAUBER”; this is an internal database of this tax administration with information collected in the field of VAT by the tax administration itself.

The same country disposed of another database called “ISI”, which was internal database containing information about foreign letter box companies.

Another tax administration (FYR of Macedonia) uses information from a system called “DANIS”. The system contains the data from the tax returns and financial reports; also a quarterly financial comparative analysis, third party information, information from other inspectorates, information from the open and free telephone lines for reporting irregularities, from the media, information from unsatisfied employees or competing companies, etc.

Most of the responding countries have their registration systems, which contain information of income, paid VAT, employers, paid wages, and much more. If tax inspectors are auditing companies they may have access to these systems via special programs, gaining access through the accounting systems, cross holding information’s, etc.

Some tax administrations of EU Member States acquire information by using an information exchange platform, named EUROCANET (European Carousel Network) or by using the regular exchange system between all EU Member States, named VIES (VAT Information Exchange System).

There exists in Latvia a “Fictive Enterprise Register”, in which information is provided by several other governmental authorities.

The Polish tax administration uses data from the analysis of documents, used in accounting, enforcement and other areas. This data is stored in their system POLTAX. Some documents are also recorded in a subsystem that is called CONTROL.

The above sources of information, IT tools and techniques are not always organised specifically to detect fraud in the construction industry.

Other IT tools/programs include:

- Taxpayers file (historic data);
- Computerised audit software & tools such as IDEA, ACL, SESAM, Safir, PUMA, Kontur and Analysis Notebook;
- Software developed by tax administrations, such as CLAIRE (the Netherlands), ALTO (France), etc.;
- Information from tax administrations databases (“everything” related to taxation);
- Other IT tools (for example “Portti”, used in Finland identifies the client with company ID number or social security number and connects information from third parties with the information in the tax administrations database; another Finnish IT tool iBase - shows the connections between persons and companies with other persons and companies and carries out risk analysis).

5.4. Tax administrations’ plans to introduce software applications implementing techniques for tax audit in the construction industry

Some tax administrations have developed specific audit methodologies (guidelines) for the construction sector, which contain recommendations for auditors how to carry out a standard audit. For example, a first control is operated on companies with tax conspicuousness. On this particular topic, the reader should refer to the IOTA Report for Tax Administrations carried out by the Task Team “Audit Methodologies” under the umbrella of the IOTA Area Group “Treatment of Specific Industries - Construction”.

Some tax administrations plan to introduce new projects to improve the selection process for tax audits using an automated tax information system - which they will enlarge in order to handle the additional information.

It is also planned to harmonise the data files of the different administrations responsible for fraud prevention (social and fiscal) in order to share the information more efficiently. Some tax administrations already provide their tax inspectors with much of the required information and consider there is no need for specific projects.

Some tax administrations are working on establishing projects for new methods, techniques and tools for audit. One example is, in cooperation with experts with advanced knowledge in the subject it is planned to organise training for inspectors in e-audit.

5.5. Use of specific instructions/guidelines and specific indicators/parameters for audit purposes

The Irish tax administration has a code of practice for auditors which applies to audits in general. This code has been amended to take into account the specific issues of the construction industry.

Guidelines for auditing specific cases are available as a part of an auditor training and also on the Intranet of the tax administrations.

Operational instructions are also issued to officers and these are available on the Intranet. Special profiles are established in the database.

Special teams for the construction area were implemented and they issue detailed guidelines for auditing large construction projects. They also generate a risk matrix with all the risks that have been detected so far and how to cover those risks. If wanted; they can provide tax inspectors with both documents. There are specific guidelines/instructions or indicators/parameters for the construction industry in the form of the description of audit methodologies and audit examples. This instruction is called for instance “Verification Manual” (Belgium) and contains detailed descriptions of different professions and craftsmanship related to the construction industry. This manual is maintained and available on the internal website. For some specific branches there are descriptions of target groups.

The following types of analysis are used when auditing large taxpayers:

- Comparing the actual cost structure and profitability index to the average (by activity, area, magnitude). These indicators are used during the audits as a useful piece of information for auditors.
- Analysing for transfer pricing (for instance “AMADEUS”) is used in some countries to prepare a comparison analysis (in relation to the general contractor (principal) and subcontractor).

Information on average profitability by profession and region are available for auditing private entrepreneurs. Those who are under the profitability average can be selected for audit.

The Albanian tax administration has created “Industrial Notes“ and an appropriate methodology for audits in the construction sector. The purpose of these industrial notes is to help tax auditors, assessment and collection, debt management inspectors as well as other interested users or groups to expand their knowledge about particular activities within the construction industry, or the construction sector in general. These notes are particularly useful for anyone carrying out tax audits.

In preparing for as well as during the course of a tax audit, inspectors use various instructions issued by the tax administration, expert opinions - answers to various inquiries received from taxpayers, papers from the construction industry area, statistics, information from the Internet and from attending seminars and lectures.

Given the significant risk of non-compliance with tax and social security legislation in many countries, a special project focusing on the collection of information on the most common risks within the construction industry was included in the project. The aim of this project running in Albania is to prepare a special paper (bulletin) that would describe all activities and processes within the sector, any specific relevant legislation (including tax, social security, accounts, etc.), sources of information, common risks and methods of counteracting them (i.e. legal treatment). This bulletin is intended to support auditors in the course of audits made to anyone involved in the construction industry. The project included specialised teams who collected and summarised feedback information on the

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presence of any risks described in the bulletin. Once an audit of a person from the construction industry has been concluded, a form was completed; reporting whether pre-identified risks were found in that particular audit and what the fiscal effect of the results were (additional liabilities identified as a result of the audit). Moreover, this form contained descriptions of new risks that were identified in the course of the audit. Risk evaluation teams for the sector then analysed the information and updated the list of risks.

The tax administration in Slovakia uses special software for calculations during a tax audit in the construction industry (based on the value of the materials and the services). This software is also used by taxpayers who cost building projects. If the relevant information is input, the programme calculates what this item consists of and gives an estimate of the price of building materials (for example, for the building of 1 m² of a wall, the programme shows the amount of costs and how many bricks and cement and building material is needed). If the tax auditor introduces all the relevant items, the software will calculate the corresponding consumption of material.

Some other tax administrations do not have specific instructions or guidelines for the construction industry. All audits are started on the basis of tip-offs, yearly planning or accidental facts. However, those administrations can gather material and good practice from other countries in order to produce a manual for audit methods and techniques

Benchmark figures for the construction industry are used mostly for plausibility checks or for the estimation of tax payable. Indicators used for that purpose are gross and profit margins. This is not specific for construction companies, but an attempt is made to produce guidelines in a more general way.

6. LEGISLATIVE COUNTERMEASURES

6.1. Introduction

This Chapter aims at describing the major legislative countermeasures in tackling non-compliant subcontractors.

In many cases implementing administrative countermeasures may be necessary when a specific legal measure is taken in order to tackle fraud schemes in the construction industry. Based on the survey, the three main possible legal countermeasures which are in use in certain countries to cope with fiscal problems within the construction industry are the implementation of:

- A reverse charge system, which moves the liability of VAT towards the principal instead of the subcontractor;
- A tax withholding system, combined with a legal obligation for registration for domestic and/or foreign subcontractors;
- Joint and several liabilities.

6.2. The reverse charge system

Definition:

Legal system for VAT purposes in which, within a B to B transaction, the customer is deemed to be the person liable for payment of the tax instead of the supplier of goods or services. Within EU national legislations can introduce reverse charge in construction industry based on the article 199 of Directive n° 2006/112/EC.

Based on the survey, countries² having actually implemented the reverse charge system are:

- Albania;
- Austria;
- Belgium;
- Germany;
- Hungary;
- Ireland;
- Italy;
- the Netherlands;
- Portugal;
- Sweden.

The reverse charge system can easily cope with problems in the field of indirect taxes (VAT), but does not have any effects in the field of direct taxes or social security contributions.

That is the main reason for the implementation of reverse charge: to tackle VAT fraud within the construction industry.

² This list may not be exhaustive since some countries have implemented reversed charge systems in other or wider domains than the reverse charge system typically applicable for construction industry.

The reverse charge system however contains its own risks since it denies the self-policing characteristics of VAT. The invoice - in its role as a tax point within the VAT-system - loses this significance once a reverse charge system is adopted. This means that neither the principal, nor the subcontractor have an incentive to respect their liabilities towards the invoice, when no VAT is at stake during the transaction (the VAT paid and deducted by the taker/purchaser of the service merely being an administrative obligation, which ends normally in a zero operation).

The system can be characterized as similar to that described in the introduction of the internal market for the Intra-Community transactions of goods and which will be extended from 1 January 2010 to the Intra-Community transactions of services (Dir. 2008/8/CE, adopting art. 44 of Dir 2006/112/CE). Both measures are combined with an administrative measure of importance, i.e. the VIES system which allows exchange of information on all the previously mentioned Intra-Community transactions between Member States.

The most predominant risks are:

- Non-payment of VAT by purchaser, when this purchaser does not dispose of a full right of deduction. Most of the time these infringements are difficult to detect because the purchaser is not registered for VAT or only a partially exempt VAT subject, or else a VAT subject who is partially exempt. This type of fraud is generally only detectable during an in-depth audit of the purchaser, which is frequently by accident.
- Deliberately invoicing by the subcontractor using the reverse charge option to persons who are not subject to any VAT liability (small enterprises, non-active taxpayers, other non-filers of VAT returns, etc.). This kind of fraud can only be detected by cross-checking data from an information system, when the legal obligation of reporting on domestic transactions is available.

An example of the importance of this risk.

The Belgian tax administration detected by cross checking the information held on invoicing against reverse charges made on the domestic market. The following figures can be classed as high risk infringements of the second type as described above (reverse charge applied to persons who have failed to file their VAT returns).

The figures below indicate the yearly total amount of transactions in which the reverse charge was applied, followed by the value of transactions invoiced to either VAT registered persons who failed to lodge a VAT return or persons not liable to file a VAT return and thus not accounting for the reverse charge that was due.

<i>Year</i>	<i>Total amount of transactions with reverse charge</i>	<i>Total amount of transactions invoiced to non-filers</i>	<i>% of total transactions with doubtful payment</i>	<i>Yearly % of growth of doubtful transactions</i>
2004	42,965,694,027.43	221,378,391.22	0.52%	
2005	51,488,083,789.31	292,625,115.24	0.57%	9.61%
2006	50,612,598,304.28	282,023,453.52	0.56%	-1.78%

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2007	56,920,693,598.09	654,238,751.98	1.15%	205.36%
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These figures show that the importance of the fake transactions with reverse charge is relatively small (less than 1.2%), but they only indicate cases where a possible payment is completely to be excluded. Tax losses may be more important when also cases are taken into account in which the purchaser, being a VAT subject with filing liability, has only a partial right of deduction and the reverse charge is applied on the invoice but not paid in the VAT return of the purchaser.

Each tax administration introducing the legal measure of reverse charge should seriously consider the necessity of a genuine reporting system for these operations, allowing the fiscal authorities to monitor the risks and assess major infringements regarding the reverse charge.

6.2.1. Other problems or risks related to the use of reverse charge

Major problems, risks or limits related:

- The definition of construction services; which construction service is part of the reverse charge system? Austria and Hungary for instance reported problems, confusions and mistakes during the starting phase of reverse charge (also see cases in Chapter 3.3.8).
- The reverse charge system is only effective within the construction sector. All construction services provided to private persons or companies not being part of the construction sector are (often) still subject to VAT.
- As mentioned at the beginning, the reverse charge system has no effect in the field of direct taxes or social security contributions.

Two other aspects of the reverse charge system may need to be taken into account:

- The problem of the legal security of the enterprises once a reverse charge system is adopted. It is obvious that the party that applies the reverse charge - and thus does not apply any VAT on the invoice that was issued - should be aware of the status of the counterpart in order to judge whether or not reverse charge is correctly applied.
- The fact that introducing the reverse charge in the construction industry drives the main contractors very often to use false and fictitious invoices in other areas than labour. It is common that the fraud will be focused upon invoices for hiring of machinery or hiring of staff (domains for which the reverse charge may not be applicable).

6.3. Tax withholding system

Definition:

Withholding tax procedures: procedures by which a fixed amount of taxes (VAT, income or corporate tax, social security contributions, etc.) due for one operation or more executed by a subcontractor, are withheld from payments by the main contractor (or master of the work) and transferred to the Treasury by the latter. The measure may not apply for contractors/subcontractors who accomplish certain registration obligations. The payments withheld are refunded as soon as taxes for the construction operation are paid on regular basis or as soon as registration obligations are fulfilled.

The countries have implemented the withholding tax system are:

- Albania;
- Austria;
- Belgium;
- Denmark;
- Germany;
- Ireland;
- The Netherlands.

A withholding tax system appears to be the most efficient when used against non-compliant subcontractors in the field of direct taxes and social security contributions, although it does not solve problems of VAT deductions by principals based on fictitious invoices. The administrative burden is rather heavy and puts the tax administration itself to a continuous and meticulous follow-up of the payments of and refunds to subcontractors active in the domestic market.

Beside the heavy administrative burden, the problem of false certificates of exemption or the illegal trade in such documents still exists.

It is also important to respect the articles of the EC if a withholding tax procedure is implemented. Belgium had to change its legal requirements for withholding tax procedures and joint liability by the beginning of 2009³.

6.4. Joint and several liabilities

Definition:

Joint and several liabilities exist when a (tax) debt can under certain legal or conventional restrictions or conditions, be collected from another person than the person liable for the payment of the debt/tax amount. This situation is therefore not merely referring to a debt owed by more than one person, but in addition to the option for the creditor (Treasury) to collect the entire amount of the (tax) debt from one or more other persons than the person who is deemed to be the person liable for payment of the (tax) amount. For VAT the principle of joint and several liabilities is based within the EU on the article 205 of Directive n° 2006/112/EC.

Besides the reverse charge system and withholding tax procedures the joint and several liability is a plausible legislative countermeasure for tackling fraud by subcontractors. This countermeasure seems (together with the withholding tax procedure) appropriate to use in the field of direct taxes (income tax and corporate tax), as well as social security contributions. In this way it may be regarded as complementary to the reverse charge system which is only applicable to VAT.

³ This amendment was imposed by the outcome of the ECJ-case C-433/04, 11 November 2006. The tax withholding obligation and joint liability were considered contrary to Articles 49 and 50 EC on the grounds that they are liable to deter principals and contractors from having recourse to contracting partners who are not established and not registered in Belgium, thereby creating a genuine obstacle for service providers who are not established and not registered there but who wish to offer their services in that country.

Though this system is not widely-used in the construction sector to tackle fraud, it seems to be appropriate as a preventive measure to tackle fraud perpetrated by subcontractors. It should be acknowledged that this system can lead to the implementation of measures that are no longer compatible with the European legislation. Tax authorities willing to implement this measure should be aware that it may be considered as being disproportionate to the risks that may occur and thus disallowed⁴.

6.5. Conclusion

The most widely-used and effective legislative countermeasures in the construction sector are the reverse charge system and withholding tax procedures or a combination of both. However, they present inherent risks and do not provide a global solution.

Other legislative countermeasures (including fiscal ones) can be found in the field of auditing, risk analysis, formal obligations and registration procedures and not based on special accounting or invoice requirements.

⁴ As was clearly specified in the ECJ-case C-433/04, 11 November 2006: the European Commission and the European Court both criticised the automatic application of joint liability, in the absence of any fault on the part of the principal or master of the work, and moreover, for all the tax debts of the subcontractor (and not only for those related to the labour to which the fiscal debts are linked).

7. ADMINISTRATIVE COUNTERMEASURES

7.1. Introduction

Since fiscal behaviour of subcontractors - especially in an international context - represents a clear and obvious risk for fraud or other fiscal misbehaviour, it is natural that the European tax administrations continuously make efforts to develop, intensify and vary their administrative countermeasures.

By “administrative countermeasures” it refers to measures which by themselves have no direct legal origin, but have been developed and based upon the common fiscal, civil and public law, existing in the field of fiscal administrative procedures. However, this does not mean that administrative countermeasures are not linked or cannot constitute part of any legal countermeasures, set up to tackle abuse or specific fraud schemes. Most of the administrative countermeasures are a series of legal measures a fiscal authority has taken in its struggle against fraud.

As a consequence a rigorous and precise distinction between administrative measures and those connected to specific legal measures appears to be difficult to establish. However, some administrative countermeasures can be defined:

- The performance by the tax administration of pre- and post-registration visits/controls for new taxpayers operating in the construction industry, and subsequently the specific selection methods that may be used for this purpose;
- The presence of a system of technical checks before registration for VAT is allowed;
- A systematic collection of information about non-compliant subcontractors (collection methodologies and use of the collected data);
- Obligations for subcontractors, local authorities, services providers or other parties to submit and/or provide access to specific information by the tax administration (examples such as permission to build, contracts for telephone services, water, electricity, gas or data of buildings (land registry), with an explanation of the collection methods and use of the collected data);
- The transmission of information of the companies issuing or receiving invoices in the construction industry (i.e. lists of the names of customers/suppliers) to the tax authorities;
- Inquiry on any other administrative countermeasure (fiscal or others) aimed at fighting fraud in construction industry.

The most important stage in the lifetime of a company is the start-up period of the business. Questions 15 and 15 of the questionnaire have been specifically designed to gather information on these issues. With questions b, c, d and e the issue of detecting, tackling and/or avoiding fraud within the construction industry and with subcontractors in particular was targeted. Here mostly all kinds of useful administrative methods or procedures were considered, such as:

- Informative or educational measures, which are intended to help taxpayers in order to understand their administrative obligations to the fiscal legislation;
- Preventive measures, which are intended to avoid tax evasion or fraud by making certain abuse is impossible;
- Preventive measures, which are intended to help in risk assessment;
- Repressive measures, which are intended to adjust the tax liability for certain taxpayers and to enforce tax collection.

In the second part of this chapter a summary will be given of all plausible proposals and ideas from all respondents. In the final part concise conclusions will be drawn.

7.2. Survey of the most appropriate administrative countermeasures

This survey of the most appropriate administrative countermeasures against fraud with subcontractors in the construction industry results from the responses to the questionnaire and therefore is not meant to be exhaustive.

7.2.1. Pre- and post-registration audits

Pre-registration checks

Pre-registration checks are generally carried out in order to determine the factual situation on three main topics:

1. Existence of the company/firm who asked for registration;
2. Existence and detection of a company/firm who did not ask for registration, but who have already set up a genuine business within the country (regardless whether these companies are local or foreign firms);
3. Confirmation of the existence of real business activities by a firm/company whose existence is not problematic.

Some tax administrations refer to these pre-registration visits as a real detection and risk assessment method, but this seems to be only a minority (36%) of the tax administrations who responded. Moreover, no single Member referred to this as a typical method as far as the construction industry was concerned. The pre-registration visits are however in all these administrations - when carried out as a preventive administrative countermeasure - common to many economic activities and sometimes part of a general approach towards new taxpayers.

One of example in this field is given by Germany, who explained that since 1 January 2002 VAT inspections (instead of the more traditional “audits”) are carried out (but this is not especially done for the construction industry). The VAT inspection is not an audit; it is a special method for real-time explanations about possible circumstances concerning VAT. It is not announced. It is especially used for:

- Existence checks of newly established enterprises;
- Settlement of requests for information for deduction of VAT on input by other tax offices;
- Settlement of requests for information from other countries within the EU.

The use of the VAT inspection allows the detection or examination for:

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- The existence of enterprises;
- The existence of fixed assets or current assets;
- Particular incoming invoices or outgoing invoices;
- Particular accounting process;
- Ratio of professional use.

Another good practice came from Ireland, one of the very few countries that have established a complete control system for the registration of subcontractors and the screening of their activities by the use of a tax withholding system, in which the principal has to withhold 35% of the payment to his subcontractor. The only way a subcontractor can possibly escape from this system, and thus receive the full amount of the invoices issued, is to get hold of a relevant payments card. Before a relevant payments card can be issued, the subcontractor must hold a certificate of authorisation (a so called C2 card). To qualify for a C2, the subcontractor must satisfy strict criteria in relation to his/her bona fides as a subcontractor. Moreover it has to be established that their business records are kept properly and accurately; that he/she or any of his/her connected partners, companies or shareholders have met their requirements in relation to the payment of taxes, the delivery of returns or other information over a period of more than 3 years prior to the date of application; and that there is good reason to believe that they will continue to meet their tax obligations in the future. This tax administration focuses on subcontractors by visiting them within a period of 6 months from issuing them with the C2 Card for the first time. The control of payment cards is generally stricter until the subcontractor has established a good track record with the fiscal authorities. Principal contractors must specifically register with the tax administration. At the point of registration, the bona fides of the principal contractor is checked.

Another interesting approach is given by the tax administration of the FYR Macedonia, who specifies that all taxpayers with a total turnover for the previous calendar year that exceeded the amount of EUR 21,060 or with a total income projected at the beginning of their business activity exceeding this amount, are held liable for registration for VAT purposes. Taxpayers who do not fall into the above mentioned category may voluntarily opt to register for VAT purposes. The tax administration pays a visit to taxpayers who would like to voluntarily register. Prior to this registration, they are presented with a check list with questions prior to or after the registration. During 2007, the tax administration developed 20 risk criteria for these new registrants.

Finally another tax administration, STI from Lithuania gave a comprehensive definition of pre-registration controls, which should consist of:

- Risk assessment of all potential VAT payers;
- Cross-check of information submitted by the taxpayer, request for additional information and/or interview with the taxpayer, if necessary;
- Filling out a form of risk assessment;
- Risk level establishment: high, medium or low.

Although some tax administrations claim to make no specific selection of new businesses with a view to operating pre- or post-registration checks, it is unlikely that every single new taxpayer is visited before or within a very short period after registration. Plausible selection criteria for these kinds of checks are generally:

- The profile of the applicant for registration (factual knowledge of the fiscal behaviour of the applier in the past). Special attention has to be given to past and present activities of the person in charge, their companies and

their tax performance (filed data and info of previous checks) planned business activity (property, employees, business partners).

- The profile of their representative (accountant, bookkeeper, fiscal advisor, etc.)
- The way the application for registration was received by the tax administration (by post, in person, by representation (use of mandate), electronic communication, etc.)
- The risk level of the business group (construction industry) should normally be considered as high risk.
- Geographical indicators (applicants from within or outside the country, the address or location of the company, the use of addresses known as “shared” residents for companies, etc.)
- The estimated turnover according to the declared activity.
- If the request for registration concerns the reactivation of a formerly existing company (with a doubtful fiscal behaviour).
- The demand for the application of special tax regimes (i.e. exemption for small enterprises, etc.)

Pre-registration audits can - once the decision to apply them is made by a tax administration - focus on the following topics:

- The genuine nature of the activity or different activities practised (correct attribution of the Nace code; cf Regulation (EC) N° 1893/2006 of the European Parliament and of the Council of 20 December 2006 establishing the statistical classification of economic activities NACE Revision 2 and amending Council Regulation (EEC) No 3037/90 as well as certain EC Regulations on specific statistical domains);
- Verification of the data concerning the establishment of the enterprise (if the address details correct, etc.);
- Verification of the governance/management of the enterprise (identification of administrators, cross-checking with critical historical information, group of enterprises sharing the same administrator, etc.);
- Information on the person responsible for the fiscal obligations that have to be met by the company;
- Existence of a business plan;
- Existence of commercial transactions (are there already contracts or actual opportunities for working contracts, incoming supplies and acquisitions, etc.);
- Verification of the solvency and financial viability of the company (bank accounts, financial resources, assets, stocks, etc.); in this respect an analysis on the availability of resources to the company in comparison to the nature and size of the planned activity can be useful;
- Information on staff (number of staff, competences needed to execute the activity, etc.);
- Check of the contact possibilities (gsm, mail, phone, etc.)

The weak point of the pre-registration audits maintains however, the difficulty that occurs once a high risk taxpayer is identified in order to take the proper measures to manage the risk level and to take appropriate precautions. This is due to the

fact that for the EU Member States the explanation given by the ECJ on the “economic activity” as understood by Article 9 of the Directive 2006/112/EC⁵ of 28 November 2006 (Official Journal L 347, 11/12/2006 P. 0001 - 0118) has to be respected. Therefore, only when the absence of any economic activity at all can be proved, is there the realistic possibility to refuse registration. However, if this is not the case, the tax administration, when refusing a registration, will be in conflict with the above mentioned EU legal disposition⁶.

Alternative measures therefore could be the temporary postponement of the allocation of the VAT registration number. However, this measure does not seem to be much more efficient, than a simple and straightforward refusal of the VAT registration and leads to the same juridical objections.

In this respect it is advisable that we should observe the results of the “*ad hoc*” working group set up by the EU Commission and meet the proposal on common minimum standards (CMS) for registration and deregistration of taxable persons in VIES. The final objective will probably be the publishing of an EU Commission Recommendation on this issue in common agreement with all Member States.

The construction industry also creates a non-registration problem (non-registration of individual workers, as well as non-registration of domestic and foreign companies active in the construction industry). One plausible countermeasure to this is site visits which help to detect non-compliant workers and subcontractors.

Post-registration audits

An important number of tax administrations rely on post-registration audits that are generally executed within a period of 6 months following registration.

The nature of these audits can be either desk audits or actual audits carried out normally at the seat of the enterprise or at the place where the records can be verified. Actual audits normally involve an examination of the bookkeeping, invoices and other records, such as payments and contracts. The advantage is that normally the company is already operational and the degree of compliance can be evaluated.

Two main streams have evolved between the tax administrations who have adopted this policy:

- Those tax administrations that consider these visits as a compliance awareness activity aimed at informing and educating the business;

⁵ “Taxable person” shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as “economic activity”. The exploitation of tangible or intangible property for the purposes of obtaining income there from on a continuing basis shall in particular be regarded as an economic activity.

⁶ Judgment of the Court (Second Chamber) of 14 February 1985. D.A. Rompelman and E.A. Rompelman-Van Deelen v Minister van Financiën. Case 268/83. Judgment of the Court (Fifth Chamber) of 29 February 1996. Intercommunale voor zeewaterontzilting (INZO) v Belgian State. Case C-110/94. Judgment of the Court of 15 January 1998, Ghent Coal Terminal v Belgian State, Case C-37/95.

- Those administrations in favour of a more repressive policy; they aim their audits at critical business groups such as the construction industry in order to detect and correct cases of non-compliance.

Pre- and post-registration audits are by seen by some tax administrations as a method to both give information to businesses and newcomers, who may be unaware of certain administrative obligations and liabilities and also as a method to collect vital information on the new businesses. In some European countries (Scandinavian countries, the Netherlands, etc.) these informative visits are considered as being a normal part of their registration and auditing strategy. Other tax administrations however merely focus on checks of the taxpayer's fiscal behaviour.

Technical eligibility

A specific question was dedicated to information obtained on the technical eligibility of the taxpayer before being registered. This verification should or could be part of the pre-registration audit.

In some countries the technical eligibility is controlled by authorities other than the tax administration.

Some countries understood the question to relate to a verification of the physical ability to carry out the work (this means that tax administration investigates the presence of assets and equipment and human resources necessary to perform in a normal way in the construction industry). No single tax administration mentioned that it actually verified the skills, know-how and practical capabilities of the principal, the subcontractor or its staff. Since this kind of information is vital to judge whether the activities that are planned can really be executed by the subcontractor and its officially known staff, it is rather surprising that this enquiry is not actually performed in the field.

Statistical material on pre- and post-registration audits

In order to give a point of reference about the perceived importance and impact of performing pre- and post-registration audits, a small survey was carried out using VAT subjects in Belgium for the year 2007:

- Number of taxpayers (submitted to the VAT) at the beginning of 2007: 722,191;
- Number of enterprises starting in 2007: 88,419;
- Number of starters as VAT subject: 71,712;
- Number of VAT registrations with low or medium risk level (no pre-registration audit): 67,832;
- Number of VAT registrations with high risk level (selected for pre-registration audit): 3,880;
- Number of pre-registration audits actually operated: 3,737;
- Registrations attributed after one visit at the enterprise seat: 3,174;
- Registrations temporarily postponed, but attributed after two visits at the enterprise seat: 301;
- Registration refused: 262;
- Registration attributed, but kept under a regime of surveillance: 2,062.

7.3. Gathering of other specific information on non-compliant subcontractors

Most tax administrations gather information on non-compliance or on risk indicators but not specifically for construction industry.

The following details relate to specific information collected about enterprises active in the construction industry by tax administrations:

- System that links subcontractors to principals;
- An e-mail based community of practice to flag up cases that may be at risk;
- Internal database of the tax administration with collected information by the a central office about foreign letter box companies;
- State Revenue Service of Latvia (SRS) uses a database for fictitious companies; it guarantees a uniform approach towards accumulating information about non-compliant subcontractors regardless of the sphere of their activities; provided that the company corresponds to some fictitious company feature, an entry is made in the SRS database regarding the company and its officials; the fictitious company's register is accessible by several other state offices; information from the fictive companies register is widely used in risk analysis.

Gathering information of a more general nature (not specifically relating to the construction industry) can be summarized as follows:

- Database - "black list" of companies that meet certain criteria (committed tax law infringements, did not obey tax administrator's orders, missing traders, engaged in fraudulent activities, persons related to them, business partners they had transactions with, etc.);
- Database with suspicious addresses, which is updated yearly;
- Auditors have the ability to refer suspicious taxpayers to be selected for audit;
- Use of a taxpayer profile software sub-program; this program is fed with all important information on taxpayers or their owners and shareholders, organized in 9 themes and 43 sub-themes, with an option for a continuous update;
- The information (about non-compliant taxpayers) is collected in a special record; the taxpayers from these special records are audited and they could be declared "inactive companies" (published in a special list named "The List of Inactive Companies" in the Official Gazette and also on the official Ministry of Finances website);
- Keeping of a so-called "Fraud Record Businesses" list; data is identified during either audits or inspections - on persons from the list that participate in tax fraud schemes;
- Database of non-compliant taxpayers, database of missing traders and database of requests for collaboration; these databases are available to all tax auditors;
- Information is systematically collected in a subsystem called CONTROL; this information may be used in the future as the potential source for inspection.

7.4. Forwarding of specified information

Based on responses to the questionnaire, the majority of tax administrations have the ability to obtain the requested information and they will use this information as required (e.g. during an audit).

Some countries have an obligation for the constructor to provide information or to grant the tax administration access to information needed - principally concerning new houses.

7.5. The transmission of information concerning invoices

Based on responses to the questionnaire, the majority of tax administrations have no legal obligation for traders to transmit information concerning invoices. On the contrary, they only have the possibility to get the information needed by special request.

7.6. Other administrative countermeasures

The analysis of the answers of the different responding tax administrations shows the following picture.

A majority of tax administrations have no other administrative countermeasures implemented or are not planning to do so.

A few administrations offer services to the companies in the construction industry (Scandinavian tax administrations in particular), but other tax authorities are trying to raise their efforts to tackle fraud by increasing their repressive countermeasures (e.g. more site controls).

7.7. Conclusions

Tax administrations have developed and implemented a set of regulations and measures in order to tackle fraud in the construction industry.

On the one hand these regulations consist of repressive measures but on the other hand there are also an increasing number of informative or educational measures.

In view of the shortage of human resources and limited means, tax administrations should try to find a balance between these measures in order to succeed in tackling fraud in the construction industry.

8. INTERNATIONAL ADMINISTRATIVE CO-OPERATION

8.1. Introduction

One of the most important issues reported by the different contributing tax administrations is the general opinion that when important construction events take place, the international aspect of controlling subcontractors' fiscal behaviour can not be neglected.

Therefore it is very important to place emphasis on the reliability, frequency and speed of international collaboration. In our opinion a major distinction should be made between the co-operation between EU Member States and co-operation between those Member States and third countries, or finally between third countries themselves.

In this Chapter, two major issues are addressed:

- First of all, the very important area of tools, rules and methods that govern the administrative assistance between the Member States of the EU. This topic deals as well with the “formal” administrative co-operation that can be described as the exchange of information between the Member States and the “active” administrative co-operation that can be qualified by the whole set of measures that rule international audits between Member States.
- Secondly, a special part of the report is dedicated to the implementation of the VAT package within the EU and, more specifically, the effect of these legal measures on the ability to exchange information between EU Member States. This topic is developed in a very practical way with examples and comments on these cases, and is oriented towards the construction industry as the domain of main interest.

Before discussing these areas of interest, the most interesting points disclosed by responding tax administrations within the Area Group are summarized and commented on briefly here.

8.2. Responses of contributing tax administrations

The responding tax administrations very rarely mentioned the presence of intense and systematic international co-operation on topics related to the construction industry. Although some tax administrations did mention the existence of systems aimed at having an overview and control on the cross-border activities of subcontractors, it must be acknowledged that these measures are mostly limited to internal national issues and rarely rise to the level of real international co-operation.

In this respect we can refer to different methods and measures that have been taken up by most of the tax administrations to register, monitor and follow-up the activities of foreign subcontractors, as follows:

- Foreign companies or subcontractors at some time during a qualifying period (the previous 3 years) must prove to the tax administration that they have complied with their tax obligations in their country of residence during the qualifying period;
- The tax administration established a central unit responsible for the control and monitoring of all non-resident subcontractors operating anywhere in the country;
- Where tax has been deducted, a central unit deals with claims to repayment or offset of this tax; specific arrangements in this area include:
 - The requirement to provide a certified/stamped claim form, from the claimant's own tax authority; this confirms that the claimant is resident in that jurisdiction for tax purposes and that the income relating to the claim is to be declared in that jurisdiction; annual checks, on a selection of claim forms supplied in support of claims, are carried out, i.e. the authenticity of the stamps are checked with the foreign tax authorities for confirmation with regards to both the claimant and the authenticity of the stamps;
 - A detailed questionnaire must be completed together with original tax deduction forms, giving full details of amounts involved to support a claim; in processing a claim, checks are carried out with regard to any inland liabilities, e.g. VAT and these must be satisfied before any refund is made;
 - Data on refunds made to non-residents is exchanged with other tax authorities;
- There can be, in certain circumstances, a requirement on foreign employers (principal contractors/subcontractors) to operate inland payroll taxes on construction employees;
- All non-resident subcontractors must register and charge VAT; unlike resident contractors, the turnover threshold for registration is considered as nil;
- Different tax administrations make agreements with neighbouring countries to start long-term monitoring of big buildings projects: collect information about contractors, subcontractors, contracts, terms, etc., or to monitor selected subcontractors tax registered in both jurisdictions;
- Some neighbour countries decided to co-operate and created a taskforce to combat fraud in the construction industry; the 3 most important issues are:
 - Profits made on immovable properties which are not declared;
 - Financing of large construction sites with black money;
 - Fraud in the construction branch (large buildings);
- Some countries pay special attention to international activities, such as permanent establishments and business records that are kept abroad;
- Many others only make use of the international exchange of information (on request/spontaneous);
- One responding country (Denmark) mentioned the opportunity of unannounced auditing, and the possibility to get access to any assets if there is a payment due; this tax administration also has close co-operation with the police and the department handling the common debt;

- Finally tax administrations refer to the use and exchange of the SCAC documents (within EU) and to the OECD Model Tax Convention on Income and Capital and valid memorandums for cooperation.

Although a few tax administrations mention having regular involvement in international co-operation, it seems that generally, few administrations went no further in their co-operation than a simple exchange of information. Moreover these experiences were not always dealing with problems in the construction industry.

However:

- Two responding tax administrations mentioned coordinated simultaneous audit action (Belgium, the Netherlands);
- Two other tax administrations mentioned a continuous spontaneous exchange of information (Norway, Finland).

This survey does not appear to be very encouraging, although all (or most) of the involved tax administrations acknowledge (mostly in an indirect way) in their responses that the problems with foreign subcontractors, such as posted workers and the discussions about permanent establishments, are very often only possible to tackle when international co-operation is possible.

9. DETERMINATION OF THE PLACE OF SUPPLY OF SERVICES CONCERNING WORK OF CONSTRUCTION

9.1. Introduction and comment on the modifications of the current VAT legislation and the impact on the exchange of information

9.1.1. Impact of the changes for construction industry and the tax administration dealing with subcontractor activities

The VAT legislation contains a set of rules concerning the place of supply of services inside and outside the Community which determine in which Member State the VAT has to be recovered. According to the rules currently in force, the place of supply of services is deemed to be the place where the supplier is established. However, there are many exceptions to this rule.

One of the most remarkable exceptions in this context is the supply of services connected with immovable property, including the construction activities, that will be located (as it was before) in the Member State where the construction site is situated. Other very important activities of subcontractors are from 1/1/2010 submitted to the new general rule for B to B transactions (see hereafter concerning the new Article 44 of Council Directive 2006/112/EC). This is the case of the service that consists in the supply of staff. The most important consequence of this change will be the obligation for reporting this kind of service from 1/1/2010 on when this service takes place within an Intra-Community B to B transaction. This will enable the Member States in which territory such services are received by subcontractors or principals to be aware of the operations that are taking or have taken place on their territory. It is obvious that these kind of legislative changes do influence directly the exploitation of exchanged information and offers more possibilities for tax administrations to control subcontractors activities.

A similar change for a service that occurs on a regular basis within the construction industry is implemented in respect of services by intermediaries.

Finally another recent change in this respect is the implementation of the new VAT refund procedure by the Directive 2008/9/EC of 12 February 2008 (Official Journal L 044 of 20 February 2008). This new procedure will go into effect from 1/1/2010 on and gives the taxpayers from other Member States the opportunity to request VAT refunds by using a digital procedure (online demand) in the Member State of their establishment. This Member State will collect and communicate the request to the Member State of the place where VAT was due and has to be refunded. This new procedure however, offers no further or new perspectives for Member States who deal with subcontractors active on their territory. However, since from now on digital information will be available as soon as a foreign subcontractor submits in its Member State a request for VAT reimbursement, which will be communicated to the Member State where its activities took place, it is not unthinkable that this information could contribute to a quicker and more sophisticated way of detecting fraudulent or unreported activities.

9.1.2. New regulations for services with an Intra-Community nature in the construction industry and summarised comment

The realisation of the internal market, globalisation, deregulation and technological changes has all combined to create enormous changes in the volume and pattern of trade in services. It is increasingly possible for a number of services to be supplied remotely. In response, piece-meal steps have been taken to address this issue over the years and many defined services are in fact at present taxed on the basis of the destination principle.

The proper functioning of the internal market requires the amendment of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax as regards the place of supply of services, following the strategy of modernisation and simplification of the operation of the common VAT system.

The Council of the European Union has adopted a number of important amendments set out in Directive 2008/8/EC of 12 February 2008. This directive defines new rules with regards to the place of supply of services as well as some formalities attached to it.

For all supplies of services the place of taxation should, in principle, be the place where the actual consumption takes place. Certain exceptions to this general rule may still be necessary for both administrative and policy reasons. The place of supply of services concerning the provision of services is, as from 1 January 2010, provided for by Articles 43 to 59b, new, amending Directive 2006/112/EC, as introduced by Directive 2008/8/EC of 12 February 2008 (Official Journal L 044 of 20 February 2008).

The new regulation is based on the fundamental distinction made in function of the quality of the recipient of the supply of services. As regards the place of supply of services, Article 44, new, of Directive 2006/112/EC concerns transactions between taxable persons while Article 45, new, of Directive 2006/112/EC relates to the supplies of services to a non-taxable person.

The basic provisions of Directive 2006/112/EC as regards the place of supply of services are the following:

Article 44

The place of supply of services to a taxable person acting as such shall be the place where that person has established his/her business. However, if those services are provided to a fixed establishment of the taxable person located in a place other than the place where he/she has established his/her business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the taxable person who receives such services has his/her permanent address or usually resides.

Article 45

The place of supply of services to a non-taxable person shall be the place where the supplier has established his/her business. However, if those services are provided from a fixed establishment of the supplier located in a place other than the place where he/she has established his/her business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the supplier has his/her permanent address or usually resides.

For supplies of services to taxable persons (usually named B to B transactions = business to business), the general rule with respect to the place of supply of services is based on the place where the recipient is established, rather than where the supplier is established. For the purposes of rules determining the place of supply of services and to minimise burdens on business, taxable persons who also have non-taxable activities are treated as taxable for all services rendered to them. Similarly, non-taxable legal persons who are identified for VAT purposes are regarded as taxable persons. These provisions, in accordance with normal rules, do not obviously extend to supplies of services received by a taxable person - natural person - for his/her own personal use or that of his/her staff.

The provision of Directive 2006/112/EC whereby taxable persons or non-taxable legal persons, already identified for VAT purposes, irrespective of their activities (even non-taxable transactions falling outside the scope of VAT) or despite the fact that they are non-taxable legal persons (but already identified for VAT purposes), are considered as taxable persons as regards the place of supply of services, reads as follows:

Article 43

For the purpose of applying the rules concerning the place of supply of services: a taxable person who also carries out activities or transactions that are not considered to be taxable supplies of goods or services in accordance with Article 2 (1) shall be regarded as a taxable person in respect of all services rendered to him/her;

A non-taxable legal person who is identified for VAT purposes shall be regarded as a taxable person.

If the taxable person - recipient of the service - has a fixed establishment in an other country than the country where that person has established his/her business and the service is provided to this fixed establishment, the place of supply of these services is the place where that establishment is located. The place of the fixed establishment as a criterion for the place of supply is nevertheless secondary and is not applied if this should lead to an unreasonable solution as regards the place where the actual consumption takes place. The reference to the fixed establishment supposes that the services are supplied for the purposes of this establishment and not for those of the establishment of the economic activities of the taxable person. Consequently, it is important that the contract is concluded

by the fixed establishment itself (or that the order is placed by this latter), that the transaction is invoiced mentioning the name, the address and the VAT identification number of this establishment and that the payment is done by way of an account opened at the name of this establishment.

If a taxable person receives services from a taxable person not established in the same Member State, the compulsory reverse charge mechanism is extended. This is a new important administrative simplification for the businesses, meaning that the taxable person - recipient of the services - should pay himself/herself the appropriate amount of VAT on the acquired service.

The provision of Directive 2006/112/EC inserting this kind of reverse charge system reads as follows:

Article 196

VAT shall be payable by any taxable person, or non-taxable legal person identified for VAT purposes, to whom the services referred to in Article 44 are supplied, if the services are supplied by a taxable person not established within the territory of the Member State.

Furthermore, for taxable businesses having a fixed establishment in another Member State and making supplies of services in that other Member State, it is accepted that the taxable business is not established in that Member State as regards the supply of service. In such cases, the reverse charge mechanism can be applied to the acquirer if pursuant to Article 196 of Directive 2006/112/EC, he/she is the person liable to pay VAT in the Member State where the fixed establishment is located.

Article 192 a

For the purposes of this section, a taxable person who has a fixed establishment within the territory of the Member State where the tax is due shall be regarded as a taxable person who is not established within that Member State when the following conditions are met:

- a) He/she makes a taxable supply of goods or of services within the territory of that Member State;*
- b) An establishment which the supplier has within the territory of that Member State does not intervene in that supply.*

As a rule, the VAT due on a taxable supply of services in a Member State has to be paid by the supplier. If the supplier is not established in this Member State, this general rule is not applicable and by applying the reverse charge mechanism, the recipient is liable to pay the tax due in the Member State where the service takes place.

To apply the reverse charge mechanism, logically, the following conditions have to be met:

- It concerns supplies of services in the relation B to B.

- The supplies of services take place in the Member State where the service takes place pursuant to Article 44 of Directive 2006/112/EC. The services whose place of supply is determined according to Article 46 et seq of Directive 2006/112/EC, e.g. supply of services connected with immovable property are not covered.
- The services are supplied by taxable persons not established in the Member State where the service takes place. Even if this taxable person has a fixed establishment in this Member State, he/she will not be considered to be established there as long as this establishment is not involved in the supply of services. In other words, the reverse charge system cannot be applied when the supplier supplies a service from his/her establishment in the Member State where the service takes place. A service is supplied from this fixed establishment when, without regard to the form, direct or indirect, this fixed establishment is involved in the supply of the service. This rule is also applied in case of supplies of goods.

Moreover, all Member States are obliged to identify every taxable person who, following the above-mentioned mechanism, is liable to pay VAT in the Member State of establishment with an individual VAT identification number, by inserting the following paragraphs in Article 214 of Directive 2006/112/EC:

- Every taxable person who within their respective territory receives services for which he/she is liable to pay VAT pursuant to Article 196;
- Every taxable person, established within their respective territory, who supplies services within the territory of another Member State for which VAT is payable solely by the recipient pursuant to Article 196.

Consequently, it is provided for in the legislation that a VAT identification number is allocated to:

- Every taxable person established in a Member State who, in view of his/her normal economic activities, is not identified for VAT purposes as a taxable person for any reason or is exempted from filing VAT-returns, when he/she is liable to pay the tax in accordance with the reverse charge system laid down in Article 196 of Directive 2006/112/EC. Following the conditions of the reverse charge system, such taxable persons must have a VAT identification number in the Member State where the service takes place and must communicate this identification number prior to the provision of services to the supplier not established in this Member State.
- Every taxable person who supplies services which, by virtue of the Community provisions, are deemed to take place in another Member State and the tax is due by the recipient of the service. This particular case concerns a taxable person who exclusively carries out transactions in a Member State for which the identification for VAT purposes is not required (e.g. exempted transactions), and who intends to carry out services for a taxable person established in another Member State who should tax himself/herself the services to VAT. The supply of service referred to will take place in this other Member State and the taxable person - recipient is liable to pay the VAT due. Therefore it is important that the supplier of services is identified for VAT purposes in his/her country of establishment,

so that he/she is able to fulfil the tax requirements laid down with regard to the transfer of data to taxable persons established in other Member States.

If services are supplied to non-taxable persons, named B to C transactions (= business to consumer) the general rule continues to be that the place of supply of services is the place where the supplier has established his/her business (see Article 45 of Directive 2006/112/EC, above).

However, in certain circumstances, the general rules as regards the place of supply of services for both taxable and non-taxable persons are not applicable and specified exclusions apply instead. These exclusions are largely based on existing criteria and reflect the principle of taxation at the place of consumption, while not imposing disproportionate administrative burdens upon certain traders.

These derogations of Directive 2006/112/EC having precedence over the general rules and in regard to the hereby listed categories of provisions of services are as follows:

Supply of services by intermediaries

Article 46

The place of supply of services rendered to a non-taxable person by an intermediary acting in the name and on behalf of another person shall be the place where the underlying transaction is supplied in accordance with this Directive.

Supply of services connected with immovable property

Article 47

The place of supply of services connected with immovable property, including services of experts and estate agents, the provision of accommodation in the hotel sector or in sectors with a similar function, such as holiday camps or sites developed for use as camping sites, the granting of rights to use immovable property and services for the preparation and coordination of construction work, such as the services of architects and of firms providing on-site supervision, shall be the place where the immovable property is located.

Article 47 of Directive 2006/112/EC states that supplies of services with regard to immovable properties take place where the immovable property is located. In fact, the rule applied before has not been amended. However the question remains about the extent of this measure, since in the past double taxation or no taxation have occurred by applying this rule according to different interpretations between the Member States concerned by the transaction.

9.2. Examples of the new rules for the place of services, typical for construction industry or subcontractors activities

9.2.1. Construction work to immovable property

Example A

Background

Construction work to immovable property located in the Czech Republic by a German supplier (A) by order of a Czech client, who can be:

- Either an Austrian private person (C) who is having a house constructed in the Czech Republic;
- Or a Hungarian business (B) that is located in the Czech Republic and submits periodical VAT returns and commissions to build a new registered office.

Situation before 2010

Pursuant to Article 45 (old) of the Council Directive 2006/112/EC, before 2010, the place of supply of services is the place where the immovable property is located, if it concerns services relating to an immovable property.

Consequently, in the example, the place of supply of the services is the Czech Republic, and the German principal contractor, as the supplier of services, should be the tax debtor pursuant to Directive 2006/112/EC, Article 193. Exceptions to this principle are possible on the basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1 (if the Czech Republic eventually were to apply a reverse charge in this respect).

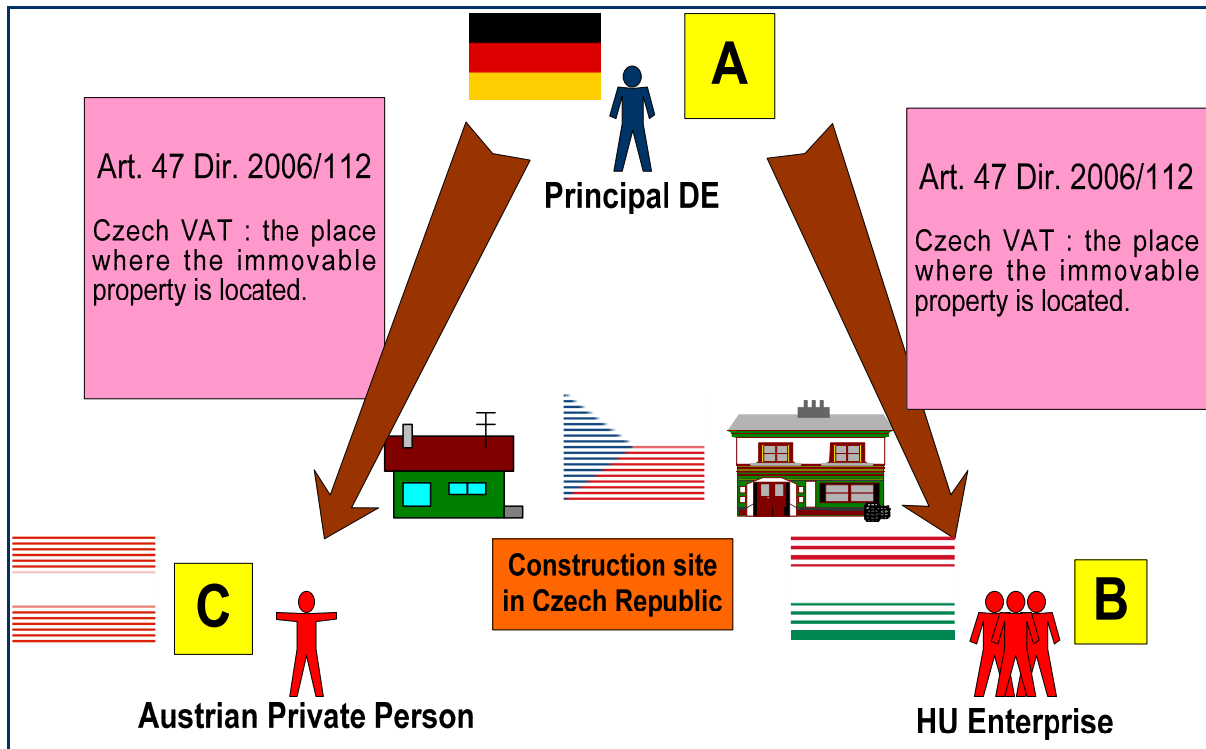
Return: the transaction should be included in the periodical return of A that has to be submitted in the Czech Republic, if a reverse charge is not possible (A would normally apply for a VAT number in the Czech Republic).

As from 1 January 2010

Article 47 (new) of the Council Directive 2006/112/EC states that the place of supply of the services with regard to an immovable property is the place where the immovable property is located.

Consequently, in this example the place of supply of the services is the Czech Republic and the tax debtor shall be the supplier of the services (unless one or another form of reverse charge could be applied on basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1).

Scheme



Conclusion

The place of supply of services remains unchanged in the present and future situation. With regards to the administrative obligations, nothing changes.

Example B

Background

Example of construction work with a subcontractor in Poland and an intermediary acting in Ireland (between the Polish and Swiss firm); the Swiss principal contractor builds a factory in Bulgaria by order of a Dutch client-taxable person - master of the work.

Both the construction works of the subcontractor and the principal are located in Bulgaria.

Situation before 2010

Pursuant to Article 45 (old) of the Council Directive 2006/112/EC, the place of supply of services is the place where the immovable property is located, if it concerns services relating to an immovable property.

Consequently, in this example, the place of supply of the services is Bulgaria, and the suppliers of the services (both the Polish subcontractor and the Swiss enterprise) should be debtors of the Bulgarian VAT pursuant to Directive

2006/112/EC, Article 193. Exceptions to this principle are possible on the basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1 (if the Czech Republic eventually applied a reverse charge in this respect).

As from 1 January 2010

Article 47 (new) of the Council Directive 2006/112/EC states that the place of supply of the services with regard to an immovable property is the place where the immovable property is located.

Consequently, in the example the place of supply of the services is Bulgaria and the Polish subcontractor and the Swiss enterprise should be considered as debtors of the tax (being the suppliers of the services), pursuant to Directive 2006/112/EC, Article 193. Exceptions to this principle are possible on the basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1 (if Czech Republic eventually would apply a reverse charge in this respect).

Supply of services by intermediaries

The subcontractor from Poland asked an Irish intermediary to find their Swiss counterpart.

Situation before 2010

Pursuant to Article 45 (old) of the Council Directive 2006/112/EC, the place of supply of services is the place where the immovable property is located, if it concerns services relating to an immovable property (including the supplies of services by intermediaries).

Consequently, in the example, the place of supply of the services is Bulgaria, and the Irish intermediary is the tax debtor of the Bulgarian VAT, pursuant to Directive 2006/112/EC, Article 193. Exceptions to this principle are possible on basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1 (if Czech Republic eventually would apply reverse charge in this respect).

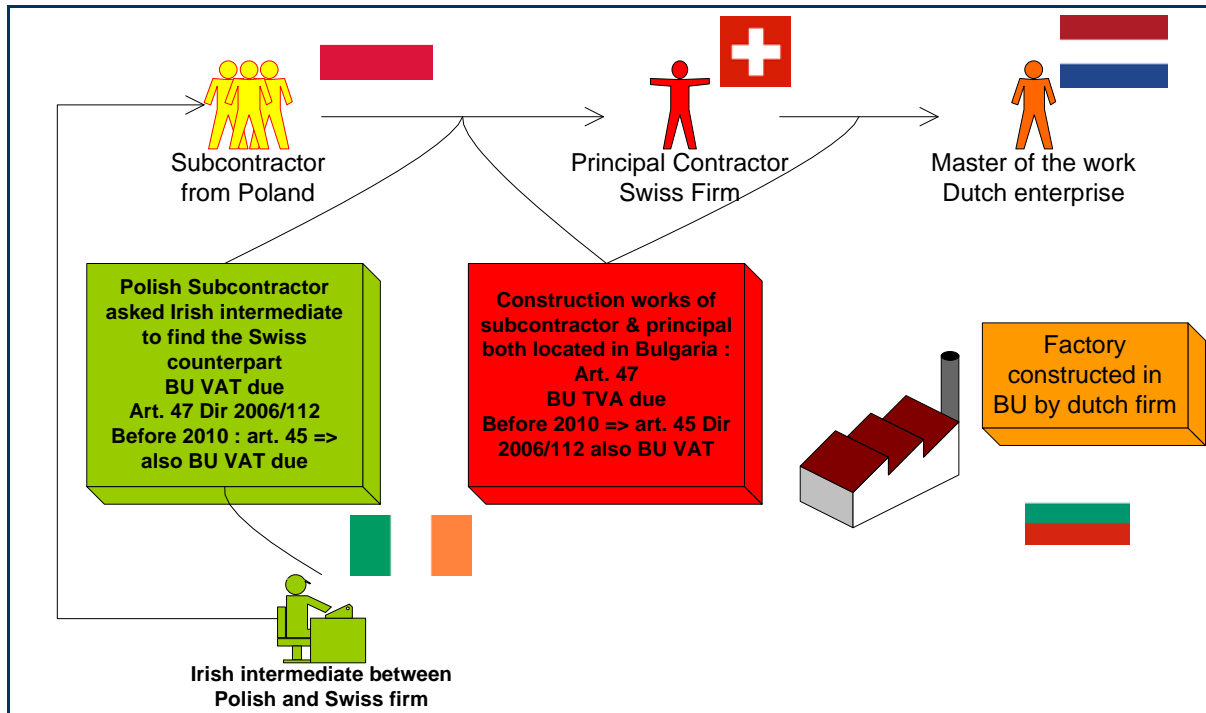
As from 1 January 2010

Article 47 (new) of the Council Directive 2006/112/EC states that the place of supply of the services with regard to an immovable property is the place where the immovable property is located (including the supplies of services by intermediaries).

Consequently, in the example, the place of supply of the services is Bulgaria, and the Irish intermediary shall be the tax debtor of the Bulgarian VAT, pursuant to Directive 2006/112/EC, Article 193. Exceptions on this principle are possible on basis of Directive 2006/112/EC, Article 194, 1 or Article 199, 1 (if Czech Republic eventually would apply reverse charge in this respect).

Article 46 (new) of the Council Directive 2006/112/EC is not applicable because the service is considered as being a service concerning an immovable property (out of the scope of Article 46 (new)). Moreover this new Article 46 is only applied in case of services rendered to a non-taxable person.

Scheme



9.2.2. Hiring of movable property, excluding means of transport

Background

Three situations/transactions are examined:

- A French private person hires a machine for construction from a Swiss hiring company, while the machine is actually used for construction of a building in the United Kingdom;
- A Dutch principal hires machines used for construction from a Swiss hiring company, while the machines are actually used for construction of a building in the United Kingdom;
- Construction of a building by the Dutch principal (B1) in the United Kingdom for a British public service - administration.

Situation before 2010

Normally, for such services, the general rule is applied (place of supply of the services is the place of establishment of the supplier), unless the recipient is a taxable person acting as such who is established in the EU, yet outside the country of the supplier or a recipient who is established outside the EU.

If the recipient is the French private person established in the EU, the general rule is applied. Pursuant to the present general rule, the place of supply of services shall then be Switzerland (Directive 2006/112/EC, Article 43 (old)).

If the recipient is the Dutch principal, the place of supply of the services is the Netherlands, which is the place of establishment of the recipient, as the derogation of Directive 2006/112/EC, Article 56, 1, g, (old) is applicable: the Dutch principal is a taxable person established in the EU, yet outside the country of the supplier (Switzerland).

Concerning the services of construction of the building in the UK, the place of supply of the services to the British public service is established in the United Kingdom pursuant to Directive 2006/112/EC, Article 45 (old) - the place of supply of services is the place where the immovable property is located, if it concerns services related to an immovable property. The supplier (Dutch principal) is the debtor of the British VAT pursuant to Directive 2006/112/EC, Article 193.

As from 1 January 2010

The first situation, in which the recipient of the service (hiring of the machine) is the French private person, the general rule with relations B=>C (Article 45 (new) of the Council Directive 2006/112/EC) shall be considered to be applicable, making the VAT not payable in the EU (place of supply of the services, Switzerland).

However, Article 59bis, b (new) of the Council Directive 2006/112/EC makes it eventually possible for the Member State of consumption/exploitation, to provide a provision in order to move the place of supply of services, which would normally be located outside the EU, to the Member State of consumption, if the general rules B=>B or B=>C are applicable. In the example, the United Kingdom would therefore be able to levy the VAT by moving the place of supply of services to the UK within the scope of a provision opposing the non-assessment of VAT. In the other two cases this is not possible as the application of the general rule does not lead to the place of supply of the services being established outside the EU, and the exception could not be applied for construction activities regulated by the Article 47 (new) of the Council Directive 2006/112/EC.

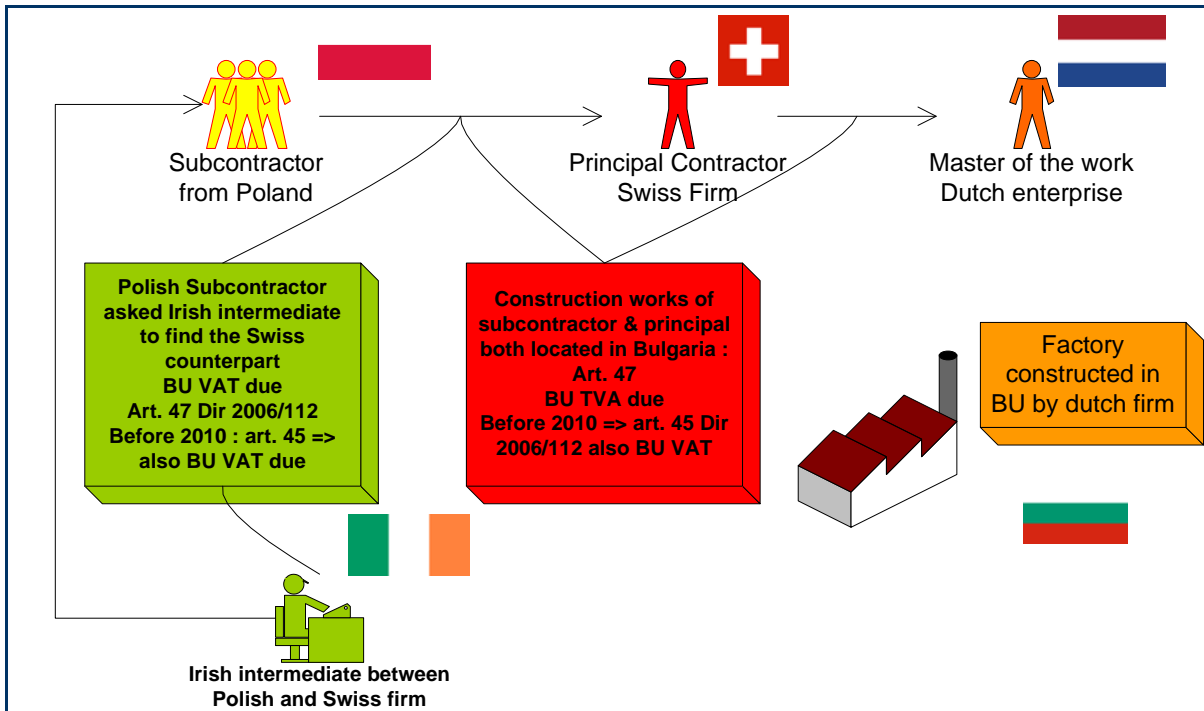
In the second case, in which the recipient of the service (hiring of the machine) is a Dutch principal (taxable person), the general rule with B=>B transactions (Art. 44 (new) of the Council Directive 2006/112/EC) is applicable as from 1 January 2010, making the Dutch VAT payable.

For the third case (the construction of a building by principal B1 in the UK for a British public service), Article 47 (new) of the Council Directive 2006/112/EC states that the place of supply of the services with regard to an immovable property is the place where the immovable property is located. Consequently, in the third case of the example the place of supply of the services is the UK. Consequently British VAT is due.

Important remark

The Swiss supplier shall not submit an Intra-Community list (VIES) anywhere for any of the above-mentioned cases. The obligation relating to submission of a VAT return for B=>B services shall only be applicable in the EU region and not in third countries, leaving the fiscal authorities of the recipient of the service (UK) without any information in respect of the supplier.

Scheme



9.2.3. Supply of staff

Background

Two different cases are compared:

- A business established in Norway (and without any establishment in the EU) supplies staff to a Belgian client-taxable person (principal contractor) in the scope of a social housing project in Vilnius. The workers are working under command of the Belgian principal contractor (B1) on the building site in Lithuania.
- A Swedish job and interim company supplies staff to a Swiss principal contractor in order to carry out work in a social housing project in Vilnius. The workers are working under command of the Swiss principal contractor (B2) on the building site in Lithuania.

Situation before 2010

The place of supply of services is the place where the person who receives the services has established his/her business or a fixed establishment for which those

services are provided or, in the absence of such a place, the place where the person who receives such services has his/her permanent address or usually resides, if services are rendered to a person who receives the services being established outside the Community or to a taxable person who is established in the Community yet outside the state of the supplier and acts for the purposes of his/her business activities, pursuant to Article 56, 1, f, (old) of the Council Directive 2006/112/EC.

In the first case, the tax is due in Belgium, since in this case, the recipient is a Belgian taxable person who acts as such in the scope of his/her business activities pursuant to the varying rule of Article 56, 1, f, (old) of the Council Directive 2006/112/EC. In the second case this varying rule is applicable as well. However, the place of supply of services is located in Switzerland, since the recipient is a recipient established outside the EU (Switzerland).

For the second case, the Belgian VAT is payable by the recipient of the services (pursuant to Article 196 of Directive 2006/112/EC, since this recipient receives services that are considered to take place in Belgium pursuant to Article 56 (old) of Directive 2006/112/EC and that are rendered by a taxable person established outside Belgium. This is the case for the supply of staff as mentioned in the example.

As from 1 January 2010

The general rule B=>B (Art. 44 (new) of the Council Directive 2006/112/EC) is applicable for both cases: place of supply of the services is the place of establishment of the recipient of the services, namely :

- In Belgium for the first case;
- In Switzerland for the second case.

For the second case, a special rule could eventually be applicable, namely: when applying the general rule, the VAT would not be payable in the EU (place of supply of the services = CH). However, Article 59bis, b (new) of the Council Directive 2006/112/EC makes it possible for the Member State of consumption/exploitation, to stipulate a provision in order to move the place of supply of services, which would normally be located outside the EU, to the Member State of consumption/exploitation, if the general rules for B=>B or B=>C transactions are applicable. In our example, it would therefore be possible eventually for Lithuania to introduce a legal rule allowing this country to make the VAT payable by moving the place of supply of the services to the country of consumption/exploitation within the scope of a provision opposing the non-assessment of VAT. In the first case (relation A1=>B1) this is not possible as the application of the general rule does not lead to the place of supply of the services being established outside the EU.

Return

For the first case, the Belgian client-taxable person includes the basis of assessment of the services in the return and the VAT due, which is deductible pursuant to the legal rules.

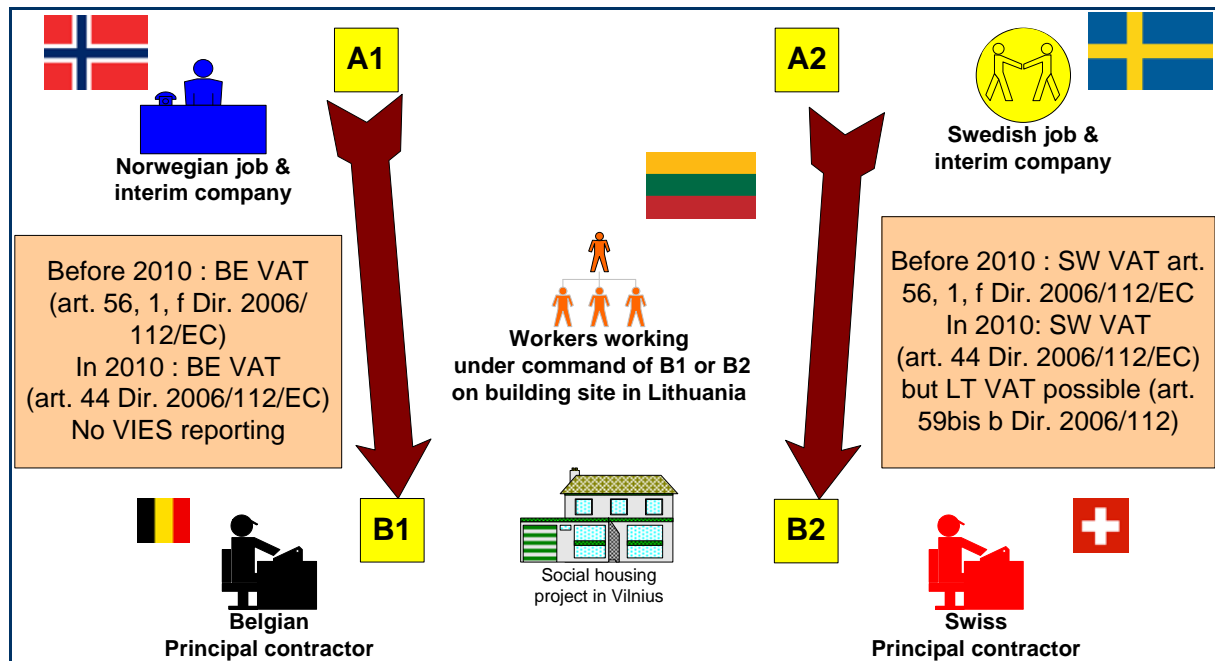
For the second case, obligations only exist in Lithuania if the VAT would be payable there (special provision pursuant to Article 59bis, b (new) of the Council Directive 2006/112/EC: this would only be possible if the service can be considered as consumed within this country).

Remarks

The Norwegian supplier would not include the services that are taxed in the Member State of the client (BE) in an Intra-Community list (VIES), leaving the fiscal authorities of the recipient of the service (BE) without any information with respect to the supplier.

All cases meant in Article 56, 1, points (a) to (l), (old) of Directive 2006/112/EC in the B=>B relations shall follow the same rules after 1 January 2010 as mentioned above and shall be dealt with in the same sense. In such relations, this exceptional rule has now become the general rule.

Scheme



9.3. Exchange of data between Member States - insertion of the provisions of services in the recapitulative statement

In order to further correct application of the new provisions, every taxable person identified for VAT purposes shall submit a recapitulative statement of the taxable persons and the non-taxable legal persons identified for VAT purposes to which he/she has supplied taxable services which fall under the reverse charge mechanism.

Every taxable person identified for VAT purposes shall submit a periodic statement of the Intra-Community transactions, namely the Intra-Community supplies of goods and the supplies of goods carried out in the Member State of arrival of the sending or the transport of the goods, in case of triangular traffic. Until now this liability was limited to transactions related to goods. From now on the directive extends this obligation to the supplies of services taking into account the following conditions:

- The statement mentions the taxable persons and the non-taxable legal persons identified for VAT purposes to whom services are supplied and for which they are liable to pay the VAT in the Member State where they are located (reverse charge system, see Article 196 of Directive 2006/112/EC, above). The location of services which are determined under the derogations of Article 47 and following Directive 2006/112/EC, e.g. the supply of services connected with immovable properties and has not to be mentioned in the statement. This liability is limited to the services in the relation B to B falling under the application of the general rule determining the place of supply of services, namely the place where the recipient of the service is established.
- The statement shows the VAT identification number of the supplier, the identification number of the different acquirers of the service under which the supply of services has been carried out as well as; for each recipient of services; the total value of the services supplied.
- Services exempt from VAT in the Member State where the transaction is normally taxable may not be mentioned: services which are automatically exempt by Directive (e.g. the exemptions laid down in Article 44 of the VAT Act) as well as the particular situation where a service is liable to VAT in the Member State of the supplier but exempt in the Member State of the recipient such as some banking and financial transactions.

This obligation is provided for by Article 262 of Directive 2006/112/EC:

Article 262

Every taxable person identified for VAT purposes shall submit a recapitulative statement of the following:

a) Acquirers identified for VAT purposes to whom he/she has supplied goods in accordance with the conditions specified in Article 138 (1) and (2) (c);

b) *Persons identified for VAT purposes to whom he/she has supplied goods which were supplied to him/her by way of Intra-Community acquisitions referred to in Article 42;*

c) *Taxable and non-taxable legal persons identified for VAT purposes, to which services have been supplied, other than services that are exempted from VAT in the Member State where the transaction is taxable, and for which the recipient is liable to pay the tax pursuant to Article 196.*

Moreover, Article 264 of Directive 2006/112/EC has been amended, allowing for reporting on provisions of services that will be reported in the statement of Intra-Community transactions.

Accordingly, necessary amendments were made to the Council Regulation (EC) n° 1798/2003 of 7 October 2003 by Council Regulation (EC) n° 143/2008 of 12 February 2008 amending Regulation (EC) n° 1798/2003 as regards the introduction of administrative co-operation and the exchange of information concerning the rules relating to the place of supply of services, the special schemes and the refund procedure for value added tax (Official Journal L 044 of 20 February 2008). Consequently, as from 1 January 2010 all Member States will be obliged to communicate the basic data for all transactions (provisions of services) for which the recipient is liable to pay the tax on the basis of Article 196 of Directive 2006/112/EC by the Member State of the supplier to the Member State of the recipient. These basic data are the same as those which are already exchanged with respect to Intra-Community supplies of goods. A separate code (S) will be allocated to the supplies of services which will be used for the simplified Intra-Community triangular traffic in the same form as code (T) is used today.

The European Union also interfered in the periodicity of submitting Intra-Community statements through the Council Directive 2008/117/EC of 16 December 2008 amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with Intra-Community transactions (Official Journal L 014 of 20 January 2009). The future legal regulation will have to start from the premise that the periodicity of the Intra-Community statements as from 1 January 2010 will be monthly.

However, all taxable persons - whether they are monthly or quarterly filers of periodic VAT returns - can opt for Intra-Community statements on a quarterly basis if their Intra-Community supplies of goods (including triangular sales) during the calendar quarter concerned and the previous four quarters do not exceed the sum of EUR 100,000 (EUR 50,000 as from 1 January 2012 with reservations) for each calendar quarter. Therefore, to calculate the above-mentioned thresholds, the supplies of services which had to be mentioned in the Intra-Community statement by the taxable person concerned do not have to be taken into account.

9.4. Conclusions

The major effect of this adaptation of administrative cooperation between EU Member States will be an auxiliary support that all tax administrations will benefit from. This future improvement results from the extension of the exchange of

information by using the VAT information exchange system (VIES) for specific services: supply of staff and hiring of machines/movable property.

As regards the most important services frequently present within the construction industry (i.e. construction work and the services offered by intermediates), this exchange of information will not be established on regular basis by the use of the VIES system since these services are not referred to in the Article 44 of Directive 2006/112/EC but in the Article 47 (new) of the Council Directive 2006/112/EC. Only services between VAT liable persons with reference to Article 47 are supposed to be reported within the Intra-Community VIES.

This gap in the exchange of information system (e.g works on immovable property) confirms the actual situation and will entail an absence of information as regards cross-border activities. Subcontractors will be aware of this lack of exchange of information and might be able to perpetrate illegal practices in the country where the construction site is located.

10. GENERAL CONCLUSIONS

Although this report was not intended to be a “good practices guide”, the importance for tax authorities to use a wide range of possible countermeasures to tackle fraud in the construction industry has to be emphasized. In the view of the Task Team members, relying on a set of a limited number of actions and legal possibilities does not appear to be effective to fight against fraudulent activities undertaken in the construction industry and especially by subcontractors.

The overview given in the report aims at highlighting possible fraud schemes, but also different ways to react. Rather than pointing out one or two specific features that could be effective, the Task Team wishes to stress the importance of implementing a versatile way of responding to risks occurring in the construction industry. The Task Team members believe that the report should give an extensive choice of options in this respect, even though they are aware that such a report is rarely totally exhaustive and complete. For example, items such as double taxation caused by the divergent interpretation of permanent establishments, is not raised in this report. Also money laundering techniques as a logical consequence of illegal actions of principals and their subcontractors were not addressed in depth. This comment leaves the challenge to continue the work and research that has already been done.

When analyzing responses from the different IOTA tax administrations, an unexpected conclusion might emerge as regards international co-operation. It appears that tax administrations’ experiences in this field remain overall quite limited, mostly in respect of exchange of information. Very seldom is a multilateral control or coordinated action in the field set up.

However this phenomenon might be explained by the following:

- Most of the construction services are supplied by small and medium enterprises. It is therefore very rare that tax auditors will make use of things such as multilateral control or other forms of international co-operation for comparatively small businesses.
- Another fact may be that more important building projects are very often set up within a specific framework (corporation, temporary firms, etc.) specially set up for the one construction site only. This sometimes discourages the auditor from setting up an international project.
- Additionally, construction sites are almost always situated in one single country. Although there are very often cross-border transactions between principals and subcontractors, still the real work is always taking place in one only country. Since this country will be usually the only demanding side for an internationally coordinated action from different tax administrations, this seems to be a burden and obviously limits the number of real active collaborations such as joint audits.

In conclusion, the Task Team members want to draw the attention of the reader towards the necessity for international co-operation as the increasing cross-border

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activities of subcontractors should lead to closer co-operation between tax administrations, better and quicker exchange of information and more joint audits.