

# How to prevent VAT fraud in gas and electricity trading?

Domestic reverse charge mechanism

Know Your Customer Rules

Admission processes

Vigilance

Vienna, 26 April 2017



Association of European Energy Exchanges

## 1.1 Europex at a glance

- Europex, the **Association of European Energy Exchanges**, constitutes the sole and **central voice of European energy exchanges** towards the European institutions and other relevant stakeholders.
- Europex was **founded in 2002**. Its Secretariat is **based in Brussels**.
- Europex represents the **interests of exchange-based wholesale electricity, gas and environmental markets**.
- Europex takes actively part in important **dialogue fora** such as the Florence and Madrid Fora, the Market European Stakeholder Committee, etc.
- Europex has currently **four Working Groups and three Task Forces**.
- For more information, please see: [www.europex.org](http://www.europex.org)

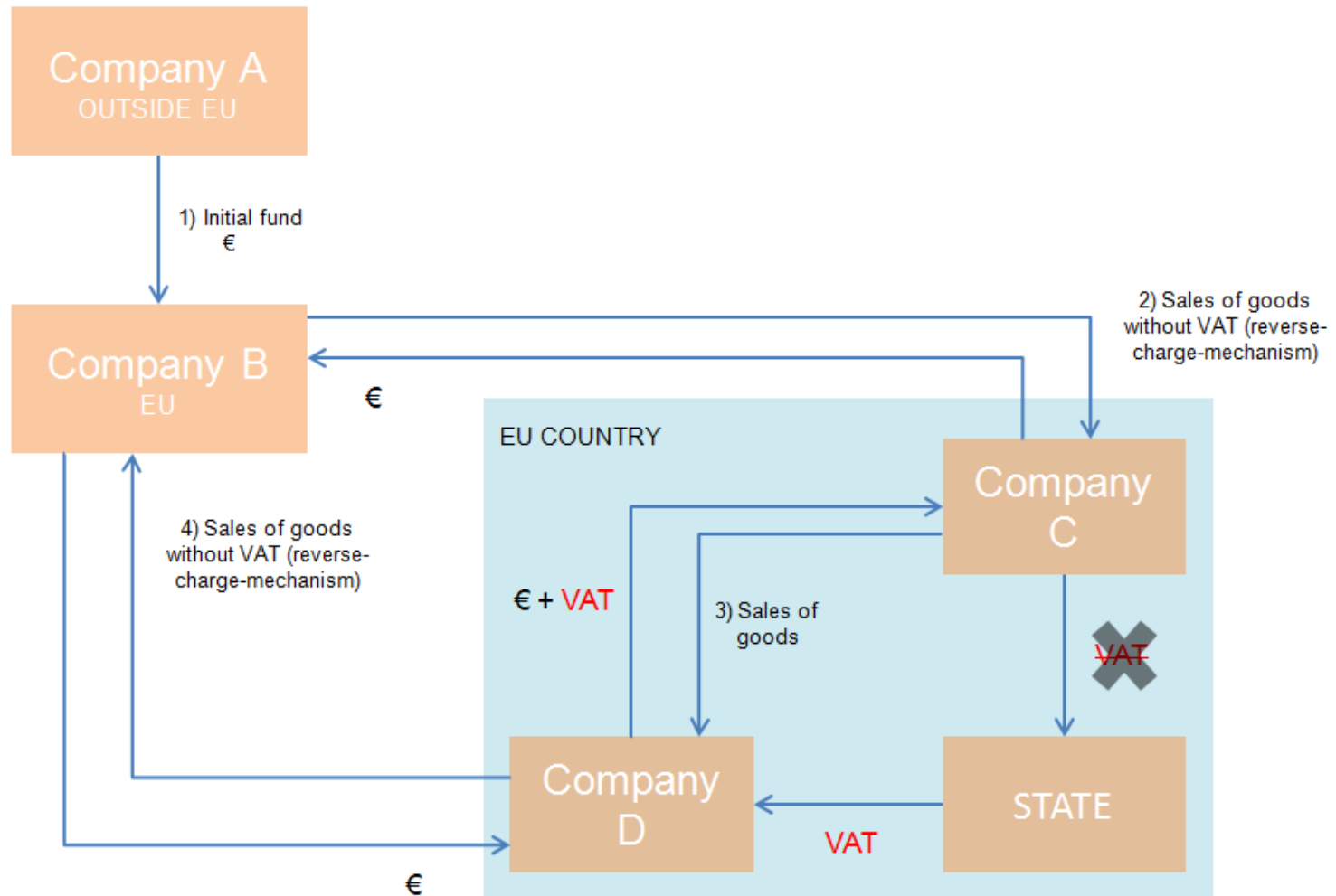
## 1.2 Our 27 members



## 2.1 VAT fraud basics: overview

- The VAT fraud mechanism, also known as Carousel Fraud or Missing Trader Intra-Community Fraud (MTIC), relies on the intra-community VAT regime.
- It requires trades between counterparts which do not pay VAT in the same country.
- In a simplified manner, VAT fraud can be summarised in three steps :
  - 1) Fraudster buys goods without VAT from a counterpart paying VAT in another country;
  - 2) Fraudster sells these goods domestically at a VAT-inclusive price;
  - 3) Fraudster disappears before paying VAT to the Tax Authorities.
- If the same goods circulates several times between companies paying VAT in different Member States, the fraud represents several times the amount of VAT levied on it, hence the term “carousel” is used.
- The fiscal damage originates when the non-paid VAT is asserted as a pre-tax by customers of the Missing Trader.

## 2.2 VAT fraud basics: carousel fraud



## 3.1 VAT fraud in emissions trading

- In 2009, carousel fraud extended to emissions trading. Criminal organisations entered the European emissions market and within a short period of time the European Exchequers were defrauded of billions of euros.
- Certain characteristics of emissions markets aided fraudsters such as:
  - The ease with which it was possible to set-up a registry account;
  - The ability to purchase emissions allowances from overseas entities and to immediately sell these allowances with VAT;
  - Lack of storage and transport requirements;
  - The instantaneous nature of the cash settlement (including VAT) for certain transactions allowing fraudsters to bank the VAT before it was due to the tax authorities.
- In reaction, legislative changes were implemented to combat the fraud. The emission market, however, had been massively damaged.

## 3.2 Why gas and electricity trading?

- As in all other sectors, fraudsters are attracted to VAT fraud because it generates large profits with a relatively low risk of prosecution.
- Gas and electricity markets have similar characteristics as emissions markets.
- The energy markets have been liberalised which has resulted in significant trading activity with big trading volumes.
- The technical requirements for trading electricity and gas (one computer, one accounting grid, ...) are minimal.
- There are no or low transportation / shipping costs.
- No entrance burden for registrations on the grid.
- Exploitable VAT Rules.
- No comprehensive monitoring of trading data.
- The place of supply is decisive – not necessary to move goods cross-border.
- No “recapitulative statements” for the delivery of electricity and gas.
- National authorities are limited in their ability to deny a suspicious company the right to obtain a shipper’s licence.
- Tax authorities and other authorities are unable to share with legitimate traders their knowledge of suspected illegal activities due to the tax secrecy.

## 3.3 What are the risks?

### ■ For Member States

- Significant financial losses for Exchequers
- Money is being laundered in the international banking system

### ■ For the market

- Legitimacy of energy trading threatened
- Competition distortion
- Worst case: repercussions for security of supply

### ■ For stakeholders

- Reputation loss
- Possible recovery of VAT loss by other parties
- Possible legal prosecution



## 3.4 Signals that our markets have been infiltrated

- Following the implementation of reverse charge on emissions transactions after 2009, many exchanges have received numerous calls from companies interested in trading power and gas.
- Since mid-2011, ten European Energy Associations have been publically addressing this concern and have pushed for long-term fiscal measures.
- In reaction, the Council of the EU adopted an anti-VAT fraud package in June 2013 as a significant preventative action allowing Member States to introduce the reverse charge mechanism on domestic trade (Domestic RCM), notably for electricity and gas transactions.
- Numerous investigations and cases have been reported by tax authorities. This has also been taken up by the media.

## 4.1 What can we do?

### ▪ **Natural Barriers to Fraudsters:**

- Special electricity/gas trading and shipping licences for traders
- Need for Balancing Agreements and the provision of bank guarantees to TSOs
- Posting of collateral
- Need for hub operator agreements
- Regulatory approval in certain Member States and a possible requirement to set up a local physical presence

### ▪ **Measures of Exchanges and Central Counter Parties:**

- High level of care and attention in the admission process
- Strict implementation of KYCR – Know Your Customer Rules
- Active market surveillance
- Regular checks of existing trading participants
- Influence legislative processes, especially regarding the introduction of the domestic reverse charge mechanism across the EU

## 4.2 Admission process

### Example: EIC Codes – Energy Identification Codes

- Significant increase of EIC Code applications
- Example from Italy: numerous companies with EIC codes
- Some potential fraudster have been identified in an early stage of admission process:

26X00000106162-5	SCORPIO POWER	IT-SCORPIO POWER	IT07788360969	Market Operator
26X00000106169-L	TORO ENERGIA	IT-TORO ENERGIAS	IT07786550967	Market Operator
26X00000106170-7	ZWILLING STROM	IT-ZWILLING STRO	IT07786630967	Market Operator
26X00000106171-4	ARIES ENERGY	IT-ARIES ENERGYS	IT07786290960	Market Operator
26X00000106183-V	VIRGO TRADING	IT-VIRGO TRADING	IT07787600969	Market Operator
26X00000106184-S	URANUS POWER	IT-URANUS POWERS	IT07793390969	Market Operator
26X00000106185-P	SATURN ENERGY	IT-SATURN ENERGY	IT07792640968	Market Operator
26X00000106186-M	PLUTO POWER	IT-PLUTO POWERS.	IT07792260965	Market Operator
26X00000106187-J	NEPTUNE TRADING	IT-NEPTUNE TRADI	IT07792430964	Market Operator
26X00000106188-G	FISCH STROM	IT-FISCH STROMS.	IT07793350963	Market Operator
26X00000106189-D	LIBRA ENERGY	IT-LIBRA ENERGYS	IT07787670962	Market Operator
26X00000106210-Q	LEO POWER	IT-LEO POWERS.r.	IT07787380968	Market Operator
26X00000106211-N	SAGITTARIUS TRADING	IT-SAGITTARIUS T	IT07788430960	Market Operator
26X00000106212-K	ACQUARIO ENERGIA	IT-ACQUARIO ENER	IT07787920961	Market Operator
26X00000106214-E	JUPITER TRADING	IT-JUPITER TRADI	IT07793530960	Market Operator
26X00000106216-8	VENUS ENERGY	IT-VENUS ENERGYS	IT07791750966	Market Operator
26X00000106217-5	MARTE ENERGIA	IT-MARTE ENERGIA	IT07791850964	Market Operator
26X00000106218-2	MERCURIO ENERGIA	IT-MERCURIO ENER	IT07793310967	Market Operator

## 4.3 KYC processes

There is no comprehensive KYC checklist to follow, however:

- **Look at the bigger picture, apply common sense and look into details!**
- What is the counterpart's main business and why do they want to trade? If a trader is specialising in property development and wishes to suddenly trade power and gas, this might be a warning sign.
- Look at payment terms. Traders who require short term settlement or are willing to make pre-payments may be suspicious.
- Screening counterparts, extensive use of commercial rating agencies.
- Company details verified by Companies House or other equivalent agencies.
- What is the legal structure of the counterpart?
- Has the trading part of the company experienced trading staff ?
- Where is the company located and to whom are the payments to be made?
- Tax numbers / VAT numbers and comparison with known data.
- Etc.

## 4.4 Introduction of domestic reverse charge

- As a result of intense lobbying work, the Council of the EU amended the existing 2006 EU VAT Directive in 2013 and now allows all EU Member States to implement a Domestic Reverse Charge Mechanism.
- This mechanism enables the seller to invoice energy deliveries without domestic VAT. The VAT liability shifts to the buyer of the energy contract.
- BUT: Precondition: reseller of energy, not applicable in case of producers.
  - Limited until end of 2018 with prior consultation process
  - Extension? Expectation: YES. But sure?
  - VAT fraudster are moving to countries without Domestic Reverse Charge Mechanism.
- Fundamental demand for a full implementation and application of the Domestic Reverse Charge Mechanism in all EU Member States in national legislation or as a minimum an unlimited extension of the above mentioned derogation.

## 4.5 Different Reverse Charge Mechanisms

### “International” Reverse Charge Mechanism

- Legal basis: **Article 38/39** of the EU VAT Directive (place of supply) + **Article 195** of the VAT Directive (reverse charge mechanism)
- Applicable in case of gas and electricity deliveries between two taxable dealers with their seats of business **in different countries**
- Member States are obliged to implement and apply the international RCM → **fully implemented**
- All such contracts will be invoiced without VAT
- The recipient is obliged to calculate and to pay VAT, eventually with the right of an input tax deduction
- **NO obligation of VAT registration** for the deliverer in the country of the buyer

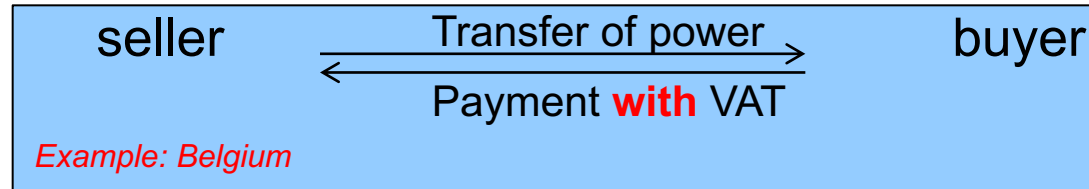
### “Domestic” Reverse Charge Mechanism

- Legal basis: **Article 38/39** of the EU VAT Directive (place of supply) + **Article 199a** of the VAT Directive (reverse charge mechanism)
- Applicable in case of gas and electricity deliveries between two taxable dealers with their seats of business in the **same country**
- **Possibility** but no obligation to implement and apply the derogation at Member State level
- All such contracts will be invoiced without VAT
- The recipient is obliged to calculate and to pay VAT, eventually with the right of an input tax deduction
- **Normal obligation of VAT registration** for the deliverer in the country of the buyer

➔ **Important to introduce the DOMESTIC reverse charge mechanism for an effective prevention of VAT fraud in energy trading!**

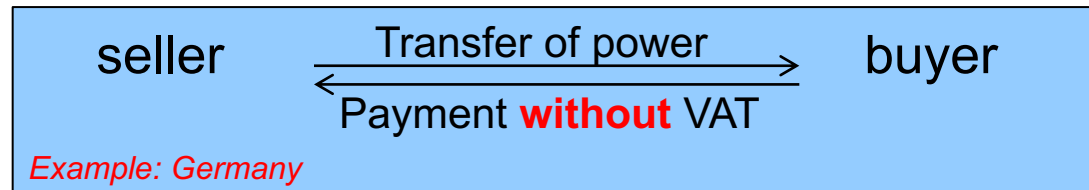
## 4.6 D-RCM: how it works

1. Usually:



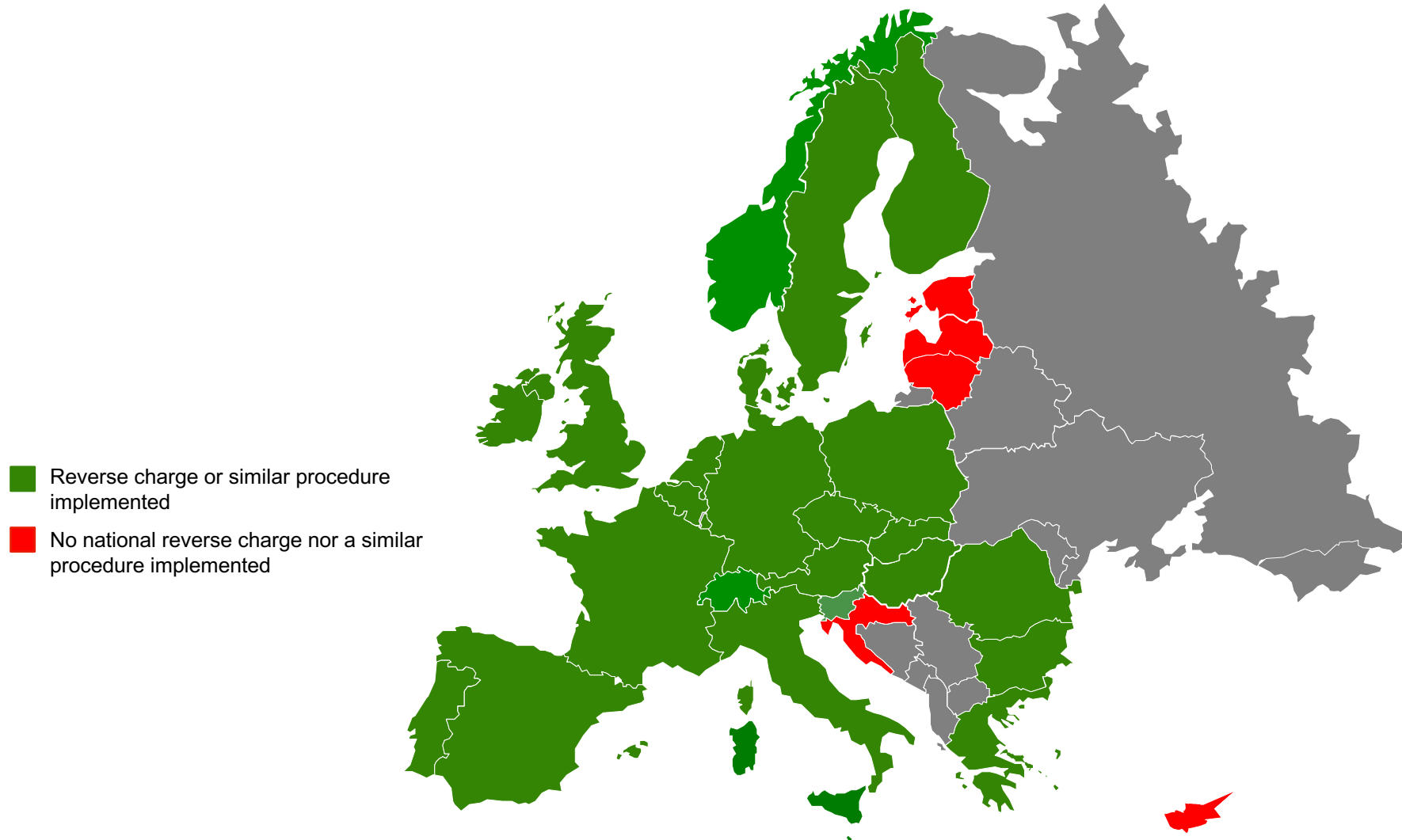
- a) seller in wholesale is obliged to pay VAT to tax authority: e.g. 100 EUR
- b) buyer in wholesale has the right of input tax deduction: e. g. – 100 EUR
- c) point of view tax authority:  $100 - 100 = 0$
- c) **risk of tax authority: loss of VAT from the seller – point a)**

2. With domestic reverse charge mechanism:



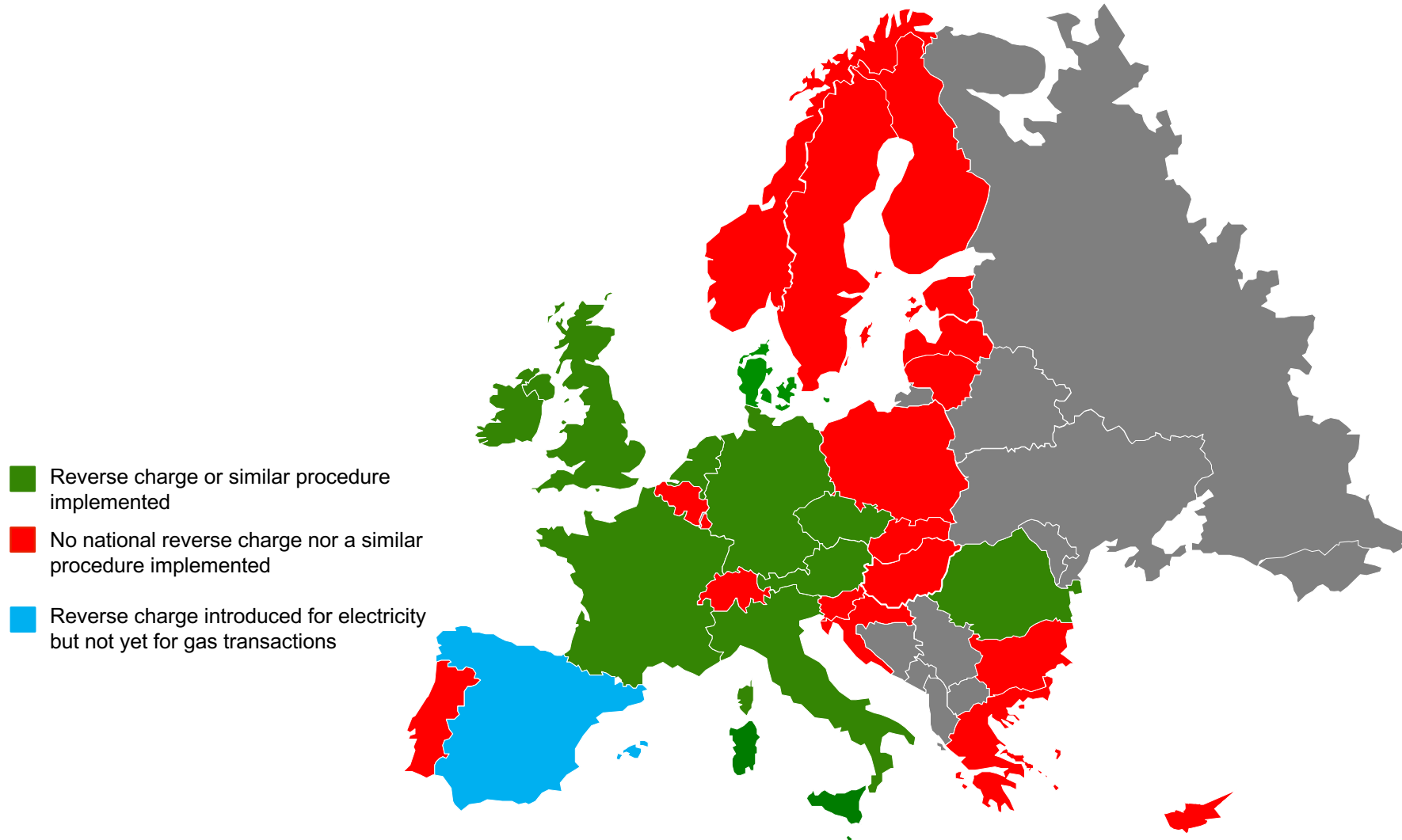
- a) The buyer is obliged to calculate VAT and to pay this VAT, but he has an input tax with the same amount which can be settled:  $100 - 100 = 0 = \text{no payment to tax authority}$
- b) No obligation for the seller to pay VAT
- c) **tax authorities is not obliged to pay out VAT = no risk to lose VAT to VAT fraud**

## 4.6 RCM coverage for emission allowances

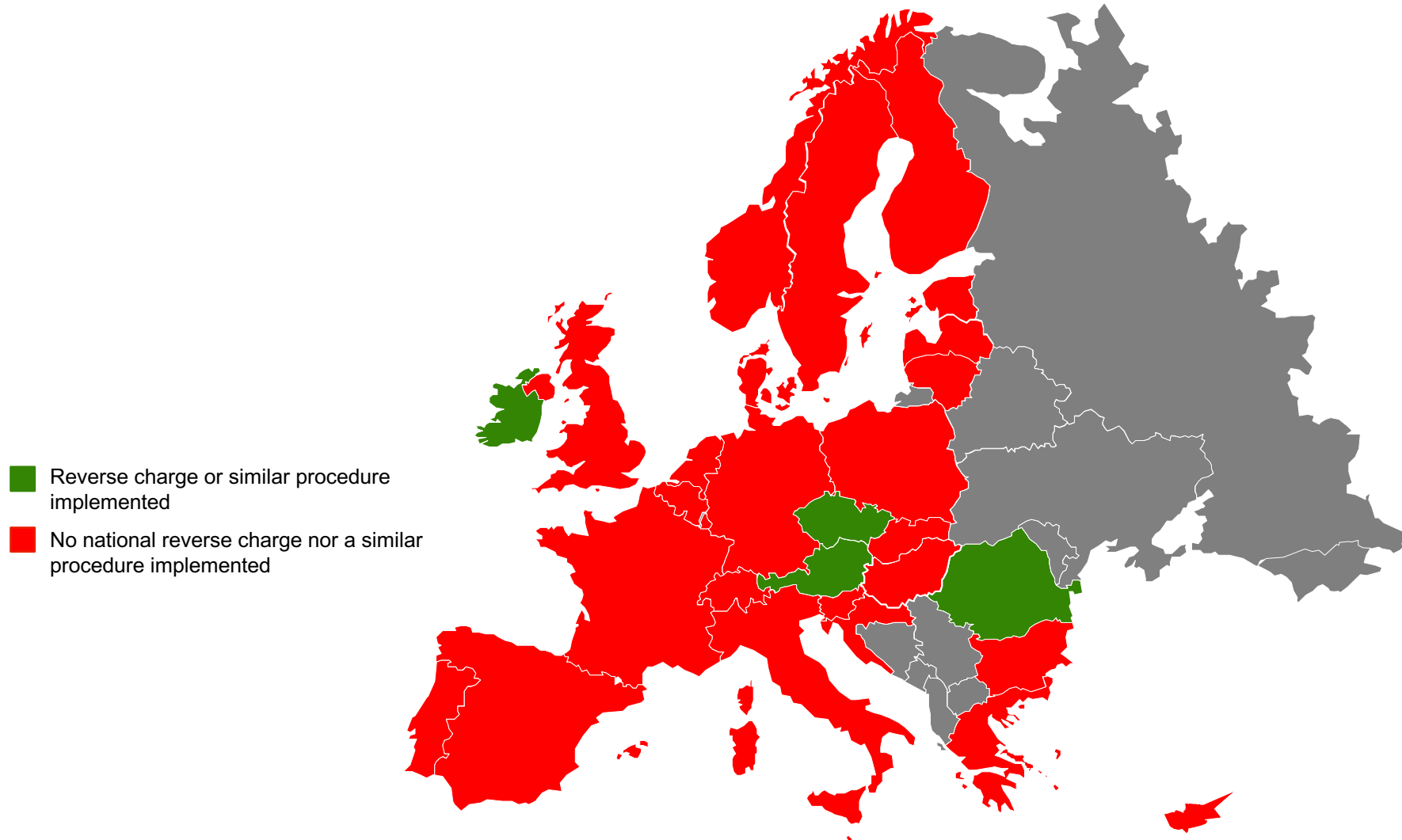




## 4.7 RCM coverage for gas and electricity



## 4.8 RCM coverage for guarantees of origin



EU-Member State *)	Gas- and Power *)	EUA *)	Guarantees of Origin *)
Austria	Yes	Yes	YES
Belgium	No	Yes	No
Bulgaria	No	Yes	No
Croatia	No	unkown	No
Cyprus	No	No	No
Czech Republic	Yes (01.02.2016)	Yes	Yes (01.02.2016)
Denmark	Yes (01.07.2015)	Yes	No
Estonia	No	No	No
Finland	No	Yes	No
France	Yes	Yes	No
Germany	Yes	Yes	No
Greece	No	Yes	No
Hungary	No	Yes	No
Ireland	Yes (01.01.2016)	Yes	Yes (01.01.2016)
Italy	Yes (01.01.2015)	Yes	Yes
Latvia	No	No	No
Lithuania	No	No	No
Luxembourg	No	Yes	No
Malta	No	No	No
Netherlands	Yes	Yes	No
Poland	No	Yes	No
Portugal	No	Yes	No
Romania	Yes	Yes	Yes
Slovakia	No	Yes	No
Spain	So far only applying to power	Yes	No
United Kingdom	Yes	Yes	No
Norway (non-EU)	No	Yes	No
Switzerland (non-EU)	No	Yes	No

\*Disclaimer: no responsibility taken for correctness of the displayed information

## 5. Active European Market Surveillance

### REMIT – a solution to go further

- **REMIT constitutes a central solution to detect VAT fraud**
  - Regulation on wholesale Energy Market Integrity and Transparency
  - Applies to electricity and gas trading
  - Centralised collection and storage of trading data
  - Active market surveillance by ACER and NRAs
  
- **ACER in cooperation with National Regulatory Authorities can detect, investigate and report VAT fraud cases**
  - ACER will monitor all transactions and is in charge to coordinate actions
  - National Regulatory Authorities (NRAs) have investigation and enforcement powers

**However: the detection and prosecution of fraud is only a second best solution. Prevention is more efficient and ultimately the better way forward!**

## 6. Conclusion

- **Take VAT fraud seriously:**
  - Be constantly cautious.
  - Alert the relevant authorities, if suspicions arise.
  - Keep raising awareness on the danger energy markets are exposed to.
  
- An International Reverse Charge Mechanism like the EU system can avoid non-taxation, double taxation and related discussions = highly effective system.
  
- A concerted **Domestic Reverse Charge Mechanism** can pull the carpet under the fraudsters' feet.
  
- Other points to ease trading in energy:
  - Assurance that special energy taxes are not applicable in case of solely wholesale trading activities (no consumption)
  - No registration obligations or tax declaration obligations in case of using an international reverse charge mechanism.
  - ....

**Thank you for your attention.**

## Contact

Europex  
Rue Archimède 44  
1000 Brussels – Belgium

Tel +32 2 512 34 10  
E-mail [secretariat@europex.org](mailto:secretariat@europex.org)  
Home [www.europex.org](http://www.europex.org)