

# Should the *Italmoda* Jurisprudence Apply to Carousel Fraud Involving Services? The ECJ's Pending *Climate Corporation Emissions Trading* Case

**In the well-known *Italmoda* case, the ECJ decided that the exemption (zero rate) of the intra-Community supply should be denied when the supplier “knew or should have known” that, by his supply, he was participating in a transaction connected with fraudulent evasion of VAT. In the pending *Climate Corporation Emissions Trading* case, the question is raised whether a similar approach should apply to intra-Community supplies of services. In this article, the author suggests that this pending case highlights the urgent need for a comprehensive solution to the issue of carousel fraud in the European Union.**

## 1. The Facts and the Question Referred to the ECJ in the *Climate Corporation Emissions Trading* Case

In 2010, an Austrian company sold greenhouse gas emission allowances to a German company. The German company was a “buffer” participating in a carousel fraud. According to the Austrian tax authorities, the Austrian company should have known that those greenhouse gas emission allowances would subsequently be used to evade VAT in a Member State other than Austria. As they initially took the view that the transfer of greenhouse gas emission allowances qualifies as a supply of goods, they applied the Court of Justice of the European Union (ECJ) *Italmoda*<sup>1</sup> jurisprudence, whereby the exemption (zero rate) of the intra-Community supply should be denied when the supplier “knew or should have known” that the supply would be used to evade VAT.<sup>2</sup> In other words, the Austrian tax

authorities requested the payment of output VAT by the Austrian company on the supply to the German buffer.

The question of the correct qualification of the supply was rapidly solved (the transfer of gas emission allowances indeed qualifies without a doubt as a service for VAT purposes). However, the referring court (the Austrian *Bundesfinanzgericht*) decided to raise the following question to the ECJ on 20 October 2021:

Is Directive 2006/112/EC, as amended by Directive 2008/8/EC, to be interpreted as meaning that the national authorities and courts must regard the place of supply of a service, which, under the written law, is formally located in the other Member State, in which the recipient of the supply is established, as being within the national territory if the domestic taxable person supplying the service should have known that, in supplying it, he or she was participating in value added tax evasion committed in the context of a chain of supplies?<sup>3</sup>

From the preliminary ruling request it appears that the referring court wonders whether the decision in the *Italmoda* case should not apply by analogy, with the result that contrary to the wording of article 44 of the VAT Directive<sup>4</sup> (whereby B2B services are, as a main rule, taxed at the place where the taxable person receiving the service has established his business), the place of taxation should be regarded as being in Austria.

## 2. Tentative Answer

We have known for years now that carousel fraud does not only concern goods but also sometimes services.<sup>5</sup> Carousel fraud involving greenhouse gas emission allowances, in particular, have proven extremely “bankable” for the fraudsters and damaging for the Member States.<sup>6</sup>

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1. NL: ECJ, 18 Dec. 2014, Case C-131/13, *Staatssecretaris van Financiën v. Schoenimport „Italmoda” Mariano Previti vof and Turbu.com BV, Turbu.com Mobile Phone’s BV v. Staatssecretaris van Financiën*, Case Law IBFD (accessed 5 Apr. 2022).  
2. See also previous decision in DE: ECJ, 7 Dec. 2010, Case C-285/09, *Criminal proceedings against R*, Case Law IBFD (accessed 5 Apr. 2022) and similar decisions in UK: ECJ, 12 Jan. 2006, Joined Cases C 354/03, C-355/03 and C-484/03, *Optigen Ltd, Fulcrum Electronics Ltd (and Bond House Systems Ltd v. Commissioners of Customs & Excise*, Case Law IBFD (accessed 5 Apr. 2022) and BE: ECJ, 6 July 2006, Case C-439/04, *Axel Kittel v. État belge and État belge v. Recolta Recycling SPRL*, Case Law IBFD (accessed 25 Apr. 2022). In the latter cases it is the right to deduct and not the exemption that was denied to the taxable person.

3. Question raised in AT: ECJ, 20 Oct. 2021, Case C-641/21, *Climate Corporation Emissions Trading GmbH v. Finanzamt Österreich*, Case Law IBFD (accessed 5 Apr. 2022).

4. Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006), Primary Sources IBFD [hereinafter VAT Directive].

5. N. Hangáčová & T. Strémy, *Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic*, 26 European Journal of Crime, Criminal Law and Criminal Justice 2 (2018).

6. Studies have shown that in this sector an “initial investment” of EUR 100 million could be “multiplied” through a VAT carousel into EUR 600 million within a few hours. M-C. Frunza, *Aftermath of the VAT fraud on carbon emissions markets*, 20 Journal of Financial Crime 2, p. 225 (2013); See also K. Nield, *Fraud on the European Union Emissions Trading Scheme: Effects, Vulnerabilities and Regulatory Reform*, 20 European Energy and Environmental Law Review 6, pp. 255-289 (2011); I. Bilbao Estrada & J. Rodriguez Marquez, *VAT Fraud and Emission Allowances*, 19 EC Tax Review 5, pp. 210-227 (2010); see also R.A. Wolf, *The*

At first sight, one may consider it logical that case law decided in the context of carousel fraud schemes involving goods is also applicable to carousel fraud schemes involving services. However, while both goods and services are in practice taxed “at destination” when sold cross border (and should both be reported in recapitulative statements), the VAT treatment of intra-Community supplies of *goods* and *services* is technically very different. As a matter of fact, in the previous case (goods) there are two taxable events: one is a taxable (but exempt (zero-rated)) supply in the Member State of departure of the goods<sup>7</sup> and the other a taxable acquisition in the Member State of arrival,<sup>8</sup> while in the latter case (services) there is only one taxable supply in the Member State of establishment of the customer.<sup>9</sup> In the case of intra-Community supplies involving goods, denying the exemption of the intra-Community supplies automatically makes the supply taxable locally in the Member State of departure of the goods, irrespective of whether it is also taxable in the Member State of acquisition. In contrast, in the case of intra-Community supplies of services, taxation at destination is not technically obtained by creating a double taxable event and exempting (zero rating) the first one, but simply by locating the supply in the Member State of establishment of the customer. Accordingly, the Member State where the supplier is established cannot “deny” an exemption that would result in domestic taxation. Therefore, even if the knowledge of fraud can be demonstrated, there is, in the author’s view, no ground for taxation in the Member State of the supplier in the case of services.

Based on the above, it seems reasonable to expect that the ECJ will decide that the *Italmoda* case law does not apply to services (and does not allow a Member State to change the place of taxation of services).

A question that arises is whether “knowledge of a fraud committed by a third party” could allow a Member State to decide that VAT is also payable on its territory, in addition to taxation in another Member State.<sup>10</sup> In this case, the payment of the VAT would not be meant to repair a damage caused to the state (as there is no loss of revenue in that state) but would rather be meant to punish the taxable person for its participation to a fraud resulting in a loss of revenue in another Member State. Therefore, the sanction would qualify as a penalty that is “criminal in nature”,<sup>11</sup> to which article 49 of the EU Charter (which provides that “[t]he severity of penalties must not be disproportionate

to the criminal offence”) applies.<sup>12</sup> Depending on how “proportionality” would be assessed in this case, where there is admittedly only “passive participation to a fraud”, the outcome may be that such a penalty is contrary to EU law. This is also a difference with the *Italmoda* case, in which the ECJ clarified that payment of output VAT in the Member State of departure of the goods is not to be regarded as a penalty imposed by the Member State of the supplier, but as a mere result of not satisfying the conditions for the exemption (zero rate), and therefore cannot be assessed in the light of article 49 of the Charter.<sup>13</sup>

### 3. Is This Bad News for the Fight against Fraud?

The (expected) decision that the *Italmoda* jurisprudence is not applicable by analogy to carousel fraud involving services may crush the hopes of some Member States eager to improve the fight against carousel fraud.

However, many authors and practitioners already highlighted that this line of case law is not an appropriate answer to the problem, mainly because the fraudsters themselves remain unpunished and because sometimes honest traders who have been too lenient are unfairly sanctioned.<sup>14</sup> Whether this line of case law prompts honest traders to be more careful and does effectively render the fraud more difficult also remains very uncertain. According to recent figures, carousel fraud is indeed still estimated to result in losses of around EUR 60 billion for the Member States annually.<sup>15</sup>

At the end of the day, the pending *Climate Corporation Emissions Trading* case actually sheds light on the fact that it is high time that the Member States take concrete actions against carousel fraud. Significant improvements have been achieved in terms of administrative assistance and detection of the fraud in the past ten years, for example with the creation of Eurofisc<sup>16</sup> and the use of new technologies such as the TNA.<sup>17</sup> However, it is striking that

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*Sad History of Carbon Carousels*, 21 Intl. VAT Monitor 6 (2010), Journal Articles & Opinion Pieces IBFD (accessed 5 Apr. 2022).

7. Arts. 2(1)(a) and 138 VAT Directive.

8. Art. 2(1)(b) VAT Directive.

9. Arts. 2(1)(c) and 44 VAT Directive.

10. In the VAT Directive, the only example where a Member State may decide to tax in its territory even though the normally applicable place-of-supply rule would allocate the power to tax to another jurisdiction is article 59a (the so-called “use and enjoyment” clause), which should in principle only be used to prevent double or unintentional non-taxation and only applies in situations where a supply is normally taxable in a third country but is enjoyed in Member State and vice versa.

11. IT: ECJ, 20 Mar. 2018, Case C-524/15, *Criminal proceedings against Luca Menci, intervening parties: Procura della Repubblica*, Case Law IBFD (accessed 5 Apr. 2022).

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 12. In accordance with art. 6(1) Treaty on European Union of 13 December 2007, OJ C306 (2007), Primary Sources IBFD, the Charter of Fundamental Rights of the European Union, OJ C326 (2012), Primary Sources IBFD, has the same value as the EU Treaties. In other words, the Charter constitutes Primary EU law.

13. To be noted, however, that the case is now pending before the European Court of Human Rights in Strasbourg as, in the view of the taxable person, the payment of output VAT in these circumstances should in fact be qualified as a penalty, with the consequence that articles of the European Convention on Human Rights concerning penalties (e.g. *ne bis in idem*, proportionality of the sentences) should be applicable.

14. See for example R. De La Feria, *Tax Fraud and the Rule of Law*, Working Paper 18/02, p. 2 et seq., with further references (University of Leeds 2018); M. Lamensch & E. Ceci, *VAT fraud, Economic impact, challenges and policy issues*, Study performed at the request of the European Parliament (2018), available at [https://www.europarl.europa.eu/thinktank/en/document/IPOL\\_STU\(2018\)626076](https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2018)626076) (accessed 29 Apr. 2022).

15. As reported in European Commission, amended proposal for a Council Regulation amending EU Regulation No. 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, 30 Nov. 2017, COM(2017) 706 final. See also European Court of Auditors, *Tackling Intra-Community VAT fraud: More action needed*, Special report 2015/24, p. 9 (ECA 2015).

16. Council Regulation (EU) 904/2010 of 7 October 2010 on Administrative Cooperation and Combating Fraud in the Field of Value Added Tax, OJ L268 (2010), Primary Sources IBFD.

17. The Transaction Network Analysis (TNA) was developed to rapidly exchange and jointly process VAT data. TNA enables Eurofisc to detect suspicious networks earlier and more efficiently (in a nutshell, TNA

the amount of VAT lost every year on account of carousel fraud remains extremely high.<sup>18</sup>

After the setback of the “definitive system proposal” which has been stalling in the Council of the European Union since 2017,<sup>19</sup> the European Commission has

performs an automated selection of information already available in the VIES system according to risk indicators. The system allows an automated, faster and more precise detection of fraudulent chains. It also allows chains of transactions and companies that may be involved in fraud to be identified).

18. As noted above, carousel fraud would result in a loss of around EUR 60 billion annually. For the record, the Member States have agreed on commitments amounting to EUR 49.7 billion to support the recovery by boosting investments in economic, social and territorial cohesion in 2022, which is thus less than what Member States lose every year on account of carousel fraud.
19. The “definitive” regime proposal consists of three proposals: Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final, Primary Sources IBFD; Proposal for a Council Implementing Regulation amending Implementing Regulation (EU) 282/2011 as regards certain exemptions for

launched a study on VAT and the digital age<sup>20</sup> and a public consultation.<sup>21</sup> It is expected to publish a proposal before the end of the year. Let us hope that this proposal will enable Member States to eradicate carousel fraud schemes involving goods and services altogether and allow us to forget that the “knew or should have known” case law once was one of the ultimate tools used by tax authorities to tackle VAT fraud.

- intra-Community transactions, COM(2017) 568 final, Primary Sources IBFD; and Proposal for a Council Regulation amending Regulation (EU) 904/2010 as regards the certified taxable person, COM(2017) 567. See also Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final (2018), Primary Sources IBFD.
20. See <https://www.case-research.eu/en/vat-in-the-digital-age-101548> (accessed 5 Apr. 2022).
21. See [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13186-VAT-in-the-digital-age/public-consultation\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13186-VAT-in-the-digital-age/public-consultation_en) (accessed 5 Apr. 2022).



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