

# **Organised forms of tax evasion and their management by the government in certain Eastern-European Member States**

**Presentation at the conference  
on the 4th of February 2015 in the European Parliament**

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## **My experience about the VAT fraud investigations in Hungary**

Between 1999 and 2013 I worked at the Hungarian Tax Authority. My field was the exploration of successive and organised (frequently cross-border) tax fraud. I worked out a specific investigative and analytical method for tracing such crimes. In 2010, as a result of my previously accumulated experience and an organisational change in the authority, I was able to extend the scope of my investigative activities to the large taxpayers of Hungary (multinational companies included) as an investigation specialist coordinator. In 2011, I exposed the complex and nation-wide system of the tax fraud network operating in Hungary in the field of corn and oilseeds trade, including their Slovakian and Romanian ramifications. As the result of my work a unique, complex inspectorial project began to investigate the procurement network of three multinational companies, and I could also take part in the first phase of the work – until I was removed from the project.

During this work, I have become conscious about the fact that there were hardly any so-called pre-allocation VAT-checks at large taxpayers (in the organisational units dedicated to their investigation) in the previous years, and – considering the fact that they operated in an area that is heavily infected by tax abuse and they had close connections with tax fraud networks – even other type of checks have finished with only modest results. According to my insight this control system – deemed discriminatory by me – is one of the main reasons for the sad fact that organised criminal groups siphon off money from the VAT-incomes and other types of tax revenues (social contributions, company tax etc.) in Hungary at a magnitude of **1000 billion HUF yearly**. This discriminatory system is upheld by administrative instruments and instruments of power, and anyone who goes against it will be cast aside in many cases. This is what I call institutionalized corruption. I also highlighted the fact that the Tax Authority moves in the direction of the easiest solutions, they make assessments of tax deficit by the companies that are situated in the lower layers of the networks (missing traders, intermediaries), and as an immediate consequence of this, there is an extremely large amount of irrecoverable due taxes.

## **My reports to the government**

Considering the fact that no opportunity presented itself within the Tax Authority to eliminate the described conditions, I addressed high level political actors of the ruling party and officers of the government in November 2011 and later in 2012 to seek help in the examination and solution of the problem. No changes were made in merit, quite the opposite: the organisational unit that was established for the investigation of cross-border successive VAT-fraud and which had a national competence was terminated on the 31st of December 2012 (after a series of cut-backs).

As I could not find any other way for revealing the operations of the Tax Authority that were in contravention of the public interest, I stepped before the public at a press conference on the 8<sup>th</sup> November 2013. There I reported about the grave fiscal damages of organised tax fraud, which I have explored during my work at the Tax Authority, and the closely related problems in its operational scheme. At the same time I have filed a complaint on the ground of abuse of office – presumably with a corruption background – as regards to the cases witnessed during my service at the Tax Authority, upon which the public prosecutor's office has ordered an investigation. This investigation has been going on for more than a year now accompanied by full news-blackout; after the outbreak of the so-called “ban scandal” they disclosed only the fact that there is one suspect in the case. (In October 2014 it has become public that the US Government had previously ordered an entry ban regarding several senior level officials at the Tax Authority because they have taken part in corruption activities.) In March 2014 another ex-colleague of mine from the Tax Authority, dr. István Vancsura also stepped before the public, pointing out the abuses of office which occurred at the Large Taxpayer Directorate. (This was the unit that was terminated on the 31st of December 2012.)

### **Governmental endeavours for hushing up the case and for intimidating the whistle-blowers**

The Tax Authority sued me for “suspicion of data breach” and for “defamation”, yet I have not been called to the court as a suspect, nor have I been interrogated in relation to these cases. The Tax Authority’s complaints were based upon an internal investigation which *they had conducted during one weekend*, and as a result of which *they declared about themselves* that they had not made mistakes, and the whistle-blower’s accusations are unfounded – *according to them*. Since then I disproved all of their “findings” in a comprehensive analysis.

My home was raided by the police who searched for Tax Authority documents in relation to my filed complaints. In the autumn of 2014, the Tax Authority sued the news portal *atlatszo.hu* (which deals with investigative journalism) for defamation – this very news portal has dealt in many articles with the statements of the two whistle-blowers and the related background information. In December 2014 the Tax Authority also sued me and István Jávör, a university researcher and sociologist, for defamation and libel, requesting a compensation of HUF 3 million from each of us on the basis of our public statements and our opinions regarding the assumed corruption of the Tax Authority’s leaders. The court called upon the Tax Authority to file in a new complaint because of defaults in their first submission.

Meanwhile the authorities refuse to have any dialogue with the whistle-blowers. There has not been a single investigation by the government or any of its bodies regarding our statements. So far we have not heard of any impeachment proceedings regarding the leaders of the Tax Authority who may have had a role in the abuse of office described by the whistle-blowers, and they are still in their position. Regarding those senior level leaders of the Tax Authority who were banned by the US Government from entering the US (among whom the President of the Tax Authority admitted being affected herself) no governmental investigation was started, and the Hungarian Government is not willing to name the other leaders of the Tax Authority banned from the US. By contrast, reacting upon the call to action by Prime Minister Viktor Orbán, the Tax Authority sued the *André Goodfriend, Chargé d’affaires* of the United States to Hungary for defamation.

The parties of the opposition have initiated the establishment of a Parliamentary investigation committee several times since my announcement in November 2013 for exploring the tax fraud and their governmental and political background, nevertheless the governing party (the Parliamentary majority) obstructed the establishment and operation of such a committee. This is where we are now, at the beginning of February 2015.

## **The international ramifications of tax fraud in Hungary**

I called the attention to the specific Central European cooperation in which the tax fraud networks damage the budget of the Member States at a significant scale with the involvement of Slovakian, Hungarian and Romanian citizens (and from time to time, Czech companies) on several occasions: in the assessment I performed after leaving the Tax Authority, in my notices to governmental actors and during my public interviews. If we observe the ownership-structure of tax fraud networks operating in the field of corn trade and food trade, we can establish that a significant proportion of these Slovakian companies have Hungarian managing directors and owners, and many of them are people who founded companies for dealing with fictitious transactions – many of which had already gone bankrupt. It is also characteristic that these Hungarian or Slovakian pre-bankruptcy companies are phantomized by Romanian citizens registered as their owners, but we can also witness reverse processes, in some cases with regard to Czech companies as well. All this shows that – and I highlighted this to the decision-makers as well – the immediate co-operational level and information swapping capacity (or its speed) lags far behind from the level that would be needed for the investigation of regional level tax fraud networks operating in countries that are complementary from the point of view of tax fraud.

Romania has implemented a reverse VAT for some agricultural products from July 2011. During my analytical work I made the observation that this is the date from which we could witness a sharp rise in VAT-refund amounts that were based on purchases originating from tax fraud networks in the Hungarian grain and oilseed trade sector. (I reported my observations to my superiors as well.) It is fair to state that the changes in the taxation system made in a neighbouring country imposed further budgetary burdens in Hungary, because the liberated capacity of organized criminal groups has been used in the other country. A year later Hungary also introduced the reverse VAT mechanism in the above mentioned trade sector. And the next victim of negligence – it is easy to guess – was Slovakia.

These processes are going on with regard to other products as well. The food industry sector is a good example for that, especially because in the European Union the VAT-rates are the highest in this region (Romania, Slovakia, and Hungary – the latter having the highest VAT-rate); this way it is no wonder that the burdens are passed over, nor the fact that these countries are tax fraud-havens. In the second half of 2013 the VAT-rate of flour was reduced in a significant extent in Romania, but the higher VAT-rate remained in effect in Hungary – the perils of which professional organizations immediately highlighted, and the problem was not unrecognized by the Hungarian Government either. But it did not take long until the “payback”: from January 2014 the VAT of live pigs and carcasses was reduced to 5%, this way Romania and Slovakia have become the “underdogs” which posed an enormous burden on the budget of these countries.

It would be of high importance to coordinate the measures which have an impact on other Member States as well. Just recently an organized group that perpetrated fraud in the meat industry was caught in Romania, and its background network did have Hungarian relations as well. In this case allegations were made against Romanian government officials as well. Speaking about food industry: it is a characteristic trend in the EU that food products have a low VAT level, in most cases below 10%, and there are quite a few reasonable causes for this. Therefore it would be necessary to examine whether it would be necessary to introduce a uniform and lower VAT-rate throughout the EU with regard to this product group.

While the Hungarian Tax Authority obviously noticed all these problems it made a cutback on the unit dealing with international relations and transferred to other areas a significant number of its employees who had a lot of cross-border experience, a good command of foreign languages and good international relations.

## **Intensified fight against tax frauds – with less success**

Since my announcement (November 2013) the number and strength of the actions made by the Tax Authority against tax fraud networks has sharply increased according to the news publicized in the Hungarian press. However, the effectiveness of these investigations is questioned by the fact that the investigations still haven't reached the main beneficiaries of tax fraud and the revenue from the suppression of organized tax fraud networks is still quite low. With regard to more products – the inherent taxation risks of which I already highlighted – advocacy organizations and government actors have stressed the importance of implementing VAT-rate cuts or the introduction of reverse-charge mechanism. (With insufficient success until this time.) The Electronic Public Road Trade Control System was launched on the 1st of January 2015, from which the government expects to curb cross-border tax fraud. The results of the upcoming months will show if these expectations are met, yet the doubt in this is backed up by the fact that there is no substantive increase foreseen in VAT-revenues in the state budget for the year 2015. The efficiency of these type of systems would be greatly enhanced if the collected data regarding transport and sales in other countries burdened with tax fraud would be accessible online and could be shared between the authorities of Member States. Slovakia combats VAT-fraudsters with another type of software that prefers other individual strands, while we have no information about such a decision in Romania.

My notes and recommendations described above will evidently meet understanding in other regions of the European Union, because the so-called “carousel” fraud is an existing problem in other country groups as well (maybe with slightly different product focus).

There are quite a number of documents related to the topic in English and German at <http://www.levago.hu/en/campaigns/vat-fraud-and-corruption-scandal>.