

Risks associated with reverse charge VAT (2/42/18)

To fight VAT fraud, Latvia has adopted reverse-charge VAT in a number of industries. This article explores the risks facing taxable persons affected by this scheme and the precautions they can take to mitigate those risks.

In an effort to prevent input tax fraud, Latvia has adopted reverse-charge VAT on the following supplies:

1. timber and related services;
2. construction services and products;
3. scrap metal and related services;
4. smartphones, tablets, laptops, integrated circuit devices, and games consoles;
5. cereal and industrial crops;
6. unwrought precious metals, their alloys, and metals clad with precious metal;
7. metal products and related services;
8. consumer electronics and electrical household appliances.

On the one hand, reverse-charge VAT helps cut back on input tax fraud involving the goods and services listed above. On the other hand, this scheme requires extra checks and reports on domestic transactions to keep the fraud out of retail. As you may know, unlike the general procedure, where VAT is paid to the government on the value that is added at each stage of the supply chain, a reverse charge means that the last stage pays VAT to the government.

Inherent risks

Since this means that the customer will account for VAT on supplies of goods and services, the supplier should check that the customer is a VAT-registered company that will carry out this obligation.

We are aware of cases where non-taxable persons tried to buy goods free of VAT by presenting the billing details of a VAT-registered company known to them, without informing that company. In another example, a company representative buys construction products for private needs but swaps the company's bank card for his private one to pay at the cash register. As a result, the company is not aware that goods have been bought in its name nor that it is required to account for VAT.

Example

An individual wants to buy construction materials for redecoration work that cost €5,000 excluding VAT. If he buys them himself, the cost will be €6,050 (€5,000 plus 21% VAT). However, presenting the details of a VAT-registered company for the purchase will push the cost down to €5,000 (a saving of €1,050).

To mitigate this risk, the VAT Act includes the requirement for paying by bank transfer in the case of reverse-charge VAT, but fraudsters try to get round this requirement as well.

Precautions

When making a supply that involves reverse-charge VAT, it is important to verify the customer's identity and find out whether he really represents the VAT-registered company, in particular checking whether

payment is made using the company's bank card or from a bank account.

We assess this risk as particularly high in industries where purchases are comparatively expensive, such as household appliances, smartphones, and construction materials.

In the situation described in the example, the tax authority might find it hard to identify the fraudulent buyer. If the seller has failed to take precautions, the tax authority might seek to recover the VAT from the seller. To mitigate the risk of falling victim to fraudsters, we suggest revising your internal controls.

UK practice

The UK has also adopted reverse-charge VAT on smartphones and integrated circuit devices but has chosen to fight retail fraud in a different way. Reverse-charge VAT applies if the total order exceeds £5,000, so most retail transactions are kept out. In other industries where end consumers are less interested in VAT fraud, no threshold is prescribed.

In its guidelines the UK tax authority says they will not hold liable a taxable person that has completed reasonable checks including these:

- Is the taxable person's number valid and owned by the person stating it?
- Does the volume or frequency of the customer's smartphone or integrated circuit orders (i.e. a number of consecutive orders for an amount slightly below £5,000) suggest that the customer wants to escape the requirement for applying reverse-charge VAT on orders above £5,000?