Value Added Tax in European Union

Adriana Ioana Filip (Croitoru)
"Valahia" University of Targoviste,
Doctoral School of Economics and Humanities / Management, Romania
filipadrianaioana@yahoo.com
Alina Puțan
"1st of December 1918" University of Alba Iulia, Faculty of Economic Sciences,
Department of Business Administration and Marketing, Romania
putan.alina@uab.ro

Abstract

EU member states he was trying through reforms to create a system as adaptable as possible to future situations and as much as possible the full. Therefore, we find useful an analysis on the efficiency of collecting value tax added to highlight the yield of the tax mechanism. The approach to this problem started from the recent changes to this type of tax and the importance it has among all citizens of the Member States to bear this tax and because it is the largest source of income from indirect taxes. In our research, we set out to focus more on two indicators of efficiency of the VAT at the member states of the European Union, namely: the indicator for assessment of the efficiency of the VAT (VRR) and the indicator of the VAT collection deficit in percentage treatment (VAT gap).

Key words: value added tax, efficiency, gap, finance
J.E.L. classification: G0, G1

1. Introduction

The value-added tax is a consumer tax. It is perceived in all phases of production, but with the possibility of allowing firms to compensate for the tax they have paid for their own purchases of goods and services with the tax they charge for the sale of the final products of goods and services. This tax is largely applicable to all goods and services marketed in the European Union.

However, when the goods are exported, they are no longer charged VAT, and in the case of imports, the VAT tax is added to the value of the goods, to strike a balance in competition on the market of the Member States with those outside the Union. Therefore, the acceptance of this tax may also be one of the transaction taxes. However, VAT can also be characterized as an expense tax, as only consumer spending and not only actual consumption are indirectly taxed (ec.europa.eu)

According to the Court of Justice of the European Union (CJEU), it is the final consumer who supports VAT. The final consumer is the last person in the chain of transactions who does not have the possibility to pass on the amount of the tax. In most cases this is a natural person or company that does not have legal personality.

Prior to the implementation of value added tax, companies were trying to expand their business operations by integrating strategies that would result in reduced tax liabilities and increased revenues. These operations provided incentives for the introduction of a tax that would induce less distortion to the duties already implemented. The basic idea of value added tax was formulated by a German named Wilhelm von Siemens in 1920, and quite influential contributions were made by Maurice Laure in 1953.

By the end of 1960, the notion of VAT and its implementation by the countries had grown until 1970, then the pace of its spread softened for a decade, and then recovered. The table to be represented shows the number of countries that have adopted VAT depending on the regions. In the initial phase, it is Western Europe that dominates, thanks to The European communities considered its implementation necessary in a common form of sales tax, then Latin America that followed the initiative Brasileira.

South Korea, Israel, Senegal, Turkey, Indonesia and the Ivory Coast are the only countries outside these regions to have adopted VAT around 1980. At the end of this year, it began to be implemented by countries with a transitional economy, developing, especially those in Africa, followed by those in Asia, Pacific and small island economies (Liam Ebrill, Michael Keen and others, 2001).

Table no. 1 The number of countries that have adopted VAT by region

	Sub-Saharan Africa	Asia and Pacific	EU (plus Norway and Switzerland)	Central Europe and BRO[1]	North Africa and Middle East	Americas	Small Islands
2001 (April)	27 (43)	18 (24)	17 (17)	25 (26)	6 (21)	22 (26)	8 (27)
1989	4	6	15	1	4	16	1
1979	1	1	12	0	1	12	0
1969	1	0	5	0	0	2	0

Source: (Ebrill, Keen, Bodin and Summers, 2001)

The financial needs of states are diversified, due to cultural, social or historical factors. To achieve a single internal market, the Treaty of Rome was established in 1957, which provided for the harmonization of indirect taxes and the removal of customs barriers. This indirect tax-focused treaty was implemented, as it was noted that direct taxes do not have as significant an impact on the single market as indirect taxes do. Initially, the VAT system was implemented in France in 1963, but it was not in line with all the approaches of this concept. The first state to adopt the complete system was Denmark in 1967.

The increase in the implementation of the VAT system in Western Europe was accelerated by a series of EEC directives, in which it called on member states to join the European Union for harmonized adoption of the VAT system. More specifically, six directives formulating the theoretical and legislative basis for the introduction of the uniform tax on goods and services. Of the six, three had a greater impact on the form of VAT in the European Union (Anna Kowal, Grzegorz Przekota, 2021).

The first directive introduced in 1967 by the member states of the European Union focused on replacing the turnover taxes with the VAT system, and the second directive contained the structure of this system and how it should be applied. These two directives marked the beginning of the value-added taxation system. When border duties were abolished between EU member states, a transitional VAT regime was addressed, and the sixth directive came as a support in making this regime a definitive one.

Currently, more than 160 countries, including all EU member countries, have adopted the value added tax system. This spread of the VAT system has been regarded as the most remarkable event in the evolution of the tax structure since the middle of the twentieth century.

2. Theoretical background or Literature review

Under European law by introducing directive 2006/112/EC, the implementation of turnover taxes has the role of avoiding distortions that may manifest in by means of the competitive market or to avoid the occurrence of inconvenience in the free movement of goods and services.

This VAT system proved to be easily applicable nowadays, and which fee was charged at a general level and at all stages of manufacturing and processing products, but also services. This common system applied by States members must achieve neutrality in the market sector, regardless of whether the quotas/exemptions which are not sufficiently harmonized.

The transactions considered taxable are those related to the transfer of the goods owned by the owner to the buyer, on purchases made between the member states, on supplies of services, when importing goods from outside the member states of the European Union. Place taxable transactions depend on how the delivery of goods is made, that is, by transport or without, on board aircraft, ships or trains, or through distribution systems.

A term that European legislation makes known to us is the generator that has as meaning the moment when the indispensable legal conditions are manifested to give the possibility of the appearance of the VAT that becomes chargeable. It becomes chargeable when the tax authority has the right to demand payment of the VAT from the taxpayer. In the situation currently, the preparation of the tax return on VAT payment is mandatory at the period established (ec.europa.eu).

The tax base is the value of a product, a service to which the quota will be assigned corresponding. This tax base is intended to harmonize so that the application of VAT operations in the Member States leads to a level of comparison of results.

Standard VAT rate decided by the European Commission and to be applied by at least 15% of EU members are concerned and the reduced rate for a certain category of goods and services described in Annex 3 under the directive is at least 5%.

Of course, there are certain exceptions to these regulations, if the situation requires preferential treatment. Special rates are as follows: very low quota, zero share, quota of type called “parking”.

Table no. 2 VAT rates for European Union member states in 2021

Member States	Code	Super-reduced	Reduced	Standard	Parking Rate	Temporary
Belgium	BE	-	6 / 12	21	12	
Bulgaria	BG	-	9	20	-	-
Czech Republic	CZ	-	10 / 15	21	-	-
Denmark	DK	-	-	25	-	-
Germany	DE	-	7	19	-	-
Estonia	EE	-	9	20	-	-
Ireland	IE	4.8	9 / 13.5	23	13.5	21*
Greece	EL	-	6 / 13	24	-	-
Spain	ES	4	10	21	-	-
France	FR	2.1	5.5 / 10	20	-	-
Croatia	HR	-	5 / 13	25	-	-
Italy	IT	4	5 / 10	22	-	-
Cyprus	CY	-	5 / 9	19	-	-
Latvia	LV	-	5 / 12	21	-	-
Lithuania	LT	-	5 / 9	21	-	-
Luxembourg	LU	3	8	17	14	
Hungary	HU	-	5 / 18	27	-	-
Malta	MT	-	5 / 7	18	-	-
Netherlands	NL	-	9	21	-	-
Austria	AT	-	10 / 13	20	13	5**
Poland	PL	-	5 / 8	23	-	-
Portugal	PT	-	6 / 13	23	13	
Romania	RO	-	5 / 9	19	-	-
Slovenia	SI	-	5 / 9.5	22	-	-
Slovakia	SK	-	10	20	-	-
Finland	FI	-	10 /14	24	-	-
Sweden	SE	-	6 / 12	25	-	-

Source: ec.europa.eu

The very low share is found in a few of the member countries and occurs if a limited number of products and services are distributed, with quotas below 5%. The zero rate also applies to certain products or services and the final consumer does not have to pay VAT.

Quota type „*parking*" is also named intermediate share and are assigned products and services not included in the annex to the directive number three linked to VAT and quotas are not reduced more than 12%.

The previous table presents the quotas implemented by the member countries of the European Union since 2022, noting that the lowest standard quota is in Malta at 18%, and the highest in Hungary at 27%.

The Directive states that there is also the possibility of exemption from VAT, and most of them are without the right to deduct the VAT, namely to financial, social and insurance and medical care, and those with the right of deduction are for the export of goods between member States or non-EU countries.

The situation in which the goods, wholly or partly deducted, are used for their own purposes or staff and not in the company's activity, are considered onerous deliveries (onerous), except where they are offered as a gift or as samples in the interest of company activity.

3. Research methodology

By analyzing the VAT system, researchers focus on both the burden and the benefits which it brings to the economy. Special attention is focused on the effect of the size of the tax base and the tax rates on the operation of the mechanism on the market. It was found that in general, reforms that are based on broadening the tax base aim to support economic growth, as policy makers offer opportunities to invest, growth of labor, savings and consumption. Reforms in this regard have as a result social welfare and increased production.

Global economic and social changes in recent years have brought the functioning of the tax system to safety. Due to the processes of digitalization, globalization, and modernization of business models, it was necessary to adapt tax administration to them by minimizing the underground economy, expanding the base tax and optimizing key tax instruments. The challenge of fiscal transparency needs to be constantly strengthened and improved, especially those on e-commerce and fast-growing businesses (Abramova, 2021).

The pandemic caused by Covid-19 has brought some changes to the Directive 2006/112/EC, in particular with regard to e-commerce, which will grow from year 2024; will simplify the administrative mode and the compliance with the rules related to VAT, so that the fiscal environment is advantageous for small enterprises starting with the year 2025, allowing VAT exemption with the right to deduct to provide products and services on vaccines and a reduced fee on medical devices. (ec.europa.eu) The regulations in force lead to an appropriate mechanism to mark VAT efficiency.

Each member state of the European Union has implemented the VAT quotas in operation by economic, historical, political, local conditions and more. By this, the governors seek obtain a favorable return on tax. The simplest method of growing the income from taxation is the increase in the rate, but in a certain limited weight.

The improvement in the performance of the tax is noted by broadening the taxable base, using more reduced rates and exemptions, more efficient tax administration and better compliance.

In a quantitative way, the performance of tax collection was marked by the efficiency indicator of a collection of VAT. The purpose of using this indicator is to provide a comparative analysis of the ability of countries to effectively secure the potential tax base for VAT.

4. Findings

According to the study conducted by the OECD team in 2020, the efficiency of VAT collection can also be achieved through the total revenue collected when applying the standard VAT rate to full tax base (VRR). VRR highlights the income collected, in the case where the standard rate would have applied to the entire tax base.

If the default rate of taxation on consumption has a lower result, it can denote the low level of compliance, it does not necessarily refer to the level of tolling. This rate is intended to highlight the level of tax burden related to tax revenue of value added.

Tax evasion and the grey economy are leading to significant losses on national budgets the European Union's. They also greatly affect the deficit of collection of value-added tax.

The tax gap is defined as the difference between the actual tax paid and the tax that should have been paid if all natural and legal people declared in a way appropriate work of the work performed. This can also be defined as the sum of all fraud, unpaid taxes and distortions (Kowal-Pawul, 2021).

Thanks to empirical studies, indicators could be established to determine concretely the level of income that the economy of the country should collect and at the same time, causes that led to when registering the collection deficit (Barbala Mirela, 2017). The main causes that have taken to the different cashing evasion: exemptions, reduced rates, ways to avoid payment (especially the one of carousel type).

The indicator of the VAT gap can be called an indicator of efficiency tax and one of compliance. The general concept of measuring indicator the deficit is relatively simple, so it is found under the formula:

VAT gap = collection deficit at VAT

The default consumption tax rate at European Union level was in a continuous growth from 2018 to 2022. Increasing trend until 2022 highlights the interest that the state has in the indirect taxation system, as well as the share revenue from consumption taxes from total expenditure per consumption.

States of The Northern European Union are the best in this chapter with the highest rate compared to the other areas, and the southern states have the weakest performance. The values of the states in the west and the east seem to be approximately the same until 2022, in which the trend line for one of the areas is decreasing, respectively increasing for the other.

The gap between the average of the EU-north states (maximum value) and the average of the EU-South states (average value) is 3.39 pp in 2021, the biggest difference in the period analyzed. The scale had a decreasing trend until 2019, after which it began to grow. The groups of countries that keep the gap from the average are the northern and southern ones, but the other groups, such as the western group, are moving away from the average, but the eastern group is approaching.

In theory, tax would be more effective if its single rate applied to all consumer goods and services. It has been demonstrated in an empirical study that from the point of view of purely economic and political view, the most effective method is the single quota, because it eliminates additional administration and compliance costs related to exemptions and reduced quotas. However, it was also noted that in certain sectors, these exemptions related to exemptions reduced rates have also brought benefits, such as the achievement of political objectives.

A fairly simple way to measure the effectiveness and productivity that tax derived from the added value it has on the EU is by the share of VAT in GDP.

From table three, it is noted that income from indirect tax from GDP did not increase or significant reductions in the period considered at European Union level. But a continuous decrease can be noted in the case of Ireland, with the biggest difference between the year 2022 And 2021 by about 0.9 percentage points.

It has the lowest result in 2022. It can also be noted that the mechanism of the VAT system is more beneficial in emerging countries than in already developed countries, in some cases exceedingly even the average The European Union, for example, Croatia, Bulgaria, Hungary and others.

Between 2018-2022, Romania is the only country that has changed its standard rate of taxation on consumption, namely from 2018 from 20% to 19% in 2019. This change had as a result the decrease in the percentage of GDP of VAT income, but it was not so much felt at budget revenues.

Table no. 3: Share of VAT collections in GDP

	2017	2018	2019	2020	2021	2022
EU-27	7.1	7.1	7.1	6.9	7.4	7.5
EA-19	6.8	6.9	6.9	6.6	7.1	7.3
Belgium	6.7	6.7	6.6	6.3	6.7	6.5
Bulgaria	9.3	9.1	9.2	9.1	9.4	9.1
Czechia	7.6	7.6	7.5	7.4	7.6	7.9
Denmark	9.4	9.6	9.5	9.9	9.6	9.2
Germany	6.9	7.0	7.0	6.5	7.2	7.4
Estonia	9.0	9.0	8.9	8.9	9.2	9.2
Ireland	4.4	4.3	4.3	3.4	3.8	3.8
Greece	8.3	8.5	8.4	7.8	8.4	9.0
Spain	6.5	6.6	6.5	6.3	6.8	7.0
France	7.1	7.1	7.1	7.0	7.4	7.6
Croatia	12.9	13.1	13.3	12.5	13.1	13.1
Italy	6.2	6.2	6.2	6.0	6.6	7.1
Cyprus	8.5	9.0	8.9	8.1	8.8	9.7
Latvia	8.0	8.4	8.6	8.4	8.6	9.4
Lithuania	7.8	7.7	7.9	8.0	8.3	8.4
Luxembourg	5.8	5.9	5.9	5.8	5.8	6.2
Hungary	9.2	9.5	9.5	9.7	9.9	10.1
Malta	6.8	7.1	6.5	6.4	6.5	6.8
Netherlands	6.8	6.8	7.1	7.4	7.5	7.3
Austria	7.7	7.6	7.7	7.4	7.6	7.9
Poland	7.8	8.1	8.0	8.0	8.6	7.3
Portugal	8.6	8.7	8.8	8.4	8.9	9.4
Romania	6.3	6.3	6.2	6.1	6.4	6.8
Slovenia	8.1	8.2	8.2	7.5	8.2	8.2
Slovakia	7.0	7.0	7.2	7.3	7.5	7.7
Finland	9.0	9.2	9.2	9.2	9.4	9.3
Sweden	9.2	9.2	9.1	9.2	9.1	9.2

Source: Extracted from EUROSTAT website

A more complex version that is also used in statistics for OECD countries, where effectiveness is rendered, is the VRR indicator, becoming a tool through which they can determine the gaps related to the income from consumption taxation.

It's called a regime of pure VAT that situation in which all final consumer expenditure applies to the standard rate. It assumes in theory that the state whose VRR indicator is closer to the value 1, that he'd have a regimen as pure as possible.

The existence of situations where the indicator exceeds value 1 arises because of deviations from the single quota which is applied to all final consumptions, and exceptions and non-collection of tax revenue were not considered.

The moment VRR of the state is close to value 1, this aspect designates that the country can effectively collect their taxes on a large scale, and otherwise, they could designate errors or incompetence of collection of fees. (OECD 2020).

5. Conclusions

It can be concluded that the member states of the European Union in the west have achieved the best results in both the VRR indicator and the VAT gap indicator in percentage treatment. It is worth noting that the deficit of collection the average of the tax at the level of the member states of the European Union decreases with the passage of time, even though consumption increased by 2020.

It was found that the value of the quota’s standard does not particularly attract VAT fraud, as noted in the case Croatia and Sweden, and Romania whose deficit is the most at the level of the state’s members of the EU have the standard quota below the average of the standard EU quota.

A simple way for member states to increase budget revenues was the high level of standard quotas, because the average standard rate at the level of EU states is approximately 6 p.p. higher than the standard minimum rate allowed by the European Commission.

The COVID-19 pandemic affected the volume of VAT receipts by reducing consumption, but the performance of tax collection was not affected, on the contrary increased in 2020.

By calculating the indicators, I have noted that, over the years of analysis, there has been no increase in the standard rates of VAT, except for Romania in the year 2019, and yet the indicators highlighted the performance of the system, which designates that there are several positive factors of influence of the system.

6. References

- Ebrill, L., Keen, M., Bodin, J.P., Summers, V., 2001. *The modern VAT*, International Monetary Fund, p. 242, https://doi.org/10.5089/9781589060265.071
- Bird, R. and P. Gendron, 2007. *The VAT in Developing and Transitional Countries*. Cambridge: Cambridge University Press, https://doi.org/10.1017/cbo9780511619366
- European Commission, Directorate General for Taxation and Customs Union, 2021. *Reports related to VAT rates applied in the Member States of the European Union*. [online] Available on: https://taxation-customs.ec.europa.eu/
- European Commission, 2021. *VAT rules for financial and insurance services*. [online] Available on: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12671-VAT-rules-forfinancial-and-insurance-services-review/public-consultation_en
- OECD, 2020. *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues.* Paris: OECD Publishing, https://doi.org/10.1787/152def2d-en
- Poniatowski, G., 2021. *VAT gap in the EU: report 2021*. [online] Available at: https://www.astrid-online.it/static/upload/vat-/vat-gap---report-2021.pdf
- Thomas, A., 2020, *Reassessing the regressivity of the VAT*, OECD Taxation Working Papers, No. 49, Paris: OECD Publishing, https://doi.org/10.1787/b76ced82-en