THE EVOLUTION OF THE VALUE ADDED TAX IN ACCORDANCE WITH VALUE ADDED TAX GAP IN EUROPEAN UNION

Cristina VLAD, Anca OPRET, Petre BREZEANU

University of Economic Studies, Bucharest, Romania

Abstract:
The paper presents the European tax sistem refering to evolution of VAT and VAT gap. In the first part, we present the position of the indirect taxes in European Union, refering to VAT rates. In the second part, we analyzed the VAT gap and its determinants. We chose variables such increased VAT rates, the complexity of the tax system ,the types of the VAT rates applied or the budget deffict and we found direct connection between them and the grew of the gap. In the last part, we emphasized the conclusions obtain with this paper.

Keywords: Tax, VAT rates, Gap

JEL*:* H25, H71

1. Introduction

Taxation system is an important tool for each fiscal policy applied in every state. The comparison between direct and indirect taxes was often discussed in the literature , trying in this way to reach a conclusion on the degree of efficiency of the tax system in a given economy. But was not possible to make a rule regarding what type of taxes can determine high budget revenues and population welfare at the same time.

In recent years, the majority of the European Union countries are recovering from the financial crisis and a powerful instrument in the hands of the governments in order to manage their significant level of indebtedness is represented by indirect taxes (Milos, 2014).

Indirect taxes are not calculated nominal and are borne by the final consumer; are perceived by selling goods and services , aiming basically spending income. In addition to the remaining taxes, indirect taxes affect also global trade transactions . Because of this, many countries, mainly the developing ones wich face a stiff and tight budget that has to be used to the maximum to cover public expenditure and reduce the budget deficit, rely on indirect taxes in order to finance or increase the budgets.

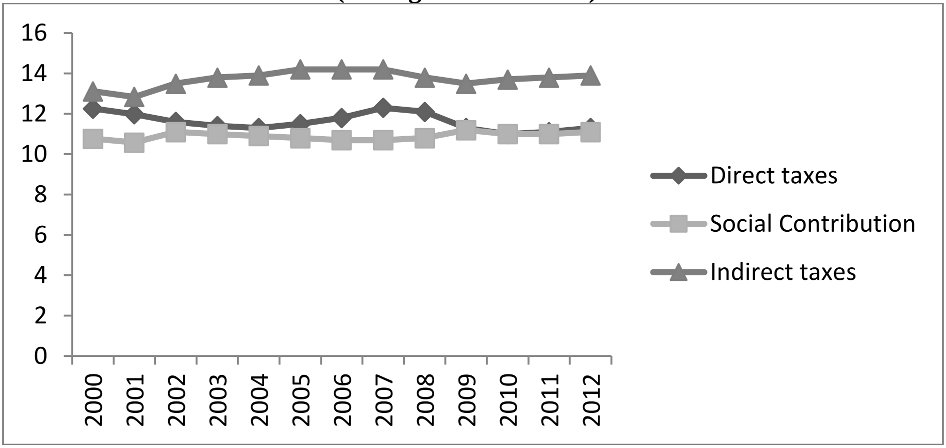
From the indirect taxes category, VAT is for sure the most important one; first, due to the share in total revenues and second due to the fact that it's a tax that is more difficult to escape than others because in the end it is the businesses that pays VAT to the Treasury rather than the consumers themselves. Furthermore, taxes like VAT are less sensitive to the economic situation of a country. In bad times you still consume, though it might be less than during good times. Even a slight rise in VAT has the advantage of massively increasing the government's revenues (EU Comission report, 2013).

2. The VAT position in European Union member states

The Value Added Tax played an important role in the fiscal environoment during and after the economic crisis. Total tax revenues (from direct and indirect taxes as well as social security contributions) expressed in terms of GDP reached their lowest point in 2010. Ever since then, the Member States tried to recover and in many cases we faced an increase in taxes instead of a reduction in expenditure.

Indirect taxes are imposed on consumption, sales, services, and are usually included in the price of goods and services, which makes them less visible for the payers in comparison with the direct taxes. They represent the main tax category for the Central and Eastern European countries, more recent members of the European Union On the contrary, the old member states collect relatively equal from direct taxes, indirect taxes and social contributions. However, in the last years, starting with the first quarter of 2009, there can be noticed a growth of the indirect taxation in European Union (Milos, 2014).

Figure 1: Indirect taxes, direct taxes and social contributions in EU (average as % of GDP)

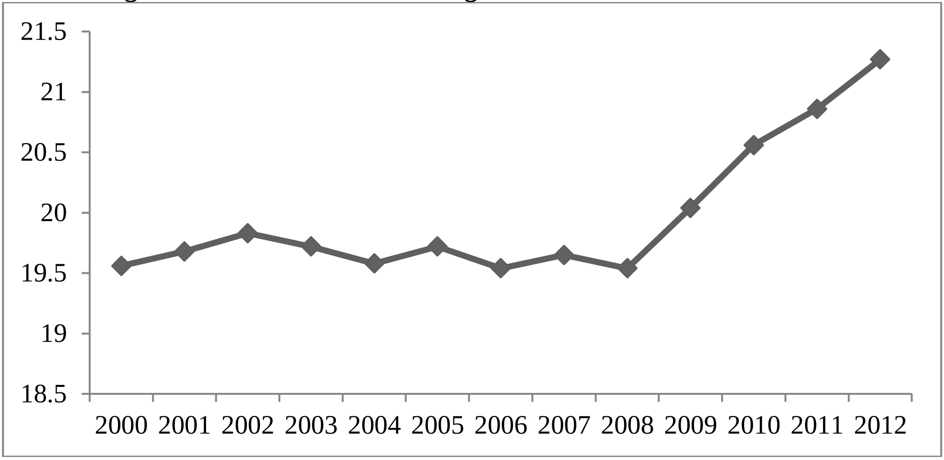


Source: Eurostat

The increase of indirect tax revenues (in terms of GDP) has been partly driven by the rise in standard Value Added Tax rates in many Member States. The EU-28 average standard rate increased by 2 percentage points between 2008 and 2014 (from 19.5% to 21.5%) (EU Comission paper, 2014). The EU has attempted over the years, in line with the objectives of the Single Market, to harmonize the tax system with a series of Directives. Currently, the VAT Directive, enacted on January 1 2007 and replacing the Sixth Directive, contains all legislations concerning the common VAT system in place. The Directive does not stipulate one uniform percentage rate for the whole Union, but sets boundaries for the Member States. For example, it restricts the minimum standard rate to 15 percent and allows for two reduced rates of at least 5 percent for some goods and services. Some derogations and exceptions for Member States are in place, entailing the existence of exemptions, zero rates and super reduced rates (EU Comission report, 2013).

We can observe in the graph below that if during the period 2000-2008, the VAT rates were quite stable , after crisis began to be felt , Member States had started to increase VAT rates in order to stabilize their budgets.

Figure 2: Evolution of the average of standard VAT rates in EU



Source: European Comission Report

The evolution of the VAT rates showed in the Figure 1 it is not random and it affected most European countries. From tax perspective, in the lasts years the coordinates transmitted by the European Union were similar and were aimed at defining the main triangle of sustainability, growth and fairness. Although at first glance, to meet these three characteristics seems impossible, directions indicated by the European Commission can insure during time a stable fiscal system, steady economic growth, a competitive labor market by adopting a balanced tax system and by continuously improving it (EU Comission report, 2014). In this sense, two of the most important priorities set by Europan Comission in its annual growth survey in the lasts years were: shifting taxation away form labour in countries where is particulary high and limits job creation on the one hand and increasing tax revenues by broadening the tax base, rather than raising taxes or introducing new ones, on the other hand. Basicaly, countries had to reduce direct taxes and encourage in this way the labour market, but in the same time to increase their budget revenues. And how can you do this? By increasing indirect taxes. This cand be a plausible explanation of the evolution of VAT standard rates.

It is also worth to mention that countries like Belgium, Luxembourg, Spain, Latvia and Poland took another measure to broad the tax base in terms of VAT in 2013: they applied the extension of the standard VAT by dropping in some cases the application of reduced VAT rate. For example, in Spain, the rate of VAT applicable in tourism or cultural activities is not any more a reduced one, but the standard is applied.

3. The VAT gap

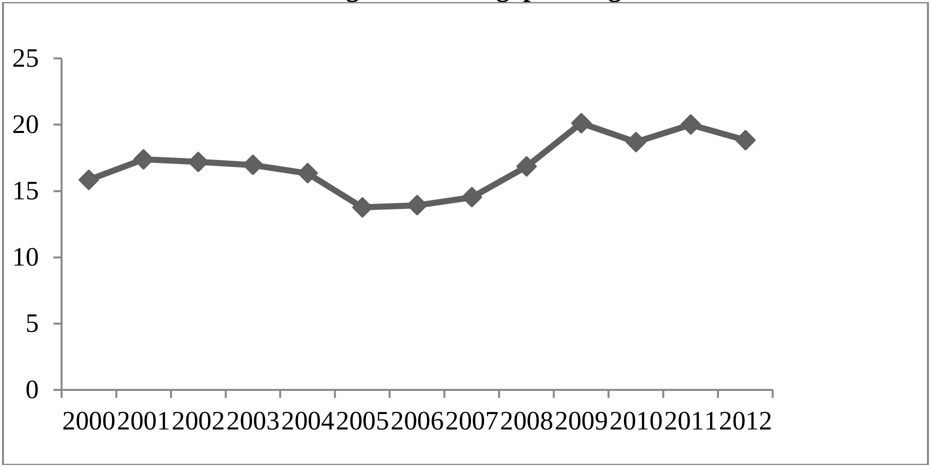
The VAT gap it's a fiscal indicator that had become important for tax administrations in European Union in recent years. This indicator is calculated as the difference between the VAT theoretical liability and accured VAT receipts in a respective state and year. Basicaly, the VAT gap help us to measure the tax fraud or the tax evasion in terms of VAT. The growing size of VAT gap may indicate either VAT evasion or a low effectivnessof tax collection and that's why sometimes we can use it as a tool to discover if the tax authorities work eficiently .

Finding the nature and causes of the VAT gap is also an issue on which many researchers
concentrate. Understanding the factors that influence the VAT gap could potentially help in reducing it by making changes to the VAT system and adjusting VAT policy (Zidkova, 2014).

The analysis of VAT gap took shape along with giving up tax barriers in European Union; starting with this moment, businesses were allowed to purchase goods and services from another Member State without beeing charged VAT. Under deferred payment, VAT on imports from one member state into another is levied not at the border but at the time of the importer's next periodic VAT return. And it may last a while (Sergioiu, 2012).

The Figure 3 shows when this indicator started to make its presence felt in European Union. We calculated the VAP gap average in the period 2000-2012 for all member states.

Figure 3: VAT gap average in EU



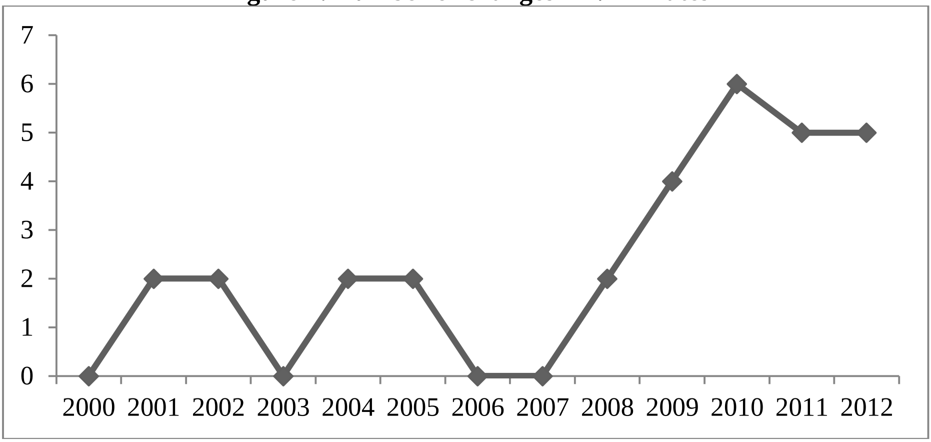
Source: European Comission Report

We can observe that the average rate of VAT gap has an evolution similar with the average of standard VAT rates. Before 2008, it had a linear trend, with small and constant increases in the period 2000-2005 and then with visible deacreses up to 2007. After the crisis started to be felt in all member states and the instability was a normal feeling, also the VAT gap average started to go up and then to have an abnormally trend. It is not going in one sense, it started to be modified year by year . And this can only bring insecurity and instability in the taxation system. We can conclude that once the standad VAT rates grew, the VAT gap grew also.

This means that the purpose of inceasing the VAT rates didn't had only the positive effect regarding the increasing of fiscal revenues, but it also determined the increasing of the gap. In a simple way of thinking, after changing the tax rates people felt a bigger burden during an unexpected economic crisis , which led to increased tax evasion in terms of VAT.

Another factor that influenced the increase of the VAT gap in the 2008-2012 period was the complexity and the unstable environoment regarding indirect taxation. First of all, bringing to the forefront the VAT system created an economic instability in European Union. If in the past the trend for VAT rates was a normal one, without big changes, suddenly governments had to modify this ”quietly” and find a way to raise their budget revenues. We can see in the Figure 3 the number of changes in VAT rates in the period 2000-2012. Most of the counted changes represented increases in standard rates of VAT. It is a huge difference between 2000 when the standard VAT rates were the same al most every year, with no big changes to 2008-2012 period. Member states started to modify VAT rates (increase or rarely decrease) in order to face the consequences of the crisis. And this behaviour can only create panic and economic instability among people. This kind of changes proved to be favorable factors in the growth of the gap.

Figure 4: Number of changes in VAT rates



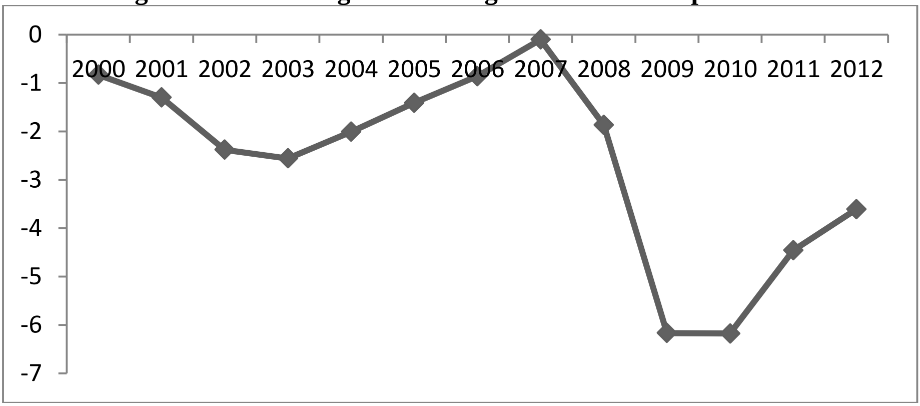
Source: Own calculation using European Comission Report

Regarding VAT rates applied in the member states we found also a connection between the complexity of the system and the evolution of the gap, because the more difficult the VAT system is, the lower VAT complince is. Through our review, we observed that also counts the difference between the VAT rates applied by each Member State (and here we refer to the standard and reduced rates): the higher is the difference, the higher is the gap.

For example, Romania has the standard VAT rate 24% since 2010 and two reduced ones, of 5% and 9%. On the average , the VAT gap in 2000-2012 period, in Romania is 42,07% from total VAT incomes estimated by authorities. This means that the revenues from VAT are with 42,07% less then they should be in the analized period. A similar situation is present in Lithuania. The VAT rates are 21% (the standard one) and 5% or 9% the reduced ones and the VAT gap calculated as avarage is 34,76%. The opposite, we obesrved that in Irlanda, were the VAT gap is 8% from total estimated revenues and the rates are: 23% standard VAT rate and 13,5 reduced VAT rate. Also Denmark is a good example: they have only standard VAT rate since 1975 of 25% and an average of VAT gap less then 10% (EU Comission Report, 2015).

At the macreconomic level, VAT is playing also an important role. Governments used the increasing of VAT rates as a tool to finance the budget deficit. It is a logical cyrcle: VAT rates are growing, so it’s growing the budget revenues and the budget deficit deacreases. But if we think deeper , during the time when the VAT rates have increased , also the VAT gap increased , which means that the budget deficit can not be covered at the estimated value. In the graph below, we can see the evolution of the budget deficit calculated as average in European Union member states.

Figure 5: The average of the budget deffict in European Union



Source: Own calculation using data from Eurostat

It can easly be observed that after 2007, the budget deficit reached much lower values comparing with previous years. And the increased VAT gap in the same period may be an important determinant for this evolution. Also we have to take in consideration the economic crisis, when the problems of public debt and budget deficit became difficult to be solved for both ’old’ EU countries such as Italy, France, UK, Portugal and Greece, and the Eastern European states that joined the EU later (Romania, Bulgaria and Hungary) (Dinca, 2010).

4. Conclusion

Considering the analysis performed we can conclude that during the period after the economic crisis, indirect taxes, especially VAT were the main tool for European Union member states in achivieng one of the most importantn goal: increasing budget revenues. To cover the losses caused by a general unstable economic environonement, governments resorted to increased VAT rates. In this sense, the average of standard rate increased by 2 percentage points between 2008 and 2014 (from 19.5% to 21.5%).

The VAT gap attracted atention in the taxation field in the lasts years because grew in a visible way. One of the reasons is the evolution of the VAT rates. We demonstrated that in the same period VAT rates grew, also the VAT gap grew. And this happend through one way: once people felt a bigger tax burden, they tried to find several ways to avoid it.

Another variable that influenced the increase of the VAT gap is the tax environonement and the types of VAT rates applied in each member state. We analyzed the stability regarding VAT system and we conclude that after the crisis, countries made a lot of changes in this field comparin with previous years and thos behaviour encourgaed the grew of VAT gap.

Also the difference between the VAT rates applied in the member states, refering to standard rates and reduced ones influenced the gap. Countries with smaller diference between this rates or with only one VAT rate applied no mather the good or the service , recorded a smaller VAT gap in comparison with countries with a complex tax system or with a big difference between the VAT rates applied.

Not least, we connected our analysis regarding the evolution and the determinants of the VAT gap with the macroeconomic environonement through one of the most important variable: budget defficit. We plotted the evolution of average of the budget defficit in European Union and we observed that after 2007, started to reach the lowest values from the last eight years. And the grew of the VAT gap was one of the influencing factors.

We have to mention that also the economic crisis that started to be felt in European Union since 2007, represented a point where macroeconomic variables and the tax system were destabilized and damaged the fiscal environment. But now, member states are trying to return to a normal path and to find the best solutions to have a stable economy.

References:

- Barbone, L.; Belkindas, M.V., Bettendorf, L.; Bird, R.; Bonch, M; Smart, M.; (2013), „Study to quantify and analyse the VAT gap in EU-27 Member States”, Case Network Report, Working paper no. 116
- Brezeanu,P.; Simion, I.; Celea,S. (2005), ”European Fiscality”, Economic Editure
- Dinca, M.S ; Dinca, G. (2010) , ”A comparative analysis of the budgetary deficits in the EU countries in the context of the global financial crisis”, 11th international conference *Financial and monetary stability in emerging countries*, pg 428-435
- European Comission, Luxembourg for Finance (2013) „The Importance of indirect taxes is growing”.
- European Comission Working papae no. 49(2014), „A wind of change? Reforms of tax systems since the launch of Europe 2020”.
- European Comission, Final Report (2013) „Study to quantify and analyse the VAT gap in the EU-27 Member States”
- European Comission (2014), „Tax reforms in EU member states: 2014 report”, Taxation papers, working paper no. 48
- European Comission (2013), ”Annual Growth Survey”, Brussels
- European Comission (2014), ”Annual Growth Survey 2015”, Brussels
- European Comission, (2015), „VAT Rates Applied in the Member States of the European Union”, Situation an 1st of January 2015
- Milos, C. M. , Milos L.R. (2014), ”Indirect taxation trends in the European Union member states”, Annals of the ”Constantjn Brancusi ” University of Targu Jiu, Economy Series, Issue 6
- Owens, J. (2013), „The policy in the 21st century: new concepts for old problems”, Global governance programme, European University Institute, issue 2013/05
- Rothbard, M. (2006), ”Power and Market – Government and Economy, Fourth Edition”
- Sergioiu, L. (2012), „VAT Carousel Fraud in the European Union”, Journal of Accounting and Management, vol.2, no. 2
- Schneider, F. (2011), „The shadow economy in Europe”, Univeristy of Linz Austria
- Schneider, F. (2012), „The shadow economy and work in shadow: What do we (not) know?”, IZA DP no. 6423
- Vuta, M.; Lazar, P. (2008), „The implication of the fiscal policies upon the economic bussines environment of European Union and all

over the world”, Studia Universitatis Vasile Goldis Arad – Economic Science 18, Vol I, pg 263-271

- Zidkova, H. (2014), „Determinants of VAT gap in EU”, Prague Economic Papers, 4
- www.eurostat.ro
- www.europa.eu
- www.imf.org
- www.oecd.org