

## FISCAL RISK OF VAT UNCOLLECTED IN EUROPEAN UNION

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**Abstract:** Since 1967, the 6 states that then formed the European Economic Community (EEC) decided that value added tax (VAT) would be the most important indirect tax of the Member States. Moreover, its use by the countries wishing to join the EEC was an indispensable condition. In 2019, VAT is a tax used by all 28 European Union (EU) Member States, but the system for collecting public revenues from this tax is not a perfect one and it can be improved. EU intervention in the area of taxation is limited because the fiscal policy of each Member State continues to be an attribute of national sovereignty. Through the directives, the European Commission sets measures valid for all countries (such as the minimum level of the standard VAT rate set at 15%), but each EU state decides on the national system of taxes and duties. The fiscal policy registers differences from one state to another and therefore provides different results in terms of performance. This article aims to highlight the link between the VAT collection deficit and the standard VAT rate applied in each of the EU countries. The analysis showed that the countries with the lowest VAT rates are also the ones with the lowest losses in VAT collection. The biggest deficits are encountered among the states with average VAT rates, especially in the east and south of the EU. Romania and Greece lose about a third of the VAT revenues, and the loss is all the more obvious as the share of VAT in the total tax receipts is higher than in Western EU states, for instance. After all, any loss harms the tax system and indirectly the society. We also mention that the data used in this analysis are those published in September 2019 by the European Commission through TAXUD and also provided by Eurostat databases and refer to 2017.

**Keywords:** value-added tax; VAT Gap; VAT revenue; standard VAT rate.

**JEL Classification:** H26; H71.

### 1. Introduction

A strict control, at national level, of the income and assets/wealth of each individual taxpayer - natural and legal person - is a utopia. The collection of taxes due to the state budget as a result of such control would rather emphasize the coercive force of the state within the society, as opposed to the increasingly studied idea of "voluntary tax compliance" (Pomeranz, 2015).

Complying with tax laws is indeed a civic obligation. However, the nominal value of the taxes owed depends on the accuracy and completeness of the taxpayer's tax returns. As the fiscal obligation affects the budget of the taxpayer, there is a well-known, intuitive possibility for the latter to make a misreporting.

From this perspective, we can see that the struggle for voluntary compliance takes place on several levels, not only strictly fiscal, but it is a complex process with social and psychological implications. In addition to the measures of the public administration to combat evasion, there is talk of forming a conscience of the taxpayer, a "tax morale" (Luttmer and Singhal, 2014) that dictates to him a responsible fiscal behaviour. The authors claim for the need to create non pecuniary motivations, capable of determining within taxpayers a uniform behaviour of compliance, so a social norm of compliance.

## **2. The situation of VAT collection in EU countries (2017)**

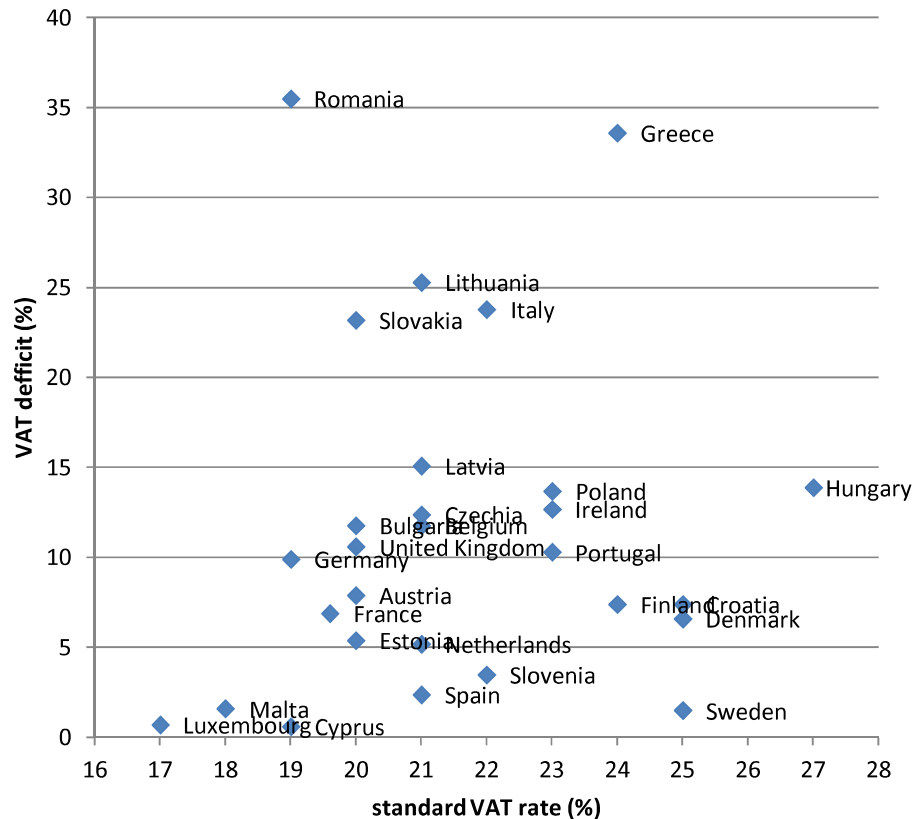
As stated in the literature, public financial resources ensure the needs of the social environment (Anghelache et al, 2018). Therefore, the failure to achieve the expected level of tax revenues is not only a loss of the state as an institution, but is a loss of the whole society in general, of each member of it in subsidiary.

The inefficiency of collecting taxes leads to a lower state budget than estimated, hence the difficulty in financing specific activities. The greater the deficit of tax collection on the budget, the greater the need for the state to find alternatives to cover the expenses. Perpelea and Perpelea (2018) state that in such situations, the simplest solutions to ensure the financial need at the state level are: "increasing the level of existing taxes, introducing new taxes or state loans". Of course, the immediate effect of these measures is positive, that of obtaining the funds, but in the long term, not properly managed, it turns out to be an unintended participation of the state in the phenomenon of tax evasion and tax avoidance. The increase of the amount of taxes, the state loans, regardless of the market from which they were accessed, only lead to the distrust of the taxpayers in the fiscal policy of the state and in the latter ability to efficiently cover its expenses.

The European Union supposes a customs union that allows the movement of goods and services internally without applying additional tariffs. However, this facility was also used for the purpose of avoiding tax payment. In this sense, at European level there is a VAT fraud of carousel type (Sergioiu, 2012). Although the phenomenon exists as well at the national level of member states, its presence in the EU implies effects on all countries, a complex network (that's why it is even more difficult to monitor and destroy), huge amounts of unpaid VAT.

In EU, for 2017, the situation of the VAT deficit and the standard rates applied for this indirect tax in each member state is illustrated in the following graph.

The lowest VAT rate in EU can be found in Luxembourg (17%) and the highest in Hungary (27%). This information emphasizes that the range regarding standard VAT rates in EU is not high and "represents a step towards harmonization" (Vlad et al., 2018).



**Figure 1:** VAT Gap (%) correlated with VAT standard rates (%) in EU (2017)  
*Source:* own representation, based on data provided by 2019 TAXUD Report.

Nevertheless, VAT collection difficulties were faced by all the member states and led to different results in terms of VAT collection deficits in 2017, from 0.6% in Cyprus to 35.5% in Romania.

The first remark we can make from this graph is that the smallest deficits were in the countries with lowest VAT rates - between 17% and 19% (Cyprus, Luxembourg, and Malta registered VAT Gaps less than 2%). At the other pole, the biggest VAT collection deficits were not recorded by the countries having the highest VAT rates in the EU, as we might think. Croatia, Sweden, Denmark or Hungary, each with a standard VAT rate of 25% or more, were not in the top of VAT gaps, their deficits were below 15%. Therefore, we cannot infer that there is a directly proportional relationship between the two elements analyzed, VAT rate and VAT Gap.

The countries with the highest levels of VAT Gap were Romania and Greece, with values exceeding 30%, followed by Lithuania, Italy, Slovakia, with values between

20% and 30%. The standard VAT rates of these states were closer to the European average and were in the range of 19% - 24% in 2017.

The graph also shows that among the VAT rates practiced, the 19% and 24% ones seem to be the most controversial, with extreme deficits. Using a VAT rate of 19% in 2017, Romania had a deficit of 35.5%, while Germany 9.9% and Cyprus only 0.6%. Similarly, with a 24% standard rate, Finland had a deficit of 7.4%, when in Greece 33.6% of VAT revenues were going missing.

Romania's VAT collection deficit, with a value of 35.5% of the total value of VAT estimated revenues, remained in the first position in the EU regarding the VAT non collected. Compared to countries such as Cyprus or Luxembourg which have lost less than 1%, or compared to the EU average of 10.1%, Romania lost from its VAT returns 34%, 25% respectively more.

Tax revenues in the countries of Central and Eastern Europe (including Romania) are based on indirect taxes, especially on VAT (Ibadula et al., 2017). Therefore, a large deficit in VAT collection, as in the case of Romania, where it exceeded one third of the total VAT expected, has an even more pronounced impact as the share of VAT revenues in the total tax revenues is higher.

Table 1 summarizes the data used to calculate the shares illustrated, data that were taken from both TAXUD report and Eurostat databases. The amounts are expressed in national currency and refer to 2017.

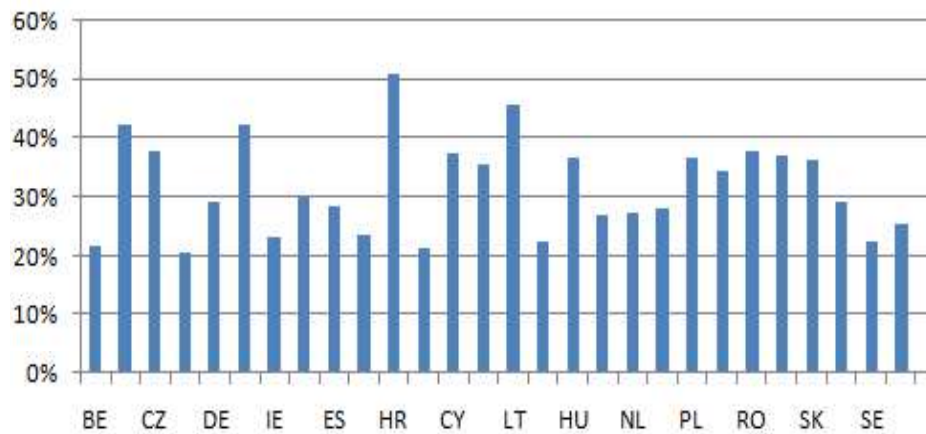
**Table 1 - VAT standard rate (%), VAT Gap (%), VAT Gap, Fiscal Revenues, VTTL and Potential Fiscal Revenues (EU, 2017)**

Country code	VAT standard rate (%)	VAT Gap (%)	VAT Gap	Fiscal Revenues	VTTL	Potential Fiscal Revenues
BE	21%	11.80%	30254.7	139820.1	33759	143816.1
BG	20%	11.80%	9121.3	21646.23	10344	22868.23
CZ	21%	12.40%	387537	1026808	442353	1081624
DK	25%	7.40%	207767.9	1008136	224395	1024763
DE	19%	9.90%	226582	779439	251598	804455
EE	20%	5.40%	2148.71	5104.26	2270	5226.26
IE	23%	12.70%	13059.92	56092.63	15215	58030.63
EL	24%	33.60%	14642	48861	22041	56260
ES	21%	2.40%	73970	260335	75913	262141
FR	19.60%	6.90%	161932	685168	173962	697198
HR	25%	6.60%	48250.9	94932.9	51831	98361.9
IT	22%	23.8%	107576	504910	141530	538539
CY	19%	0.60%	1851.4	4963.1	1862	5050.1
LV	21%	15.10%	2163.7	6121.38	2549	6506.38
LT	21%	25.30%	3310.4	7288.93	4429	8407.93

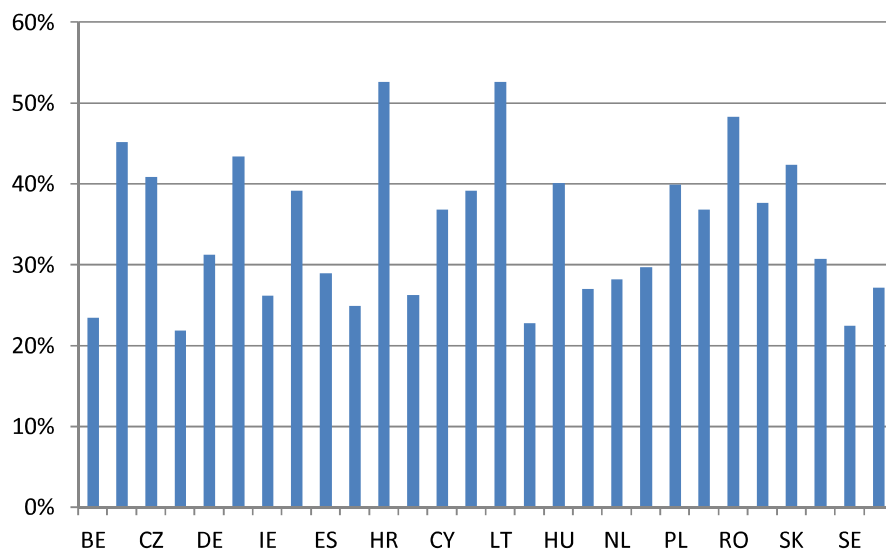
Country code	VAT standard rate (%)	VAT Gap (%)	VAT Gap	Fiscal Revenues	VTTL	Potential Fiscal Revenues
LU	17%	0.70%	3434.9	15312.76	3492	15335.76
HU	27%	13.90%	3626566	9908427	4210262	10493579
MT	18%	1.60%	810.19	3012.96	823	3043.96
NL	21%	5.2%	49833	183688	52644	186432
AT	20%	7.9%	28299.79	100921.9	30748	103365.9
PL	23%	13.7%	154656	423937	179194	448475
PT	23%	10.3%	16809.45	48890.38	18738	50819.38
RO	19%	35.5%	53228.6	141387.9	82528	170686.9
SI	22%	3.5%	3481.73	9432.27	3606	9560.27
SK	20%	23.2%	5918.74	16383.68	7708	18174.68
FI	24%	7.4%	20404	69985	22026	71607
SE	25%	1.5%	425053	1912945	431357	1919249
UK	20%	10.6%	142655	565047	158421	581878

Source: TAXUD Report and Eurostat databases. The following graph shows the share of VAT revenues in the total tax revenues of each EU member. We note that in the case of Croatia most of the tax revenue consists of VAT collection, with a share of approximately 51% in the total tax revenue. Among the countries the most affected of the VAT deficit, Lithuania, Slovakia, Romania and Greece have 30% or more of their total tax receipts based on VAT. Therefore, a poor VAT collection has a greater impact in country's fiscal revenues.

The *Figure 2* expresses the share of the total value of the VAT, if it had been collected at the level estimated by each EU state, in the total of the tax revenues, all the other sources of tax receipts remaining unchanged. VTTL designates VAT Total Tax Liability. There is a considerable increase compared to the representation in the previous graph, except for Cyprus, whose VAT deficit, if collected, would not have led to a higher share of VTTL in tax revenue. For Romania and Greece, the countries with the largest deficit, a complete collection of VAT would have generated a higher VAT share in tax revenues with 10.7 percentage points, respectively 9.2 percentage points.



**Figure 2:** VAT revenues in total tax receipts / EU Member State (2017)  
Source: own representation, based on data provided by Eurostat databases.



**Figure 3:** VTTL in potential tax receipts / EU Member State (2017)  
Source: own representation, based on data provided by Eurostat databases.

The main sources of VAT deficits are reviewed by the European Commission: the level of voluntary tax compliance, fraud, avoidance, bankruptcy, insolvency or an imperfect tax administration system. Apparently, these notions seem to be very

different, but the VAT Gap actually comes from the chaining of these processes: from the use by the taxpayers of the legislative deficiencies, of the procedural gaps regarding the tax administration, by adopting an evasive behaviour.

Specifically, the procedures by which the VAT payment is avoided are listed by Ciobanu (2019): undeclared or registered sales accounting with a lower value than the real one, false invoices or the use of the same invoice several times to obtain unmerited deductions, use the exemptions provided by law without these being applicable, the deliberately erroneous registration of certain amounts that may change the amount due to the state budget.

### 3. Conclusions

The most important conclusion that emerges from the analyzed chart is that the level of the standard VAT rate does not guarantee the deficit in a certain interval. However, the EU Member State's experiences show that a reduced VAT rate also implies a lower risk of losing revenue from this source. Greatest deficits are encountered by the countries having fiscal revenues based especially on VAT.

The need to reduce the VAT Gap is even greater as VAT is a major source of tax revenue collection, as we presented in the last two graphs.

If the level of standard VAT rates does not decisively influence the VAT Gap, it means that the deficits are the result of the interaction of several factors, such as: organization of the tax administration system, events in the life of companies with an impact on the VAT collection - bankruptcy, insolvency, the extent of tax fraud, VAT exemptions used abusively, factors that deserve to be studied separately.

As we mentioned, the VAT collection deficit is not a mere loss of the state. Underneath it can hide a system of deficient collection, a distrust of the taxpayers in the role of the tax system or an intention of certain companies to generate profits to the detriment of social welfare.

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