The EU VAT Experience: What Are the Lessons?

By Ine Lejeune

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Introduction

VAT is a significant and increasingly prevalent form of consumption tax, representing a major source of revenue for governments around the world. The contribution of VAT to total government revenue is increasing rapidly. VAT systems have been implemented in 156 countries, and seven more are considering implementing a VAT by 2013. Major VAT reforms are on the way in India and China. Figure 1 on the next page shows the VAT regimes1 around the world.

The VAT was conceived by a German businessman in 1920 and first implemented in France in 1954.2 In the late 1960s, when the European Union consisted of only six member states3 and 1884 million citizens, the VAT was introduced by the First Directive and the Second Directive5 to replace national turnover taxes. As part of the EU’s acquis communautaire, VAT is now imposed in the entire internal market of 27 member states, and 5016 million citizens are familiar with it.

The VAT has become a cornerstone in the EU’s tax and economic system. It contributes to a nondistortive trade policy and respects the fundamental freedoms of the EU: the free

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1As used in this article, the term VAT includes all forms of the tax, including the goods and services tax.  
3Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands.  
Figure 1. VAT/GST Regimes Around the World

PricewaterhouseCoopers Global VAT/GST map

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Figure 1 (continued).
movement of goods, capital, and persons. Recently, an increased shift to VAT has been suggested both to reduce national budget deficits\(^7\) and to meet the EU’s Lisbon objective of raising the average labor participation rate.\(^8\)

The Global Shift to VAT

Statistics show rapidly declining corporate income tax rates throughout the EU and other global economies, while standard VAT rates have increased.\(^9\) As a consequence, VAT revenue is increasing as a percentage of total tax revenue. We may therefore conclude that the global revenue balance is shifting away from corporate income taxes in favor of VAT. Table 1 shows that VAT is a significant percentage of total tax revenue in OECD countries.

![Table 1. VAT/GST as a Percentage of Total Revenue](image)

As one of the most broad-based taxes, VAT is a key revenue generator for all governments in the EU. In the current economic climate, and with high government deficits, several governments

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\(^8\)Lang, Melz and Kristofferson, IBFD, *Value-Added Tax and Direct Taxation*, 2009, p. 73.

are looking to increase the share of VAT as part of total taxes collected (Table 2, on the next page).\textsuperscript{10}

Two approaches are used to achieve this. First, countries have increased their VAT rates. Over the past two years across the EU, 12 countries have increased their standard VAT rates. However, the U.K. first lowered its standard VAT rate from 17.5 percent to 15 percent from December 2008 until January 2010.\textsuperscript{11} As of January 4, 2011,\textsuperscript{12} the standard VAT rate in the U.K. will increase to 20 percent. Poland and Portugal will also increase their standard rates for 2011. Table 3 shows the evolution of the standard VAT rates in the EU over the past three years.

Those VAT rate increases are usually combined with a reduction of income tax rates. Over the last two years, seven EU member states cut their corporate income tax rates (Czech Republic, Greece, Hungary, Luxembourg, Slovenia, Sweden, and the U.K.). Several countries have reduced their statutory rate of personal income tax (Bulgaria, Czech Republic, Hungary, Lithuania, Romania, Slovenia, and Slovakia). The increased VAT revenue has also been used by some governments to reduce social security contributions payable by employers or employees (Bulgaria, Hungary, Germany, and Sweden).\textsuperscript{13}

The second approach that governments take is to improve VAT collection. The VAT gap has been a problem in the EU. The European Commission studied the gap in 25 member states and estimated it at €106.7 billion in 2006. (Bulgaria and Romania had not yet entered the EU; the study also excluded Cyprus.)\textsuperscript{14}

Table 2. VAT as Percent of GDP in the EU

Table 3. The Recent Trends in Changes of the Standard VAT Rate in the EU

The member states are individually acting to reduce their VAT gaps in different ways. One way is to improve their auditing through increased reliance on electronic auditing and advising or requiring taxpayers to have or submit standard audit files for tax (SAF-T), as recommended by the OECD. That is being done in Portugal and Luxembourg effective in January 2011. Another way is to introduce voluntary compliance programs and tax control frameworks, as in the Netherlands. Finally, penalties for noncompliance are being increased in the U.K.

EU-wide action and cooperation between member states to combat fraud are aided by the creation of the EuroFisc. As part of its new VAT strategy, the European Commission will soon propose more measures to reduce both the VAT gap and the costs of collection and enforcement.

Designing a Best Practice VAT

When designing a best practice VAT, a balance must be found among the objectives of three stakeholders: the government, businesses, and citizens.

The government’s aim would be to increase its budget, allowing it to invest in the country (infrastructure, healthcare, education, etc.) and to attract and retain businesses while creating new jobs and securing existing ones. Businesses act as unpaid tax collectors in a VAT system. They want to compete globally and deliver a sustainable profit without risking violating the VAT rules. Citizens, as the final consumers, are looking for a fair tax

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OECD, “Guidance for the Standard Audit File — Tax (SAF-T),” http://www.oecd.org/LongAbstract/0,3425,en_2649_33749_34910278_1_1_1_1,00.html.
Figure 2. VAT/GST Win-Win Taxation Model

Governments
- Revenues
- Business attraction and employment

Businesses
- Sustainable global profit
- Total risk management

Use of technology to reduce cost of collection

Equitable/Efficient

Citizens
- Long term future and employment
- Non-regressive and fair
that is not regressive or inflationary. Citizens also expect the revenue to be invested by the government to provide long-term benefits such as jobs.

To maximize the revenue collected and reduce compliance costs, technology is required.

**OECD Principles and IMF Recommendations**

To assess the EU VAT system, we will use three benchmarks: OECD principles, IMF recommendations, and PwC’s experience in implementing and reforming VAT systems.\(^{20}\)

The OECD\(^{21}\) proposed the following principles:

<table>
<thead>
<tr>
<th>Principles</th>
<th>Key results for both the business community and the tax authorities (government)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neutrality</td>
<td>Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.</td>
</tr>
<tr>
<td>Certainty and Simplicity</td>
<td>The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.</td>
</tr>
<tr>
<td>Effectiveness and Fairness</td>
<td>Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.</td>
</tr>
<tr>
<td>Flexibility</td>
<td>The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.</td>
</tr>
</tbody>
</table>

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\(^{20}\)PwC has used its experience in designing and implementing VAT systems and in reform programs in 37 of 71 countries that used external advisers around the world. PwC has delivered more than 20 studies on VAT to the European Commission.

The IMF has also recommended some best practices to be used in VAT design, as follows:

- a single rate rather than multiple rates;
- a single, relatively high threshold regarding turnover;
- a broad base with minimal exemptions to avoid distortion of purchase (input) decisions and to provide transparency;
- use of the destination principle whereby exports are zero rated and imports are taxed;
- use of the invoice credit method whereby output VAT remitted is reduced by input VAT paid on purchases and imports; and
- the timely provision of input credits for the purchase of capital goods.

The IMF experience demonstrates that VAT implementation is an opportunity to significantly improve overall tax administration, such as by:

- introducing a function-based organization and integrated tax administration starting with the integration of VAT and income tax;
- ensuring coordination between VAT, income tax, and customs agencies with unique taxpayer identification numbers;
- introducing modern procedures based on voluntary compliance;
- implementing self-assessment, whereby taxpayers declare and pay taxes based on their own calculations subject to the possibility of an audit by the tax authorities;
- implementing effective audit programs based on risk-based analysis selection methods;
- issuing prompt refunds of excess input VAT to taxpayers.

**The EU Legal Framework**

Before describing the key features of the EU VAT system, we will review the legal framework and overall functioning of the EU VAT.

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VAT in the EU is regulated by a council directive.24 Any changes to the regime require a unanimous decision by the 27 state secretaries of finance.25 The VAT directive is an EU legal instrument.26 Directives are binding and must be implemented in the member states’ domestic legislation. However, each state has a choice regarding the method of implementation. The European Court of Justice has the power to ensure that the EU legislation is applied in accordance with the treaty establishing the EU and provisions of the European Community institutions.

The ECJ rules on cases referred to it under two procedures. Under the first, it hears cases to decide whether member states have failed to fulfill treaty obligations (the infringement procedure). These actions are usually initiated by the European Commission, although they can also be initiated by another member state. Action can also be taken by the commission under a complaint made by any interested party. Under the second procedure, the ECJ hears cases referred to it by national courts (preliminary rulings) requesting an interpretation of the EU legislation. Once the ECJ has ruled on a case referred to it, its ruling will be binding in all member states.

Over the past 40 years, 449 VAT cases have been referred to the ECJ. As of 2010, 43 are pending. Table 6 on the next page shows the number of ECJ judgments and pending cases on major VAT topics from 1970 through June 2010.

ECJ case law has been instrumental for an EU-wide harmonized interpretation of VAT rules. However, differences in national legislation and practices and the large number of VAT cases referred to the ECJ indicate that the system is inefficient and fails to provide certainty.

242006/112/EC (the VAT directive) of Nov. 28, 2006, on the common system of value added tax. Since then there have been several changes. The latest non-official consolidated version was available in April 2010 at http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/index_en.htm.
Table 6. Overview of ECJ Decisions on VAT in the Period 1970-2010

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>Taxable Person</td>
<td>Taxable Supply</td>
<td>Place of Supply</td>
<td>Taxable Amount</td>
<td>Exemptions</td>
<td>Deduction</td>
<td>Liability</td>
<td>Abuse of Rights and Fraud</td>
<td>Special Arrangements</td>
</tr>
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<td>50</td>
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<td>30</td>
<td>20</td>
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<td>40</td>
<td>30</td>
<td>20</td>
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</tr>
</tbody>
</table>

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Best Practice

Here we benchmark some of the key features of the EU VAT system using the above OECD and IMF criteria and lessons learned by PwC, together referred to as best practice.

Taxable Persons

Definition

The concept of taxable person\(^{27}\) is important in ensuring that the VAT is broad based, proportional, nondistortive, and efficient. The VAT directive defines a taxable person as “any person that independently carries out in any place any economic activity, whatever the purpose or results of that activity.”\(^{28}\) The economic activities are all activities of producers, traders, and persons supplying services. Mining, agricultural activities, and activities of professions are included. Member states have implemented this definition differently. Legislation varies in Belgium, Finland, Italy, Latvia, Portugal, Sweden, and the U.K.

In practice, problems have arisen in defining when an economic activity makes a person qualify as taxable (for example, preparatory activities or feasibility studies before launching a business). Other issues brought before the ECJ and dealt with in several member states concern the treatment of holding companies\(^{29}\) and of governments and their agencies.\(^{30}\)

Pure holding companies and governments are treated mostly as nontaxable persons for VAT purposes. Should that be revisited, the EU concept of taxable person would be in line with best practice.

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\(^{27}\)Also further in the text, business or company.


\(^{29}\)ECJ Case C-291/07 (Kollektivtvaelsstiftelsen TRR Trygghetsrådet), a pure holding company is not qualified as a taxable person for VAT purposes; ECJ Case C-60/90 (Polysar), a financial holding company is not an entrepreneur for VAT purposes.

\(^{30}\)ECJ Case C-102/08 (Salix), according to the VAT Directive, article 13, “States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities . . . . However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.”
Registration Thresholds

A taxable person must be registered for VAT purposes. A registration threshold is used to relieve some taxpayers of this requirement, which can create a disproportionate compliance and administrative burden for taxpayers with low turnover. If the turnover is equal to or higher than the threshold, VAT registration is required. Businesses with a turnover below the threshold can opt for registration. A high threshold reduces fraud and the number of taxpayers that must register and comply and that need auditing.

The VAT registration threshold among EU member states varies, from zero to €80,000. The thresholds in the EU are very low compared with those in countries that have more recently introduced a VAT.31 Some member states use different thresholds for different business sectors. The thresholds in most member states do not apply to non-established companies that must register for VAT (Bulgaria, Cyprus, and the U.K. are exceptions).32

The thresholds in the EU do not meet the OECD and IMF criteria and are neither efficient nor effective. A consistent threshold for all member states set at a high level would be best practice.

Taxable Transactions

Only taxable transactions can be subject to VAT. There are four taxable transactions:

- supplies of goods;33
intra-Community acquisitions;\textsuperscript{34}

- imports;\textsuperscript{35} and

- supplies of services.\textsuperscript{36}

All supplies provided by a taxable person for consideration that are not taxable as one of the first three categories (supplies of goods, intra-Community acquisitions, or imports) are considered services. The EU definitions bring all transactions into their scope, creating a broad-based VAT, which is a best practice.

**Place of Taxation**

The EU VAT applies to all consumption in the EU, as a broad principle, and it is levied according to the destination principle. Supplies of goods from other EU member states to businesses and nontaxable legal persons are zero rated and subject to VAT in the EU member state of arrival. Shipments of goods to non-EU countries and supplies made outside the EU are not subject to EU VAT. This rule works well for the supply of goods.

\textsuperscript{34}VAT directive, article 20, intra-Community acquisition of goods: “shall mean the acquisition of the right to dispose as owner of movable tangible property dispatched or transported to the person acquiring the goods, by or on behalf of the vendor or the person acquiring the goods, in a Member State other than that in which dispatch or transport of the goods began.

Where goods acquired by a non-taxable legal person are dispatched or transported from a third territory or a third country and imported by that non-taxable legal person into a Member State other than the Member State in which dispatch or transport of the goods ends, the goods shall be regarded as having been dispatched or transported from the Member State of importation. That Member State shall grant the importer designated or recognised under Article 201 as liable for payment of VAT a refund of the VAT paid in respect of the importation of the goods, provided that the importer establishes that VAT has been applied to his acquisition in the Member State in which dispatch or transport of the goods ends.”

\textsuperscript{35}VAT Directive, article 30, importation of goods, “shall mean the entry into the Community of goods which are not in free circulation within the meaning of Article 24 of the Treaty.

In addition to the transaction referred to in the first paragraph, the entry into the Community of goods which are in free circulation, coming from a third territory forming part of the customs territory of the Community, shall be regarded as importation of goods.”

\textsuperscript{36}VAT Directive, article 24, supply of services, “shall mean any transaction which does not constitute a supply of goods.”
For the international trade of services, the destination principle is applied differently across jurisdictions. In some cases it leads to double or involuntary nontaxation.

In the EU on January 1, 2010, some new place of supply rules for services were introduced, also referred to as the VAT package. As a general rule, cross-border services between businesses are now taxed where the business customer is established. That was done to simplify and apply the destination principle more broadly to services in line with best practice.

Exemptions

Probably the most complex issues in the EU VAT system concern exemptions and the right to deduct input VAT.

Exemptions With Right of Deduction

The directive provides that activities like exportation, some transport services, international transport, services by intermediaries, some international trade transactions, and supplies by tax-free shops are zero rated. In many situations, those rules are difficult to apply for businesses, and they are applied differently among member states, which runs counter to our best practices. Such treatment is complex, fails to provide certainty, and results in high compliance costs.

Exemptions With No Right of Deduction

Activities in the public interest like medical services, education, not-for-profit activities, insurance and reinsurance, financial activities, and special investment funds are in principle exempt from VAT without the input credit. In these cases the supplier will not need to charge VAT on sales out, but the input VAT incurred on purchases of goods and services for running the business cannot be recovered. In many cases the exemptions were introduced to reduce the regressivity of VAT.

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38 VAT Directive, articles 135-137, exemptions.
39 This is the general rule. There are exceptions and options provided to the member states to apply VAT to the supply, such as for the sale of land and buildings and leasing or letting of immovable property. VAT directive, exemptions, articles 135-137.
Much litigation has arisen due to the wide range of exemptions and different interpretations by EU member states regarding the criteria for determining whether a transaction is subject to an exemption. From 2000 to 2009, 57 of the 204 VAT cases referred to the ECJ (28 percent) involved an exemption matter, as shown in Table 7 on the next page.

The EU VAT has a relatively narrow tax base because of the prevalence of these exemptions without a right of deduction. Across the EU, the amount of consumption subject to VAT, per country, averages 52 percent of GDP. In New Zealand, by contrast, the percentage is 105 percent.\(^{40}\)

Where the input deduction is denied, the nondeductible VAT becomes a cost to the provider of the supplies of goods or services. That cost is then passed on to the consumers in a phenomenon referred to as cascading. A study that PwC performed for the European Commission\(^{41}\) showed that the EU VAT treatment was hurting the global competitiveness of EU-based industry.

VAT exemptions without a right of deduction are not harmless; they create distortions and uncertainty and keep the EU VAT system from being broad-based and neutral to business. And regressivity is not solved efficiently because the measures don’t target the low-income wage earners. The prevalence of such VAT exemptions cannot be considered a best practice.

### VAT Rates

The VAT directive provides\(^{42}\) that the standard VAT rate must be between 15 and 25 percent. Each member state may choose its

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\(^{40}\)OECD, *Consumption Tax Trends* (Paris: OECD, 2008) pp. 66-67, the VAT revenue ratio = (VAT revenue)/([consumption - VAT revenue] x standard VAT rate). However, in making comparisons with other OECD VATs that do not include public-sector bodies within their scope, it is necessary to exclude New Zealand’s departmental GST (which produces no net revenue to government). If the GST is excluded from the calculation of the old C-efficiency ratio, the New Zealand C-efficiency ratio is reduced by about one-third.


Table 7. Number of Cases Referred Between 2000 and 2009* (Including Infringements) Related to Exemptions

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Number of cases referred between 2000 and 2004*</th>
<th>Number of cases referred between 2004 and 2009*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical Care</td>
<td>468</td>
<td>10</td>
</tr>
<tr>
<td>Cost Sharing</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>Welfare</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Education</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Sport</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Financial</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Gambling</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Immovable</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Disposal of Goods</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Miscellaneous exemptions</td>
<td>10</td>
<td>4</td>
</tr>
</tbody>
</table>


standard rate. A reduced VAT rate of at least 5 percent can be enacted for supplies of goods and services referred to in an exhaustive list in the VAT directive. Only Denmark applies a single standard rate of 25 percent; all other countries apply one or more reduced rates. Some countries have negotiated zero rates when they joined the EU (for example, the zero rate for children’s clothing in the U.K.43 or a reduced rate for wines produced on an agricultural holding by the producer or farmer in Austria44).

Differences in standard VAT rates create problems for businesses operating in multiple EU member states. Multiple rate structures within a country are an even bigger hurdle. Multiple rates are driven by social and economic concerns. They are one of the means used to solve the regressivity of the VAT. It is considered socially beneficial to tax luxury goods at a higher rate than necessities because it avoids placing a heavy tax burden on low-income groups. However, members of the high-income group also benefit from the lower VAT rates when they purchase necessities. Therefore, it’s preferable to reduce the regressivity of VAT using other targeted measures. Those might include lowering income taxes and employee social security contributions or providing family allowances. This has been successfully applied by New Zealand when GST was introduced and more recently when the VAT rate was increased was compensated for by a reduction of the personal and corporate income tax rates.45

Apart from the fact that lower rates are not the best means to mitigate regressivity, a multiple rate structure increases complexity and costs for businesses and creates economic distortions.

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43VAT Directive, article 114, “Member States which, on 1 January 1993, were obliged to increase their standard rate in force at 1 January 1991 by more than 2 percent may apply a reduced rate lower than the minimum laid down in Article 99 to the supply of goods and services in the categories set out in Annex III. 1. The Member States referred to in the first subparagraph may also apply such a rate to children’s clothing and children’s footwear and housing.”

44VAT directive, article 119, “Austria may apply a reduced rate to wines produced on an agricultural holding by the producer-farmer, provided that the rate is not lower than 12 percent.”

45OECD, Tax Notes International, Sept. 20, 2010, “An International Perspective on VAT,” by Alain Charlet and Jeffrey Owens, p. 952, “the basic personal income tax rate is cut from 12.5 percent to 10.5 percent, and the top rate from 38 percent to 33 percent. The corporate income tax rate is changed from 30 percent to 28 percent.” www.oecd.org/dataoecd/47/45/46073502.pdf.
also leads to disputes with the tax authorities on the correct application of the different rates. For example, electronic books are subject to the standard VAT rate, but paper books may be subject to a reduced rate. In France a piece of chocolate may be subject to either the standard rate (19.6 percent) or the reduced rate (5.5 percent depending on its composition, and sometimes its dimensions). One recent ECJ case examined the VAT rates applicable to the sale of a racehorse (subject to the standard rate) and the sale of a horse used for agricultural production (subject to the reduced rate).46 Nine cases on VAT rates47 are pending before the ECJ as of this writing.

That is why a single VAT rate (other than the zero rate for exports) is considered a best practice. Many countries that recently introduced VAT have opted for a single rate, such as Australia, Lebanon, Singapore, and Thailand.48 The lessons learned from the EU experience show that a moderate single VAT rate taxing a broad consumption base with very limited exemptions is far better than applying a high standard rate with many exemptions and multiple rates. The latter design — the norm in the EU — does not meet OECD or IMF criteria and is not a best practice.

Right to Deduct Input VAT

VAT should not be a cost of doing business. Businesses collect the VAT but are not the end consumers. The neutrality of VAT is guaranteed by granting businesses a right to deduct input VAT. For businesses that are VAT registered in the EU member state where the input VAT is paid, the right to deduct input VAT is exercised via their VAT return. For businesses that are not VAT registered in the EU member state where the input VAT is paid, the deduction is, in principle, granted through a refund procedure.

48Lang, Melz and Kristofferson, IBFD, Value Added Tax and Direct Taxation, 2009, p. 84.
To exercise the right to deduction, a business must be able to prove that it incurred the VAT for business purposes and that it has a purchase invoice or the necessary import documentation.

At first sight, the right to deduct input VAT meets all OECD criteria. But EU member states can, to an extent, restrict the deductibility of VAT on expenditures such as those for entertainment or luxuries. And some tax authorities take a formalistic approach in granting the input VAT deduction. They refuse the deduction if required invoice details are missing, even if the business can prove the purchase took place so that the transaction cannot be said to be fraudulent. These restrictions and the form-over-substance approach often taken by tax authorities do not meet the benchmarks of neutrality, simplicity, and certainty.

**Compliance Requirements**

The compliance requirements are broadly defined in the VAT directive. The details are mostly left to the member states, such as:

- How can a VAT registration be obtained?
- What is the required content of a VAT return?
- What are the deadlines for filing VAT returns?
- When are payments due?
- How would the government refund VAT when input exceeds output due?

All these rules vary among member states. The complexity increases the cost of compliance and hurts businesses regardless of a firm’s size and how many member states it operates in. Table 8 shows how long it takes a case-study company to prepare and file a VAT return and make the related payment in different member states.

The VAT directive includes no common rules for statutes of limitation, audits, investigations, and enforcement measures in

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Table 7. The Time to Comply With VAT for Economies in the EU, Excluding Malta
(Prepare/File VAT Return and Pay VAT Due, If Any)

<table>
<thead>
<tr>
<th>EU Economies</th>
<th>Hours to comply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>50</td>
</tr>
<tr>
<td>Belgium</td>
<td>60</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>70</td>
</tr>
<tr>
<td>Cyprus</td>
<td>80</td>
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<tr>
<td>Czech Republic</td>
<td>90</td>
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<tr>
<td>Denmark</td>
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<td>Germany</td>
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<tr>
<td>Greece</td>
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<td>Hungary</td>
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<td>Ireland</td>
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<td>Italy</td>
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<tr>
<td>Latvia</td>
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<td>Lithuania</td>
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<td>Luxembourg</td>
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<td>Malta</td>
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<td>Netherlands</td>
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<td>France</td>
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<td>Germany</td>
<td>330</td>
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<tr>
<td>Greece</td>
<td>340</td>
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<td>Hungary</td>
<td>350</td>
</tr>
</tbody>
</table>

Source: PwC — “Paying taxes 2010.”
the case of noncompliance involving penalties and criminal sanctions. Those are left to the discretion of the member states.

Invoicing rules are an exception, as they have been defined at the EU level. Regarding the contents of an invoice, the VAT directive requires minimum details for all member states. The EU has made significant progress by implementing the two invoicing directives.51 It’s expected that by January 1, 2013,52 e-invoicing and e-archiving rules will be simplified to allow further cost reduction for businesses.

A harmonized “compliance” model within the EU would provide for the best practices of efficiency and effectiveness and considerably reduce compliance costs.

Conclusion

The revenue balance is shifting to VAT, both in the EU and globally. When introducing a VAT regime, policymakers should find a balance between the interests of government, businesses (the unpaid tax collectors), and citizens. Also, a VAT design should meet best practice standards. Important lessons can be learned from reviewing the EU VAT system, which has existed for more than 40 years.

The EU VAT system has many strengths and meets best practice standards regarding the definition of taxable person, the scope of application of VAT to all transactions, and the place of taxation. It also results in high tax revenue to governments, but revenue isn’t maximized.

The EU VAT is applied on too narrow a base. That is mainly due to the exclusion of most activities of governments, their agencies, and many public interest activities (medical care, education, not-for-profits, and financial institutions). Multiple rate structures and nonharmonized compliance and enforcement rules create unnecessary complexity, uncertainty, and inefficiencies. The figure on the next page shows where we believe the EU VAT system fits on the best practice scale.

52For more details, see the PricewaterhouseCoopers publication “Global E-Invoicing and E-Archiving: Increasing Efficiency and Reducing Costs,” https://globalvatonline.pwc.com.
Figure 3. Impact of Design of the VAT/GST Law

Narrow Base
- Narrow definition of taxable person
- Low registration threshold
- Multiple rates
- Many exemptions
- Many zero-rated supplies

Broad Base
- Wide definition of taxable person (including government bodies)
- High registration threshold
- Single rates
- Minimal exemptions
- Minimal zero-rated supplies

Source: PwC research. © 2010 PricewaterhouseCoopers Tax Consultants bcvba. All rights reserved. 'PricewaterhouseCoopers' refers to PricewaterhouseCoopers Tax Consultants bcvba in Belgium or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.
The European Commission is working hard to develop a new VAT strategy that harmonizes and simplifies VAT rules while also combating VAT fraud. A green paper on the topic was issued in December 2010. If, based on lessons learned in the EU and other regions, the strategy is directed at moving closer to best practices, that can bring great benefits to governments, businesses, and citizens. However, those benefits must be clearly identified before the 27 EU member states unanimously agree to improve the VAT system.