VAT COLLECTION METHODS

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To link to this article: https://doi.org/10.11118/actaun201967030883
Received: 5.10.2018, Accepted: 17.5.2019

To cite this article: ZÍDKOVÁ HANA, ŠŤASTNÁ ANETA. 2019. VAT Collection Methods. Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis, 67(3): 883–895.

Abstract

Although, the VAT contributes significantly to tax revenues in all EU Member States, the current VAT system is vulnerable to organized fraud schemes and suffers from large scale tax evasion. The EU Member States and the European Commission are discussing new ways of VAT collection to prevent the evasive and fraudulent practices. This paper aims at the description of different VAT collection methods including their flaws and benefits that are addressed in the available literature. The conclusion is that reverse charge and split payment method are changing the character of the VAT system. The One stop shop system is lacking trust of the EU member states. Therefore, the recommendation is to improve current system by electronic means of reporting.

Keywords: VAT, collection method, VAT evasion, reverse charge, split payment, one stop shop

INTRODUCTION

Value added tax (VAT) is one of the most important taxes to the public budgets, and almost all OECD countries have implemented it. The VAT was firstly introduced in France in 1967 (Tait, 1988). Since then, 165 other states have implemented this tax (OECD, 2016). In 2014, according to OECD (2016), VAT collected by the EU Member States represents on average 6.8% of their gross domestic products. Among the EU Member States with the highest proportion of VAT on gross domestic product in 2014 were Denmark (9.5%), Hungary (9.4%) and Finland (9.2%). Although many countries attempt to raise the VAT revenues to the public budget, there is no apparent increase in the proportion of VAT on gross domestic product in OECD countries (OECD, 2016).

The reason for this could be a growing phenomenon of VAT evasion and even fraud (Manea A. C. and Manea L., 2011). Based on the VAT collection figures available, the total amount of VAT not collected across the EU Member States in 2015 is estimated at EUR 151.5 billion¹ of EUR (CASE, 2017). Around 50 billion of EUR (European Commission, 2015) are lost each year due to so called carousel fraud which abuses the exemption of the intracommunity supplies of goods and the current VAT collection method. The principle of current VAT collection system is that the buyer pays the VAT in the price of goods or services and the seller then remits the collected tax to the state. Generally, the VAT payers can deduct the tax incurred on their inputs. At the end, the VAT is born by the final customer who cannot deduct the tax paid in his purchases. The carousel

¹ This represents a loss of 12% of the total expected VAT revenue
fraud involves the supply of goods between EU member states followed by local supply of those goods where the supplier charges the output VAT on it but does not remit it to the tax authorities. However, the buyer claims the input deduction and the state budget incurs a loss by refunding it. The EU Member States are trying to find various measures to prevent such evasive and fraudulent practices.

Beside increased focus on tax compliance and tax enhanced inspections including international coordination, the European Commission considered the implementation of an optional reverse charge mechanism (further “RCHM”) as described in European Commission (2007). The RCHM changes the standard VAT collection in terms of the person who remits the VAT payable on each transaction to the state budget. Not the supplier but the buyer transfers the VAT to the tax administration. This helps against the carousel fraud as the seller cannot go missing after charging the VAT on his sale without remitting it to the tax authorities.

A Green paper with the objective to launch a broad-based consultation process with stakeholders on the functioning of the current VAT system and how it should be reframed in the future (European Commission, 2010) was published in 2010. In 2015, the Czech Republic proposed to the European Commission the introduction of a general RCHM for commodities and services over EUR 10,000 per invoice. Subsequently, the European Commission has prepared a proposal for the implementation of the general RCHM in 2016, which is still considered (European Commission, 2016). In 2017, the European Commission presented the basic principles of the so called Definitive VAT system (European Commission, 2017c). This system changes the tax treatment of the cross-border supplies of goods and should help against the carousel fraud.

It is apparent that a better system of VAT collection or an improved co-operation between EU member states is needed to combat the VAT fraud. However, it is extremely difficult to change current VAT rules. They must be implemented by all EU Member States in line with the current Directive 2006/112/EC (the “VAT Directive”) and interpreted based on valid judgments of the European Court of Justice. The VAT Directive can only be amended or altered if all EU member states unanimously agree on the proposed change. It is important to discuss all suggested changes to the current VAT system properly and compare the individual alternatives that are considered so that the politicians can decide with the adequate knowledge.

This paper aims at the description and comparison of different VAT collection methods currently discussed in the European Union. The main objective is to define the main advantages and disadvantages of individual methods. The results should help in the public discussion on the best VAT system.

Our qualitative research is based on the content analysis of the current EU legislation about the standard VAT system and the proposals of alternative VAT collection methods. We also gathered valuable data from the studies and scholar papers evaluating the proposed alternative methods. In searching for benefits and flaws of individual VAT collection methods, we used inductive reasoning (COPI et al., 2006). We applied the principles of the individual VAT collection methods on the standard types of business transactions and on the situation of VAT fraud. Based on this application, we concluded on potential impacts of new VAT collection methods from the perspective of businesses and tax administration bodies. Furthermore, we used comparative analysis of the effects of individual methods in order to conclude on the best option to be chosen when deciding about the definitive VAT system.

As mentioned above, several alternatives are considered how to collect the VAT in the distribution chain. In the following text, we describe the individual methods and compare their advantages and disadvantages from various points of view.

**CURRENT VAT SYSTEM**

The basic principle of the VAT system is defined in the VAT Directive in Article 1 stipulating that all goods and services are subject to a general consumption tax in an exact proportion (equal to the applicable VAT rate) to the price of the commodity or service regardless the amount of transactions carried out in the chain before the final consumption (Tait, 1988). Apart from the exceptions listed in the VAT Directive or in the national legislation of the EU Member States, each transaction is subject to the VAT calculated from the price of the goods or services using the applicable rates (Schenk et al., 2015). Each taxpayer is obliged to pay a tax liability equal to tax imposed on his “output” supplies of goods and services after the deduction of the tax directly incurred by him on all cost elements setting the price of goods or services supplied by him (Terra and Kajus, 2015). The so called tax credit
or invoice method\(^2\) of VAT collection is depicted in the following scheme.

Each VAT payer in the chain remits to the tax authority the difference between his output and input tax. For instance, the VAT payer A would pay to the state budget the amount equal to 25 200 less 21 000 which is 4 200 CZK. In the whole chain, the VAT payers collect the total VAT applicable on the goods (or services) distributed through the chain. Each VAT payer transfers to the state budget the VAT corresponding to his added value (margin) and the total VAT on the goods or services is thus paid in fractions. That is why this method is also called fractional payment method (Cnossen, 2010).

This method ensures a fiscal neutrality which means that the final VAT collected in respect of the goods and services sold for the same price does not depend on the length of the distribution chain (Terra and Kajus, 2015). This feature is important benefit of VAT in comparison to other turnover taxes imposed on each stage of production without the possibility to deduct the input tax (so called cumulative taxes). Another advantage is the international neutrality. The international advantage of VAT lies in the fact that export could be entirely de-taxed, and then re-taxed at the rate of the state of consumption, thus preventing distortions of competition (Terra and Kajus, 2015).

As already mentioned VAT is important fiscally, this is caused by its general character, i.e. all consumption in the economy is subject to VAT. Even a relatively low rate will yield a relatively high revenue. Also, its easy to raise the VAT rates if additional revenue is needed. Another fiscal advantage is the fact that the VAT is a less fluctuating source of revenue (Terra and Kajus, 2015). Further benefit of VAT is the psychological factor, because the VAT is hidden in the consumer price. It avoids confrontation with the VAT and minimizes resistance towards paying it. One of the disadvantages of VAT is its regressive character. The VAT taxes lower incomes more

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1: Standard VAT system
Source: VAT Directive, own elaboration

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\(^2\) Theoretically the VAT could also be collected by calculating the value added as sum of wages and profits, but this system is not used in practice (Tait, 1988).
heavily. EU Member States try to reduce regression by introducing exemptions, reduced rates (zero rates) or introducing higher rates for luxury goods (Terra and Kajus, 2015).

The VAT system has the positive or negative impact on the VAT payer’s cash-flow. There could be a time difference for the seller between receiving the money from the buyer and the payment of the collected VAT to the tax authority. Positive cash-flow only occurs if supplier’s invoices are due before the deadline for the submission of the VAT return and the VAT liability settlement. For the buyers, the cash flow impact is opposite. If the buyers pay VAT on their purchases prior to receiving the refund of it, the cash flow impact is negative. The impact of the current VAT system on the cash-flow of different types of businesses (e.g. retailers, exporters, etc.) is described for example in European Commission (2007).

Current VAT system is prone to VAT fraud especially due to the existence of input VAT claims. In the so called “chain” fraud, the fraudulent VAT payers charge the output VAT together with the price of the goods or services sold. They receive this VAT from their customers, but they do not transfer it to the state budget as they are supposed to. They go missing and the tax authorities cannot contact them and collect the VAT due. On the other side, the buyer who purchased the goods or services from those “missing traders” claim the input VAT deduction. If tax officers refund this input tax, the state budget suffers a loss. “Carousel” fraud is similar to the chain fraud, but it involves the cross-border exempt transactions and exploits the fact that the person acquiring the goods or services from other member state does not have to pay the VAT on them. This person then supplies these goods or services locally and goes missing without remitting the output VAT as in the case of the chain fraud. But in carousel fraud, not only the VAT from the margin of such person is lost but the VAT on the whole price of the sold goods is not collected (Ainsworth, 2006). This makes the carousel fraud the most dangerous of all VAT evasion types as the traded goods can even be fictional (existing only on invoices serving for VAT deduction only). Other types of VAT evasion include commodity smuggling, redemption of unlawful refunds on personal consumption, incorrect using of various exclusions, formal errors, etc. (Keen and Smith, 2006).

As discussed earlier, the EU member states discuss alternative VAT collection methods that could help eliminating the VAT fraud. Another way of combating the VAT evasion is increasing the information flow towards the tax authorities so that they do not refund the input tax deduction in the case of fraud. This was also recommended by OECD (2005) in the guidelines on so called Standard Audit File for Tax purposes (“SAF-T”). Some EU Member States implemented SAF-T already (Asquith, 2016). Other countries require other reporting obligations, where the businesses must declare their input and output transactions including the identification of their partners. As for example control statement or the evidence of cash sales in the Czech Republic and in Slovakia. This enables the tax officers to check that the VAT was paid before it is refunded. The standard VAT system has been also extended by the possibility for the EU Member States to hold the recipient of the taxable supply liable for the applicable VAT instead of the supplier. There is also an option for the recipient to secure VAT and send it directly to the tax officers instead of paying it to the supplier within the price of purchased goods or services.

The following Tab. I shows the summary of advantages and disadvantages standard VAT system.

The above Tab I. shows that VAT has many benefits mainly from economic point of view in comparison with other turnover taxes which could be cumulative or applied only on one stage of the chain. In our further analysis of other VAT collection methods, all advantages (e.g. neutrality) and disadvantages (e.g. regressiveness) of VAT still apply. Therefore, we focus only on benefits and flaws arising from different collection of VAT and will not further elaborate on main characteristics of VAT as such.

### REVERSE CHARGE MECHANISM

The RCHM is based on the rule that the output tax on each transaction is paid the buyer and not by the vendor as in the standard system. Only transactions between VAT payers can be subject to reverse charge. If the buyer has full right to

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3 More precisely, the VAT payer pays the output tax on acquisition of goods and then deducts the same amount, so the transaction is tax neutral.

4 Portugal, Austria, Luxemburg, France, Lithuania and Poland

5 Under Article 205 the Directive
VAT Collection Methods

I: **Advantages and disadvantages of the current VAT system**

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal stability of VAT revenue</td>
<td>Regressive character of VAT (taking a higher fraction of low incomes than of high incomes)</td>
</tr>
<tr>
<td>Cash-flow advantage for the state</td>
<td>Invisibility of VAT for the final consumers who bear the VAT burden (tax is hidden in the consumer price)</td>
</tr>
<tr>
<td>Invisibility of VAT for the final consumers who bear the VAT burden (tax is hidden in the consumer price)</td>
<td></td>
</tr>
<tr>
<td>Fiscal neutrality (VAT does not influence the length of the distribution chain)</td>
<td>VAT evasion, especially chain and carousel fraud</td>
</tr>
<tr>
<td>International neutrality (exports could be entirely de-taxed, and then re-taxed at the rate of the state of consumption, which prevents distortions of competition)</td>
<td>Prevailing negative impact on the VAT payers' cash flow</td>
</tr>
<tr>
<td>General character (each person is reached by the tax)</td>
<td>Large administrative burden on VAT taxpayers due to increased compliance caused by the anti-fraud measures</td>
</tr>
<tr>
<td></td>
<td>High administrative costs of tax authorities to combat tax evasion</td>
</tr>
</tbody>
</table>


input VAT deduction, his tax liability due to the tax authorities is zero (output tax on purchased goods and services less input tax in the same amount). As a result, the VAT on goods or services subject to reverse charge would be paid only by the last supplier in the distribution chain, whose customer is a VAT non-payer (usually the end consumer). Application of the RCHM requires extended reporting of transactions between businesses (VAT payers) so that the tax administrators can check the correct taxation of each transaction on the side of the purchaser. Therefore, all VAT payers have to file special sales and purchase lists\(^6\) reporting all their transactions sold and purchased in the RCHM.

The following scheme shows how the VAT is collected in the RCHM:

2: **Reverse charge mechanism**

Source: The VAT Directive, own elaboration

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\(^6\) They already file such reports in respect of supplies on which the specific reverse charge is applied (e.g. scrap, emission allowance, etc.).
The VAT payer A and the VAT payer B don’t pay the VAT to the tax authority, if they are fully entitled to deduct their input VAT. The VAT from the total price of the goods or services that are subject to RCHM is paid only by the last supplier in the distribution chain, whose customer is a VAT non-payer.

The main advantage of the RCHM is that it would certainly prevent carousel frauds (Ainsworth, 2006), because the VAT payer (customer) cannot claim entitlement to VAT deduction without remitting the output tax on this transaction. However, the general RCHM is targeting only on chain and carousel frauds, but it is necessary to find tools which eliminate all types of VAT evasion (Borselli, 2011).

Another advantage of general RCHM could be the positive cash flow impact on businesses. As already mentioned, the impact depends on the business model. However, the total impact of the specific reverse charge on all businesses in all EU member states is calculated as positive in European Commission (2014). It can be expected that the general RCHM would also influence the cash flow of VAT payers in a positive direction.

On the other hand, this system would have some disadvantages. One of them would be the negative impact on the public-budget cash flow due to the collection of VAT at the last stage of the distribution chain. Kohoutková and Zídková (2015) calculated the negative cash-flow impact for the Czech Republic in the amount of 53 billion CZK. The negative impact on the public-budget cash flow can be solved by the acceleration of the VAT collection at the end of the chain as retailers are paid immediately by final consumers (Wohlfahrt, 2011).

Another argument of the opponents to the general RCHM is shifting the risk of tax avoidance to the last member of the chain, probably smaller VAT payer, from whom the total VAT on the goods or services sold through the chain will be collected. This type of avoidance could, however, be eliminated by increased audits of those end-suppliers. The proponents of general RCHM claim that the tax administration would save time and human resources currently being used on auditing the input VAT claims in the chain.

In the specific RCHM, it is also difficult for suppliers to determine whether a supply is subject to a standard VAT collection system or RCHM. If the supplier mistakenly determined that the goods or services provided by him were subject to the RCHM, the VAT could be additionally assessed to him by tax administrator. On the other hand, if the standard VAT system is misapplied, the customer is not entitled to deduct the wrongly paid tax. If the general RCHM is implemented instead of the specific one, the errors in determining whether services/goods are subject to the RCHM would be eliminated.

The RCHM obliges the purchaser to quantify and pay the VAT on his input supplies, which significantly alters the standard VAT system. Where the purchaser is fully entitled to deduct VAT, there should be no increased VAT risk as the resulting tax liability is zero. However, a completely different situation would arise if the customer had not the full right to deduct input VAT. Such entity, usually the VAT exempt business will be responsible for the settlement of VAT. Under the standard VAT system, these persons do not apply output VAT and they also do not deduct the input VAT. Therefore, they miss a practical experience with the proper VAT reporting and payments and often lack appropriate accounting systems for a correct VAT calculation. For these entities implementation of the general RCHM, would entail significant costs, as they would have to adjust their systems, train their staff and hire tax advisors (Toman, 2015).

One of the other disadvantages is also ongoing compliance costs for VAT payers related to regular sales and purchase lists. However, the reporting obligations have increased under the current VAT system due to the anti-evasion measures in many EU member states. Therefore, general RCHM would not extend current administrative burden significantly.

The following Tab. II lists some advantages and disadvantages of implementing a general RCHM.

### SPLIT PAYMENT METHOD

The split payment method is also one of the examined alternatives VAT collection (Amand and Boucquez, 2011). The method changes the flow of VAT payments in the chain. There are more versions of this system. One alternative is a model in which the buyer (customer) pays the VAT to a special blocked bank account used for

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7 Applied on specific goods and services as scrap, metals, emission allowances, mobiles, etc.
8 Each CZK collected on VAT to the Czech state budget involves auditing of 9 CZK when deciding on the refunds in the chain (Kryl, 2018)
9 Financial institutions, health care providers, educational institutions, non-profit entities, etc.
II: Advantages and disadvantages of the general RCHM

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eliminating taxpayers’ mistakes arising from an incorrect VAT treatment if general RCHM is implemented (comparing to current VAT system with some items subject to specific RCHM)</td>
<td>Implementation costs for VAT payers and tax administrations.</td>
</tr>
<tr>
<td>The disappearance of carousel fraud</td>
<td>Ongoing compliance costs for VAT payers related to regular sales and purchase lists</td>
</tr>
<tr>
<td>Improving cash flow for most VAT payers</td>
<td>Risk of mistakes in application of RCHM if it is not general and applies only to selected goods and services</td>
</tr>
<tr>
<td>Simplification of the VAT audits for tax administration (it will not be necessary to audit all VAT refunds in the chain if the output and input tax is cumulated at the same VAT payer)</td>
<td>Negative impact on the public-budget cash flow</td>
</tr>
<tr>
<td></td>
<td>Increasing the risk of non-compliance in the last stage of the chain (retailers, providers of services to final consumers)</td>
</tr>
<tr>
<td></td>
<td>Higher administrative burden and risk related to incorrect VAT payments for entities with a partial or no claim for VAT deduction</td>
</tr>
</tbody>
</table>

Source: Own elaboration, Wolhart (2011), Borselli (2011)

VAT purposes. This VAT account can only be used for paying the VAT to the tax authority or another taxable person's VAT account. A split is made between the VAT and the tax base. The second version is, that there is a third party, which has an authorization to split the payment and transfer the VAT amount to the tax authority or blocked VAT account. The third party could be the supplier's bank.

Supplier calculates and communicates VAT amount, he also is obliged to report the split VAT in VAT return. The supplier is responsible for the VAT liability but does not remit the VAT to the tax authorities (he has no liability for the VAT payment). Customer (buyer) can possibly act as a splitting agent and after that he is obliged to transfer the VAT amount to authorities' or blocked account. Therefore, he has no VAT liability, but he is responsible for the VAT payment. The third party (splitting agent, supplier's bank) has also no VAT liability but is liable for the VAT payment. For the splitting agent, there might be a joint liability with the supplier if the payment is not correctly split (European Commission, 2017a).

The limited split payment method is already implemented in Italy (B2G transactions). Also, other Member States, such as Romania and Poland, have started considering the method (European Commission, 2017a). The split payment method is also implemented into the Czech legislation as

![Diagram](attachment:split_payment_method.png)

Source: European Commission (2017a), own elaboration
a special way of securing tax\textsuperscript{10}. If the purchaser suspects, that the supplier will not pay the VAT on the taxable supply rendered, he can pay the VAT himself directly to the tax authorities’ specified account.

The main benefit of split payment method would be the elimination of the carousel and chain fraud. In the carousel fraud the seller charges the output VAT together with the price to his customer but then he goes missing without remitting the VAT to the tax authorities. As the VAT would be settled not by the supplier but by the buyer, this type of VAT evasion would no longer be possible. Other advantage of a split payment method would be that some anti-evasion measures would not have to be applied to split payments and payers would be more confident.

This method would have a negative impact on VAT payers’ cash flow. The buyer would not be able deduct his input tax from his output tax. As the output tax will be remitted to the tax authorities directly by the buyer. In contrast to businesses, public budgets are likely to benefit from a positive cash-flow impact. This is because the part of output VAT collected by businesses that are subject to split payment will be transferred sooner than it would have been under the current VAT system (European Commission, 2017a). This only applies if invoices have a due date before the deadline for the VAT payment to the tax authorities\textsuperscript{11}. In the case of a longer maturity of invoices, the cash-flow under split payment method would be negative for the state.

Split payment method results in substantial administrative costs on both sides, VAT payers\textsuperscript{12} and tax administrators\textsuperscript{13}. On the other hand, it provides a large amount of data to the Financial authorities on all taxable transactions which would certainly help them to assess taxes. Administrative costs could be reduced with an increased automation of the system (e.g. e-invoicing, pre-filled VAT returns, automated split payments).

The following Tab. III summarizes the advantages and disadvantages of implementation the split payment method.

### ONE STOP SHOP

The EU Member States, led by the European Commission, are trying to streamline the VAT system so that tax evasion, and especially carousel fraud, is minimal. The carousel fraud is based on the exemption of intracommunity supplies of goods. Therefore, one of possible ways how to eliminate or at least significantly reduce this type of evasion is to remove this exemption (Amand, 2014).

In a proposal for a definitive VAT system, three basic principles were defined (European Commission, 2017c). The first principle concerns the taxation of intra-Community supplies of goods at the rate of VAT applicable in the country of destination. The second principle focuses on the liability of the supplier (vendor), who is responsible for quantifying the VAT and its subsequent levy to the tax administrator. However, if the buyer was a so called certified tax person\textsuperscript{14}, he would be liable for the VAT payment in the state of consumption. The third principle is the instrument ensuring that the VAT is reported and paid by the suppliers and subsequently distributed between the member states called the One Stop Shop (“OSS”). This proposal was

<table>
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<tr>
<th>III: Advantages and disadvantages of the split payment method</th>
</tr>
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<tbody>
<tr>
<td><strong>Advantages</strong></td>
</tr>
<tr>
<td>Reduction of VAT fraud and avoidance especially carousel fraud</td>
</tr>
<tr>
<td>Positive impact on the public-budget cash flow (invoice with standard due date)</td>
</tr>
<tr>
<td>Large amount of data to the Financial authorities</td>
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</tbody>
</table>

Source: Own elaboration, European Commission (2017a)

\textsuperscript{10} Section 109a of the VAT Act.

\textsuperscript{11} Standard due date of invoices in the Czech Republic is 2 weeks and the deadline for VAT payment is 25 days after the end of the taxable period.

\textsuperscript{12} Compliance costs for businesses related to the split payment method would range between EUR 74.2 billion and EUR 123.7 billion, depending on the version of split payment system.

\textsuperscript{13} Administrative costs for public bodies are calculated at the amount about EUR 600 million.

\textsuperscript{14} Reliable person approved by the tax authorities.
already processed into the paragraph wording of a proposal amending the VAT Directive (European Commission, 2018).

Traders would be given an access to the online portal, where they would fill VAT returns reporting all their sales to other member states and then quantify the VAT for each EU Member State in the given taxable period. The tax administrator in the supplier’s state would transfer the VAT to the tax authorities in the state of consumption (Gendron, 2016). This would be processed through the OSS in the supplier’s own Member State. The state of consumption would refund the VAT settled by the suppliers through the OSS to the buyers on condition that they are entitled to deduct input VAT. The suppliers would be able to deduct the input tax incurred on their purchases made in other EU Member States from the output tax applicable on their sales to those EU Member States through the OSS (European Commission, 2018). The OSS is depicted in following scheme.

OSS is applicable only on cross-border trade between businesses. Therefore, VAT payer A purchases locally the goods under standard system. Then he sells the goods to another member state and he declares the output VAT via OSS mechanism in his own Member State. The national tax authorities of the member state where VAT payer A is seated then transfers the collected VAT to the state of consumption (state of VAT payer B). The VAT payer B pays the invoice to the VAT payer A including the VAT. Afterworlds, the state of consumption refunds the VAT collected through the OSS to the VAT payer B as his input VAT deduction. Further local supply from VAT payer B would be taxed under standard VAT system.

One of the main advantages of the OSS is a significant reduction of carousel fraud. The European Commission (2018) believes that carousel fraud would decrease by EUR 41 billion due to the fact that goods would not be exempted from the VAT when sold to another EU Member State. The seller would invoice his customer the total price including the VAT and remit this output VAT to the tax authorities via the OSS portal. The definitive system would in fact unify the method of collecting the VAT for cross-border transactions and domestic supplies. The chain of VAT payments will not be interrupted by the cross-border supply. Even if the VAT payer who purchased the goods from another member state disappears without remitting the VAT on his subsequent local supply, the state would not lose the entire tax, but only the tax on the missing trader’s margin.

### Diagram

**VAT payer A**

- Purchase of goods (locally), receiving the invoice from his supplier, claiming input tax deduction
- **The full amount:** 121,000 CZK, Tax base: 100,000 CZK, VAT: 21,000 CZK, Deduction: 21,000 CZK

**VAT payer A**

- Sale of goods to other member state, issuing the invoice including 21% VAT, settling output VAT through OSS
- **The full amount:** 145,200 CZK, Tax base: 120,000 CZK, VAT: 25,200 CZK

**VAT payer B**

- Purchase of goods from VAT payer A (from other member state), receiving the invoice from supplier A, claiming input tax deduction in his own member state
- **The full amount:** 145,200 CZK, Tax base: 120,000 CZK, Deduction: 25,200 CZK

4: One Stop Shop

Source: European Commission (2017c), own elaboration
One of potential difficulties of implementing the OSS for the suppliers would undoubtedly be the erroneously identified VAT rate applicable on their supply in the state of consumption (customer's country). The European Commission suggests solving this problem through a web portal with a list of products that are not covered by the standard rate in each EU Member State. However, the suppliers would still incur additional administrative costs, as they would have to keep track of the list of reduced rate products of other EU Member States (VAT EXPERT GROUP, 2016). The supplier could also incorrectly identify the state of consumption, this could happen particularly in chain transactions where the goods are transported from the supplier to the final customer and between them are one or more intermediaries. In such a case, it is important to allocate the transportation correctly as this is decisive for the taxation. A mistake would mean that payment the VAT to wrong country and subsequent correction would be associated with penalties.

Taxpayers would also have to check whether their customer is a certified taxable person because in such a case the VAT treatment of the cross-border supply would be different. This monitoring will also increase the compliance costs of taxpayers. Administrative costs would also increase for the tax authorities in the EU Member States, as they would have to settle the VAT on cross-border transactions between themselves. Another disadvantage would arise for the buyer in his cash-flow as he would have to wait for the VAT paid on his cross-border purchase to be refunded15. This is not necessary in the current VAT system where the cross-border supplies are exempt from VAT.

Any major change in the VAT collection system also triggers implementation costs for tax authorities and for tax subjects. Not only that the accounting and tax programs would have to be adjusted, but also the employees would have to be trained for the new rules. Moreover, additional costs related to the VAT payers' requests for the status as a certified taxable person16 can be expected on both sides, the VAT payers and the tax administrators.

Another major disadvantage of OSS is the necessity of the VAT clearance between the member states. The EU Member States where the suppliers are seated and identified for OSS (states of identification) would collect the VAT due on all cross-border supplies dispatched from them and transfer it to the respective EU Member States to which the goods were supplied (states of consumption). The states of consumption would have to rely on the member states of identification that they would collect the VAT for them. This represents a major problem of OSS due to a low level of trust and cooperation between member states.

The following Tab.IV summarizes the advantages and disadvantages of implementation the OSS.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
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<tbody>
<tr>
<td>The disappearance of carousel fraud</td>
<td>Administrations costs (ongoing compliance costs for VAT payers associated with OSS, costs for tax administrations related to VAT clearance between member states, etc.)</td>
</tr>
<tr>
<td></td>
<td>The mechanism is effective only for carousel fraud and not for other types of VAT evasion</td>
</tr>
<tr>
<td>Unification of the method of VAT collection for domestic and cross-border transactions</td>
<td>Implementation costs for taxpayers and tax administrators (new software, new databases, requests for certified person’s status, etc.)</td>
</tr>
<tr>
<td></td>
<td>The risk of taxation of the supply of goods incorrectly (e.g. in the wrong EU Member State due to incorrect assignment of transport in a chain transaction)</td>
</tr>
<tr>
<td></td>
<td>Potential uncertainty for the VAT payers related to the status of certified person (the buyers status could change without supplier noticing)</td>
</tr>
<tr>
<td></td>
<td>Complexity for VAT payers consisting in the variety of applicable VAT rates in different EU Member States</td>
</tr>
<tr>
<td></td>
<td>Cash-flow disadvantage (waiting for the input tax)</td>
</tr>
</tbody>
</table>

Source: Own elaboration, Lamensch (2012), VAT EXPERT GROUP (2016)

15 Should the invoice be due after the input tax refund, the purchaser would not suffer any cash-flow disadvantage.
16 It is probable that the VAT payers will try to obtain this beneficial status
CONCLUSION

The current VAT system is prone to tax evasion. Each EU Member State has a different structure of the VAT gap, which also affects the requirements laid on an effective system. All suggested methods of VAT collection efficiently reduce carousel fraud. However, they do not suppress other types of VAT evasion as for example hiding of revenues. Our qualitative analysis reveals that all new methods involve additional administrative and compliance costs. One of the reasons is that all these methods require various administrative obligations in form of sales and purchase listings reported by taxpayers to tax authorities. Also, implementation costs associated with new methods significantly different from the current VAT system cannot be disregarded.

The methods have different impacts on cash-flow of businesses. Generally, Reverse charge mechanism has positive impact on majority of VAT payers whereas Split payment method and One stop shop would have negative effect. Although all of the discussed methods retain the main advantages of VAT, namely fiscal and international neutrality as well as its general character and reliability as the source of public revenues. Some of them, reverse charge and split payment method, change the nature of the VAT collection. In fact, these methods cancel fractional payments that were always viewed as the main advantage of the VAT system. The definitive system with OSS does not change the principles of VAT collection but it is opposed by most EU member states. This negative approach is caused by a low trust among them regarding the collection of VAT on cross-border transactions and its subsequent clearance between countries of origin and destination.

In our opinion, if the reporting obligations suggested for the new methods of VAT collection were implemented to the current system and the access of the tax administrators to all important information would be on-line and automated (Ainsworth, 2013), the VAT fraud could be eliminated without the necessity of implementing a brand-new VAT collection method. For the entrepreneurs as well as for tax administrators all changes result in additional expenses and uncertainty. Therefore, the preferable approach would be enhancing the current VAT system by the technology base solutions without changing its principles.

Acknowledgements

The contribution was prepared as one of the outputs of a research project of the Faculty of Finance and Accounting at the University of Economics „Public finance in the Czech Republic and the EU” registered by the Internal Grant Agency of University of Economics, Prague under the registration number F1/1/2016 and within the research project of institutional support IP 100040.

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17 Cash flow impact may vary according to the type of business but this is expected overall impact


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