

Zoltán Pitti

The operational efficiency of tax burden sharing systems and experiences with the completeness check on VAT

Motto: What is not measured, will decline!

It is a frequently expressed opinion of experts that the distribution of the tax burden is disproportionate and cuts down on efficiency and, besides all these, the tax burden sharing system works with low efficiency. These opinions are, however, mostly subjective and contain few particular arguments. The author of this research article, a scientific researcher at CORVINUS University of Budapest, Hungary, as well as an external expert of IOTA, will now make an attempt to compare and contrast the theoretically possible and the actually realised tax- and contribution revenues and explore the phenomena potentially causing the differences between them, relying on data on consumption taxes from the EU-27. Our editorial office considers this RA as a piece for debate and gladly invites you to give your opinion on the subject matter.

In the professional debates about tax burden sharing, a growing attention is paid to the development of the total tax burden and to the distribution thereof. While representatives of the *competitive sector* point out to the great extent of tax and contribution liability, the decline in international competitiveness, the lengthiness of financial settlements and the increase in the administrative burden, *natural*

persons (taxpayers) feel aggrieved at the frequent changes in the rules and the disproportionate distribution of burdens, and *both parties* often complain that tax burden sharing systems are not performance-incentive and do not operate with the expected efficiency. This is a warning signal in the case of a single country already, however, this may be especially so if the tax burden sharing practice of a given country does not stimulate but restrains the expansion of international connections. At the same time, it is rather difficult to judge the authenticity of these claims nowadays since the methods by which the operation of the tax burden sharing systems can be objectively measured are either not mature (or familiar) enough or are not suitable for international comparison.

In this RA, we will first have an overview of the operational characteristics of the tax burden sharing systems in the EU-27 countries, then we will *attempt* to carry out a completeness check on the consumption taxes, with special attention to VAT, in other words to *measure the differences between the theoretically attainable VAT revenues and those actually attained*. In the course of this completeness check comprising the period 2000–2007, we will touch upon the

changes in the tax burden sharing systems only to an unavoidable extent, focusing our attention on the results measurable at the macroeconomic level as well as on the presentation of the lost performances from a methodological point of view. Through this research article we hope to contribute with useful information to lawmakers and law users, while it may also serve as a good starting point for researchers investigating the operation of the tax burden sharing systems.

THE EXTENT OF TAX BURDEN AND ITS DISTRIBUTION ACCORDING TO THE MAIN TYPES OF TAX BURDEN SHARING

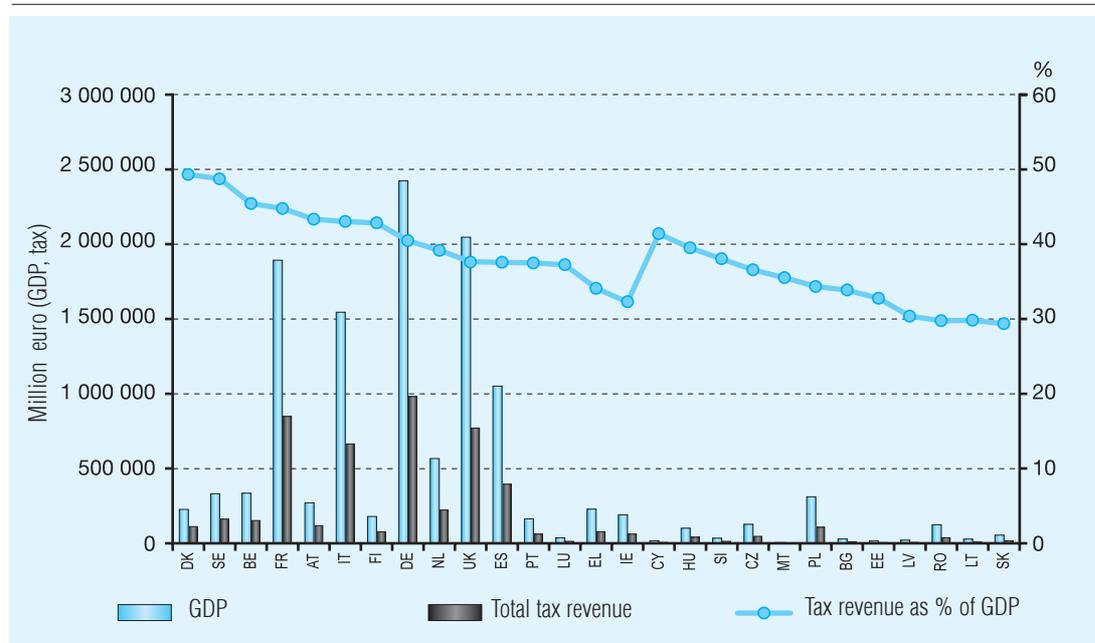
The most often used method for comparing and contrasting the tax burden sharing systems applied in different countries is to compare the taxes and contributions collected in a country in one year to its GDP produced in that partic-

ular year. According to this indicator, *the tax burden compared to GDP* shrank in almost all of the EU-27 member countries after the turn of the millennium and it reached its lowest at 39.8%¹ in 2004, however, in the following period the decrease stopped and movements in opposite directions could be observed. According to our research, during the period between 2000 and 2007, tax burden compared to GDP increased in 14 countries and decreased in 13. It is remarkable that in all of the newly joined countries – with the exception of Romania – the tax burden increased, while among the old member countries the burden went up only in Ireland, Italy, Portugal, Spain, and the United Kingdom.² (See Chart 1)

As a result of the changes, the *tax burden is above* the Community average in Austria, Denmark, Finland, France, Italy and in Sweden; the ratio compared to GDP *is to be considered average* in Germany, Hungary, the Netherlands, Portugal, Slovenia, Spain and the

Chart 1

TOTAL TAX REVENUE AS PERCENT OF GDP, 2007



Source: European Economic Statistics, EUROSTAT, Database

United Kingdom; while the tax- and contribution burden is *well below the average* in Greece, Ireland as well as in the majority of the newly joined Community member countries.

The above-average, average or below-average labels for tax burdens are *not unchanging categories*; due to changes in the role of the state, in economic development strategy requirements or in the socio-political aims, the analyses looking back to longer periods indicate *continuous changes in the burdens*. It is more than interesting that in the years immediately following the turn of the millennium it is not the intentions to directly increase or reduce taxes that were the determining factors in the changes of tax burden; the main role in the shaping of the tax revenues was played primarily by economic performance as well as by changes in law-abiding behaviour. (See Chart 2)

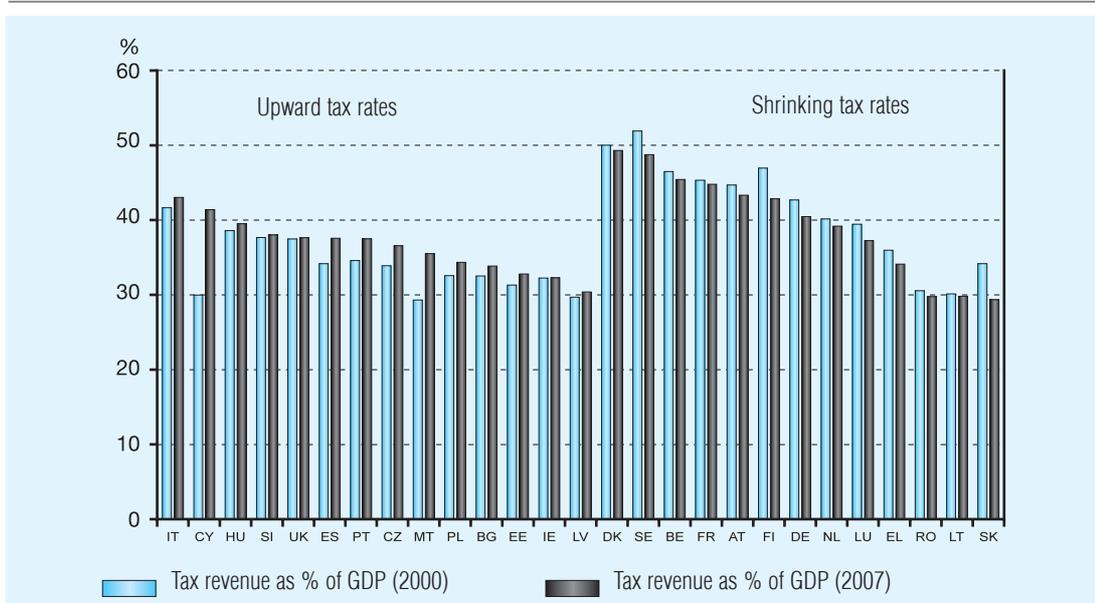
Based on experiences gained from longer periods, changes in the tax burden do not proportionately affect the different types of tax burden sharing, thus the shaping of the ulti-

mate result; especially regarding the period after 2005, a distinguished role is assigned also to the structural changes in tax burden sharing systems. The gradual moderation of *corporate tax rates* (cf.: Belgium, Finland) in order to improve the ability to attract and/or to reserve capital, or the decrease of *labour burdens* (cf.: Romania, Slovakia) in order to improve international competitiveness, have played such roles. The lost incomes have been basically replaced by an increase in consumption taxes, while there have been several examples also for the introduction of new types of taxes. The expanding and increasing tax burden on environment pollution activities, which may become the source of financing of a future “green reform” (cf.: Germany), could belong to this category, among others. (See Table 1)

According to data provided by EUROSTAT, the ratio of tax- and contribution revenues within budget revenues and the structural distribution of tax burden sharing *show significant differences*. This can be well experienced among

Chart 2

CHANGES IN TAXATION RATES IN THE EU-27 COUNTRIES IN 2000–2007



Source: European Economic Statistics, EUROSTAT, Database

Table 1

TOTAL TAXES AND SOCIAL CONTRIBUTIONS AS % OF GDP IN THE EUROPEAN UNION

(Percent)

	Indirect taxes		Direct taxes		Capital taxes		Social contributions		Total tax revenue	
	2000	2008	2000	2008	2000	2008	2000	2008	2000	2008
EU-15	13.4	13.0	14.0	13.4	0.2	0.4	14.0	13.9	41.6	40.7
EU-12	13.0	13.4	7.7	8.5	-	0.1	12.7	12.1	33.5	34.1
EU-27	13.4	13.0	13.7	13.1	0.2	0.4	13.9	13.7	41.2	40.2
HU	16.1	15.7	9.5	10.7	0.1	0.1	12.9	13.8	38.6	40.3

Source: Government finance statistics, Summary tables 1/2009, EUROSTAT

Table 2

THE DISTRIBUTION OF THE TAX- AND CONTRIBUTION BURDENS ACCORDING TO ECONOMIC FUNCTIONS*

(Percent)

	Labour tax and contribution burden		Consumption tax and contribution burden		Capital tax and contribution burden		Total tax revenue	
	2000	2008	2000	2008	2000	2008	2000	2008
EU-15	20.6	20.2	11.4	12.1	9.6	8.4	41.6	40.7
EU-12	19.1	18.6	11.9	12.3	4.4	3.2	33.5	34.1
EU-27	20.4	20.0	11.4	12.1	9.4	8.1	41.2	40.2
HU	19.1	19.4	15.1	15.9	4.4	5.0	38.6	40.3

Source: Government finance statistics, EUROSTAT, Summary tables, 2009

the old and the new EU member countries, which can be explained partly by historical traditions (cf.: payments kept at a low level), partly by differences in the regulatory policy (cf.: handling of capital gains), partly by the slow-track changes in the performances of the competitive sector (cf.: specific productivity indexes), and partly with the heavy polarisation of society. Thus, whilst income types of taxes have a decisive weight in the EU-15 countries and so do social contributions shared proportionately by employers and employees, in the EU-12 countries, due to the lower income level, it is consumption taxes as well as the social contributions increasing employers' costs primarily that take the main burden. However, *the growing significance of consumption taxes and within*

this especially the revaluation of the VAT is generally characteristic. The natural consequence of the structural differences is the contradictory effectiveness of the economic effects of taxes and contributions. (See Table 2)

The *tax burden sharing system* that has developed in the EU-27 countries until the present day is *caught in a Catch-22 trap*. The essence of the problem is that the standard of communal services operated by the nation states of the EU could only be maintained at increased expenses, while strengthening the centralisation of income would, however, seriously threaten international competitiveness. Under these circumstances, the tightening of public services by shrinking the contents thereof seems to be a natural solution, but already the

mention of the intention of such measures has triggered immediate and heated social reactions. The single way out of this contradiction is the broadening of tax- and contribution liabilities; the further refinement of tax burden sharing systems (cf.: besides consumption, imposing taxes also on assets, as well as a more forceful taxation on environmental polluting activities), but *the most serious expectations are connected to the improvement of the operational efficiency of tax burden sharing systems*. We would like to continue with a review examining whether and to what extent these expectations are justified.

THE COMPARABILITY OF TAX BURDEN SHARING SYSTEMS AND THE MEASURING OF THEIR OPERATIONAL EFFICIENCY

Improving taxation efficiency has been an old demand, although the conditions needed for measuring operational efficiency have evolved, for objective and subjective reasons, only at a slow pace. Within national frames, the homogenous interpretation of concepts, the development of the methodology and IT conditions of accounting and the provision of the human background for the professional analysis are still relatively easy to solve, but *the development of the conditions necessary for comparative analyses and efficiency examinations comprising more countries has presented a more complicated and time-consuming task*.

International organisations and international financial institutions started to develop a unified methodology and an information system relatively early, but the conditions for categorising the legal titles of tax burden sharing, varying from country to country, according to the same philosophy, summarising the tax- and contribution payments kept in various currencies according to purchasing power parity, and publishing the results in accordance with com-

parability requirements, have developed only in the last decade. The difficulty of the task is indicated by the facts that, for instance, in the European Union there are *27 types of taxation systems in operation*, the number of legal titles related to tax burden sharing varies from 38 to 232 and the financial and procedural rules are also relatively diverse. In the case of OECD countries, due to the lower level of harmonisation, the task is even more complicated. It is basically due to the above that the information systems in operation at present are far from being perfect, but even in their current state they are suitable to enable cooperative countries not to remain merely at the server level but to become users of the large information systems.

Such utilisation possibilities are the role assessment of tax and contribution revenues within budget revenues, the structural analysis of the tax systems varying from country to country and the assessment of the operational efficiency of tax burden sharing systems with indirect methods. However, beyond the possibilities mentioned, the international information system, taking the national characteristics into account, *provides opportunity for measuring the international "setting level" of a given country*, qualifying the law-abiding behaviour of its taxpayers and, what is probably most important, assessing the effectiveness of the operation of the tax authority. In order to achieve this, new approaches and methods are needed, at the same time (*see Chart 3*).

It has been well known for a relatively long time that, in order to qualify the operational efficiency of tax burden sharing systems, *it is important but not sufficient to be familiar with the GDP proportionate value of tax- and contribution revenues*. We gain a lot more information about efficiency by comparing the real tax- and contribution revenues to the tax potential calculated according to the top statutory tax revenues.³ The easiest method for this, calcu-

Chart 3

GAP BETWEEN STATUTORY AND REAL CORPORATE TAX RATES, 2007



Source: European Economic Statistics, EUROSTAT, Database

lated for various tax types individually, is the comparison of *statutory tax rates and real average tax rates* (calculated from the total yearly tax returns), referred to as “tax gap”⁴ in the international literature. This method can be well-used in the cases of personal income taxation and corporate income taxation.

The difference between the statutory tax rate and the average tax rate calculated according to the real performances is an *important “symptomatic” characteristic of a country’s behaviour in compliance with the law*; therefore more attention should be paid to the temporal changes in the deviations as well as to discovering the phenomena behind them. This is justified even despite the knowledge of the fact that the changes between the rates could also be effected, besides objective circumstances, by numerous subjective factors. Such subjective elements could include lax regulations on the conditions for benefits and exemptions, deficient or unsubmitted tax returns, unfulfilled pay-

ment obligations or even the lack of sanctions by tax authorities. Exactly for the latter reasons, an increased attention should be paid to the examination of tax rates.

A basic condition for calculating the statutory tax rates and the real average tax rates is to develop a purpose-built information system, incessantly follow the economic trends, and comprehensively assess the factors influencing the results. *This method, however, can be applied only to a limited extent*, as the method of calculation builds on voluntary and enforced tax returns and can draw conclusions merely from the data provided by taxpayers which, to tell the truth, deviates significantly from the values displayed by the National Accounts.

Results more reliable than those gained by investigating the differences between statutory and real average tax rates can only be *guaranteed by using the completeness check* that is applied in the international practice and which is under continuous development. The essence

of the method is that, building on data provided by national accounts systems and with a professional correction method adjusted to the various types of taxes, it develops the value of the so-called theoretical tax base and then, calculating with the statutory tax rates and the revenues maximally attainable under tax laws, it determines the theoretically attainable revenues and compares the real revenues to these values. The *advantage* of the method is that the completeness check, based on the data provided by the national accounts, does not only take the performances and taxes reported in the tax returns into account but it also comprehensively investigates macroeconomic performances. From the results obtained, relatively precise conclusions can be drawn regarding the processes ongoing in the “informal sector” as well as on shortcomings in law-abiding behaviour, and the logic of the calculations can also be well used in the risk analyses carried out by the tax authority. Its indisputable *drawbacks* are, however, that it only operates if the national accounts and the taxation information are matched and that its use requires serious professional competence as well as an analytical routine.

COMPLETENESS CHECK ON VALUE ADDED TAX

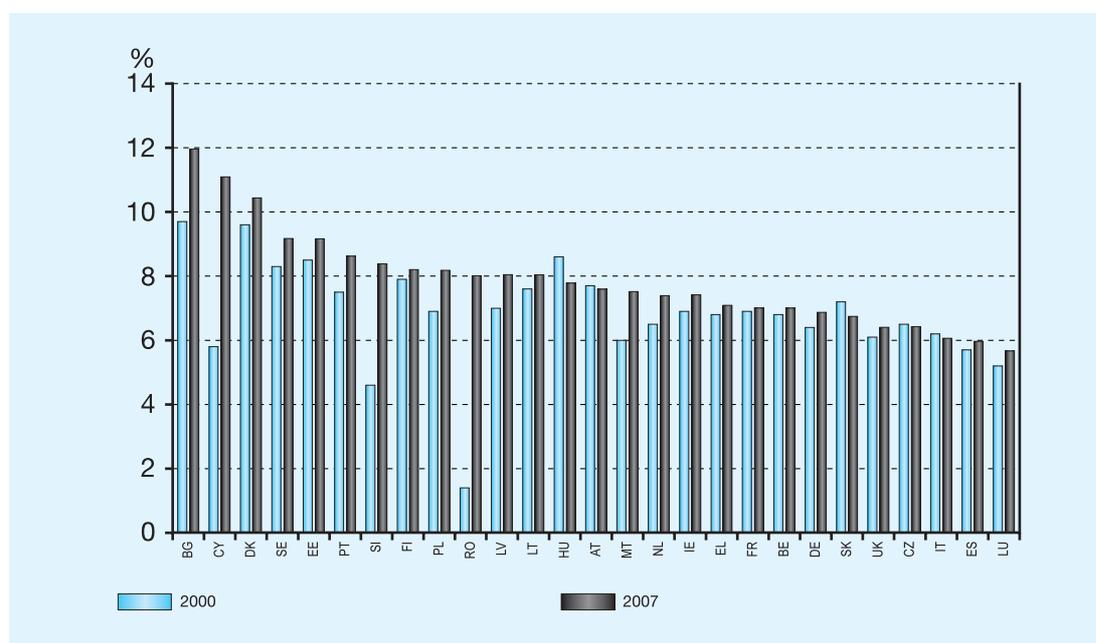
One of the most interesting questions considering the operation of the tax burden sharing system is the operational efficiency of the VAT, which accounts for almost two thirds of all consumption taxes. The VAT balance (net return), which is to be paid into the budget according to turnover or which can be deducted by producers by the right of utilisation, made up 7.0–8.0 per cent of the annual GDP in the average of the years 2000–2007, so it provided almost one third of the tax- and contribution revenues. Inferring from this propor-

tion, the operation of VAT accurately reflects the “added value” performances of different countries, the development of domestic consumption as well as the safety in the formation of budget revenues, arising from the consumption-based philosophy of tax burden sharing. (See Chart 4)

On the basis of a longitudinal study it deserves attention that the tax burden on consumption as a proportion of GDP is *significantly higher in small and medium-sized countries* than in more developed countries with a higher GDP performance and higher final consumption. There are *several factors playing a role* in the deviation: in Central and East European countries, due to the historically low level of the incomes, only consumption could serve as the basis for tax burden sharing and this distorting effect of the regulation was even further strengthened in the period following the political and economic change when the propensity to consume increased. Besides the extreme characteristics of household and communal consumption, there are also other factors playing a role in the phenomenon. Thus, the *VAT rates ranging between wide extremes* should not be left out of consideration (one extreme is Denmark and Sweden applying the maximum normal rate, the other extreme being Spain, the United Kingdom and Germany until 2007). Other influential factors include the special characteristics of foreign trade (cf.: foreign trade surplus or deficit), since the positive or negative balance either increases or decreases the basis of VAT. And the *law-abiding behaviour of the taxpayers* as well as the operational efficiency of the *control mechanisms⁵ of tax authorities* even exceed the above factors in importance. It is hardly by chance that international organisations pay a growing attention to the operation of VAT and strive to provide methodological help to national tax authorities as well as foster the efficient operation of the control mechanisms

Chart 4

VALUE ADDED TAX REVENUE AS % OF GDP IN THE EU-27 COUNTRIES



Source: European Economic Statistics, EUROSTAT, Database

of the cross-border movement of goods and services.⁶

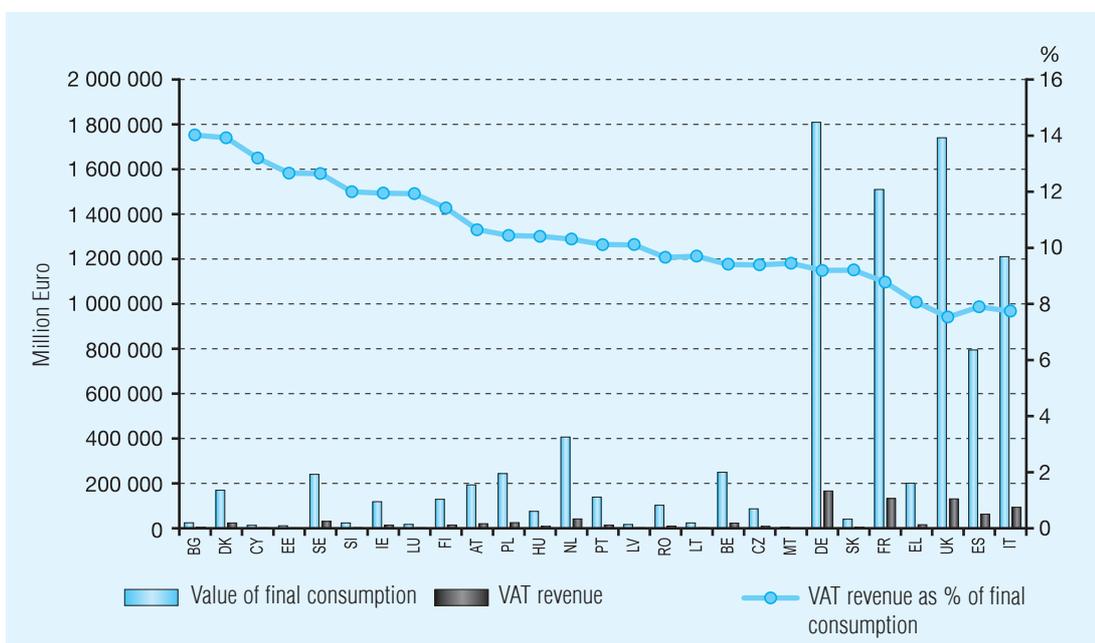
The method applied for the characterisation of the operational “efficiency” of VAT is to introduce a *ratio between the values of real VAT revenues and final consumption* within the consumption of the gross national product (GNP). The advantage of the method is the availability of the information base (cf.: pieces of information accessible from the National Accounts) as well as the direct international comparability. The drawback of the method is, however, that it is only suitable for “symptomatic diagnosis”, which means that it is not capable of demonstrating what factors influence the results and to what extent or what measures should be taken in order to improve the ratio. (See Chart 5)

The method that analyses the operational efficiency of VAT more deeply and comprehensively is the so-called completeness check. This method, also relying on data provided by the

National Accounts but already taking the correction factors into account as well, determines the *so-called calculated VAT base* according to the compounds of the value added type of tax and then, considering the normal rate according to the regulation in force (in some cases, the weighted average VAT rate calculated after consumption) it calculates *the value of the so-called calculated VAT revenue*, which is also to serve as the benchmark afterwards. Although the method of the completeness check is primarily used for the analysis of the tax burden sharing practices of individual states, in what follows, we will overview the procedure of the calculations, relying on preliminary data from the year 2007, using the summarised data of the EU-15, EU-12 countries and EU-27 countries. (See Table 3)

It can be seen also from these data that the completeness check on VAT revenues *builds also on the summarised data of total consumption* but, with regard to the VAT free nature of social benefits, it deducts the value of the non-

VAT REVENUE AS % OF FINAL CONSUMPTION IN THE EU-27 COUNTRIES, 2007



Source: European Economic Statistics, EUROSTAT, Database

cash compensations paid to households from the value of the communal consumption measured within total consumption. This way we get the value of the final consumption corrected according to VAT liability, the technical term for which is “purchased” consumption.

In the case of taxes based on turnover, besides final consumption, *gross capital formation* (and, within this, the value of gross fixed capital) also has a base extending function, but also in this case it should be considered that the participants of the competitive sector, apart from an inconsiderable minority, are VAT payers and, as a consequence, have the right for deduction (reclaim) according to their investments of production nature. This means that, from the point of view of the VAT base, only the budget accumulation, households and the investments of the non-profit sector are to be taken into account. (See Table 4)

The data on fixed capital from the years 2000–2007 indicate that the investment per-

formances affecting the VAT base have contradictory effectiveness in the EU-15 and the EU-12 countries: while in the old member states the capital rates ranged between 20–22 per cent of the GDP, in the EU-12 countries, with the exception of Cyprus and Malta, the corresponding rates fluctuated between 26–30 per cent. And considering the fact that the majority of the investment took place in the competitive sector, it made a downwards modification to the VAT base.

From the point of view of the development of the single European market, a distinguished role is assigned to the broadening of production and sales relations, to an increase in the turnover of goods and services. At the same time, while the foreign trade asset plays a positive role considering the current payments balance, from the viewpoint of the VAT base it has a negative effect. As a consequence, sales inside the community or the external export, owing to the application of the zero rate VAT, decreases,

Table 3

DETERMINATION OF THE CORRECTED VALUE OF THE FINAL CONSUMPTION, 2007

(at current prices, billion Euro)

Denomination	EU-15	EU-12	EU-27
1 Actual final consumption, total	8 928.6	666.7	9 595.3
2 of which Final consumption of households	6 569.9	509.1	7 079.0
3 General government final consumption	2 358.8	157.6	2 516.4
4 of which Social benefits	1 753.0	109.9	1 862.9
5 Corrected ("purchased") final consumption /5=2+(3-4)/	7 175.7	556.8	7 732.5

Source: European Economic Statistics, EUROSTAT, Database

Table 4

CORRECTED GROSS FIXED CAPITAL FORMATION

(at current prices, billion Euro)

Denomination	EU-15	EU-12	EU-27
6 Total gross fixed capital formation	2 416.1	214.1	2 630.2
7 of which Business investment	2 107.2	173.7	2 280.9
8 Corrected gross fixed capital formation (8=6-7)	308.9	40.4	349.3

Source: European Economic Statistics, EUROSTAT, Database

while purchases inside the community or the import, owing to the tax burden imposed on the import, increases the VAT base. (See Table 5)

After the ahead-mentioned corrections, depending on the total value of the corrected final consumption, the corrected gross fixed capital as well as the balance of the foreign trade and payments transactions applied as a correcting item, we obtain the so-called *calculated VAT base* as a result. The next step is determining the *calculated VAT revenue*, which is considered to be the benchmark for the real VAT revenues, and which is obtained as the *multiplication product of the calculated VAT base* (to be calculated according to the ahead explained way) and the normal VAT rate applied in the given country.

The determination of the value of the calculated VAT revenue according to the normal VAT rate produces a higher revenue value than the application of an average VAT weighted to consumption but, in the course of internation-

al comparative analyses, *the requirements of the neutrality criterion are also to be observed*. This in fact means that we cannot make the results of the calculations dependant on what types of preferential rates are used in the different countries tailored to the national characteristics, or on what types of products and services are classified under preferential rates. According to the logic of the completeness check we cannot determine anything else but the fact that *by applying a broadened version of the preferential rules, countries voluntarily waive a part of their potential revenues*. Nevertheless, in the course of a single country's assessment of its VAT performances, it is not only possible but is absolutely necessary to fine-tune, in other words to apply the VAT rate weighted to consumption. (See Table 6)

In the current calculation, however, hoping that the simplification of the calculation does not threaten the acceptability of the methodology, we applied a compromise solution, i.e.

Table 5

THE BALANCE OF THE FOREIGN TRADE AND PAYMENTS TRANSACTIONS AND ITS MODIFYING EFFECT ON THE VAT BASE

(at current prices, billion Euro)

Denomination	EU-15	EU-12	EU-27
9 Export (sales inside the Community and external export)	4 487.5	484.6	4 972.1
10 Import (supply inside the Community and external import)	4 386.7	521.1	4 907.8
11 Balance of the foreign trade and payments transactions (11=10-9)	-100.8	36.5	-64.3

Source: European Economic Statistics, EUROSTAT, Database

Table 6

THE VALUE OF THE CALCULATED VAT BASE AND THE POTENTIAL VAT REVENUES

(at current prices, billion Euro)

Denomination	EU-15	EU-12	EU-27
12 Value of corrected final consumption	7 175.7	556.8	7 732.5
13 Value of corrected capital	308.9	40.4	349.3
14 Balance of foreign trade and payments transactions	-100.8	36.5	-64.3
15 Value of the calculated VAT base	7 383.8	633.7	8 017.5
16 Extent of VAT rate (arithmetic mean)	19.8%	19.2%	19.5%
17 Theoretically realisable VAT revenue	1 462.0	121.7	1 583.7

Source: European Economic Statistics, EUROSTAT, Database

Table 7

THE THEORETICALLY REALISABLE AND THE ACTUALLY REALISED VAT REVENUES

(at current prices, billion Euro)

Denomination	EU-15	EU-12	EU-27
18 Theoretically realisable VAT revenue*	1 462.0	121.7	1 583.7
19 Actually realised VAT revenue*	787.6	69.0	856.6
20 Real VAT as % of potential revenue (19:18)	53.9%	56.7%	54.1%

* preliminary data

Source: European Economic Statistics, EUROSTAT, Database

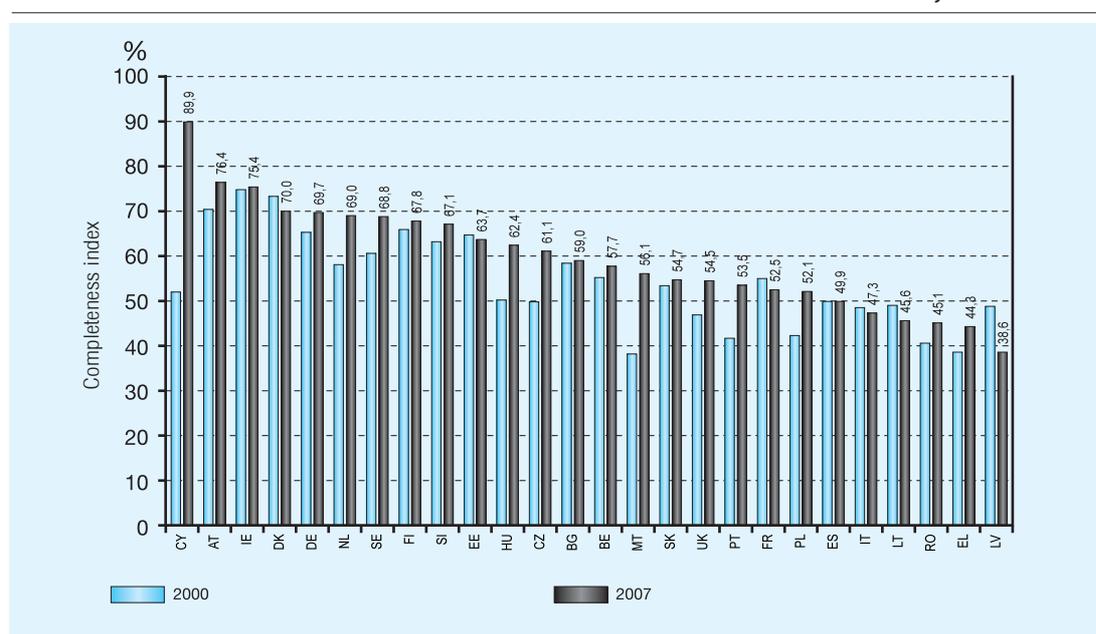
instead of the very diverse normal rates of the member countries, we took the mean of the VAT rates of the EU-27 countries as a calculation basis and multiplying the thus calculated average VAT rate by the calculated VAT base, we determined *the theoretically realisable VAT revenue* at the Community level. (See table 7)

Between the theoretically realisable and the actually realised VAT revenues, regarding both the absolute values and the completeness rates,

there is a *surprisingly great difference*, which immediately raises the question whether this extent could be real, and if so, what factor could explain this significant deviation. The first question has to be answered with a definite “yes”, despite the fact that the completeness check outlined with methodological intention is only the result of a calculation reflecting average values. So as to support our argumentation, in what follows we will present the VAT

Chart 6

CALCULATED VAT EFFECTIVENESS INDEXES IN THE EU-27 COUNTRIES, 2007



Source: European Economic Statistics, EUROSTAT, Database

effectiveness indexes calculated per member country during the completeness check of the year 2007. (See Chart 6)

The effectiveness indexes calculated in the member countries show a 15–20 per cent deviation – downwards or upwards respectively – from the average values in the EU-15 and EU-12 countries. One explanation for the relatively wide extremes is that the *volume of the theoretically realisable VAT revenues*, especially in the newly joined countries, *increases at a slower pace than the values of the actually realised VAT revenues*; the other explanation, however, is the fluctuation of the revenue efficiency between wide extremes. And having said this, we have arrived at the second question raised previously, i.e. at the question how the difference between the theoretically realisable and the actually realised VAT revenues can be explained.

The phenomenon is a *consequence of complex reasons*, including: deficiencies in the statutory regulations, hectic changes in the economic performances, a decay in the composition of

taxpayers and in their law-abiding behaviour, and last but not least a slower than required improvement in the control mechanisms. The following points deserve to be mentioned in detail:

➔ *Deviations to be traced down to Community directives, statutory requirements:*

- Survival of the VAT “destination principle” introduced temporarily (cf.: the effect of foreign trade and payment transactions on the VAT base);
- the value limit of taxpayer exemption and the broad range of taxpayers using the exemption;
- the varied application of preferential rates at a larger than justified scale;
- a lenient ranking of the products and services classified under preferential rates;
- a wide range of activities exempt from invoice issuing obligation and VAT payment (cf.: agricultural producers);
- the settlement system of the services and inconsistent changes in the regulations

As a way of summary, 15–20 percent of the deviations can be traced down to deficiencies in the statutory regulations (lack of regulation, distorting effects, problems of consistency).

➔ *Deviations to be traced down to economic processes and to the structural characteristics of the economy:*

- the indicators of fixed capital calculated as a ratio of GDP fluctuating between wide extremes (cf.: the effect of FDI);
- a dynamic broadening of activities specialised in the further processing of imported raw- and semi-finished materials (cf. paid processing), as a consequence of which the VAT balance, generated on the basis of the import and reclaimed on the basis of the export, is steadily and increasingly negative at the budget level;
- the atomised nature of the economic participants (98 percent of the enterprises can be classified as micro- and small enterprises), due to which the enforcement of lawful operation presents itself as an outside control task.

As a way of summary, 25–30 percent of the deviations can be traced down to the distorted nature of economic strategy, to the operation problems arising from the structure of the economy; all in all, to the extent of the informal economy.

➔ *Taxpayers' Behaviour*

- fictitious trade issues and real VAT settlements with several countries involved;
- commercial distribution without issuing invoices, due to which the turnover of both goods and services and VAT liability remain hidden;
- invoicing by deviating from the usual market prices (application of transfer pricing);
- the extensive practice of unlawful VAT deduction and reclaim, whose “most frequented” techniques include fictitious invoicing as well as the settlement of the

costs of personal consumption as entrepreneurial costs;

- the practice of “carousel invoicing” among companies belonging to the same owner circle, which distorts VAT results as well as corporate performances.

As a way of summary, 35–40 percent of the deviations may be put down to the conscious or unintentional tax avoidance of taxpayers, as well as to the intentional deception of the authorities.

➔ *Deviations owing to the operation of the tax authorities or to other circumstances*

- large companies are organised in a network system reaching beyond borders, while the operation of tax authorities, their authority to take measures, is bound to national borders;
- the control capacity is insufficient compared to the revaluation of the taxes on turnover, which comprise the majority of government revenues, and to the growth in the number of enterprises;
- instead of the assessment of macroeconomic processes and the analysis of the information of tax returns, a mechanical summary of the returns still dominates today, while risk analysis methods are still immature.

As a way of summary, 15–20 percent of the deviations can be traced back to the weakening of the law enforcement power of tax authorities, the disadvantage in human resources compared to the competitive sector and the immaturity of risk analyses.

Some of the items listed as explanations for the difference between the theoretically realisable and the actually realised VAT revenues have been known previously already and the termination of these reasons could be the result of an organic development. Other cases are, however, thought-provoking and require governmental or Community measures. Thus *governmental measures are required* in the

refinement of statutory regulations (cf.: narrowing of loopholes), the moderation of the disproportionality of the consumption-based tax burden sharing, the modernisation of the structure of the economy (particularly improving the foreign trade balance calculated at the macroeconomic level, with regard to both the current payments balance and the VAT base), as well as the repression of the “informal or black” economy. The *national tax authorities face the tasks* of developing information systems for measuring the efficiency of tax burden sharing systems, and risk analysing methods, improving the organisational and HR conditions of international cooperation and strengthening control mechanisms. Cases reaching beyond national borders and thus

requiring Community measures are the correction of the VAT settlement principle (instead of applying the destination principle planned for temporary application, the application of the original principle), the extension of the VAT, similar to the trade of goods and services, to international cash flow (cf.: Tobin tax), as well as the widening of the organisational framework of cooperation among tax authorities and the improvement of international relations. It is time we moved from the mechanical summary of information onto the substantial utilisation of the summarised information; in the knowledge of the past, onto the consideration of the risks concerning the future, and from monitoring the events, onto taking preventive measures.

NOTES

¹ However, already at that time, the average tax burden exceeded the extent of the tax burden in the USA or Japan, the greatest rivals, by 10–12 percentage points.

² According to the preliminary data of 2008 also other countries will have to increase the centralisation of income.

³ Tax potential is all the return that can be realised by keeping all the tax rules perfectly.

⁴ Tax gap is the total amount of the voluntarily unpaid taxes in a given financial period.

⁵ Through the technical development and broadening of VAT fraud, EU member countries experience a loss worth of 260–280 billion, a proportion exceeding one fourth of the total revenue.

⁶ OECD Forum on Tax Administration Compliance Sub-Group, European Union Contact Committee.