Assoc. Prof. Nikolay Galabov, PhD

EMERGENCE, DIFFUSION AND DEVELOPMENT OF THE VALUE ADDED TAX IN EUROPE

The paper discusses the development of VAT in Europe since its emergence, based on the achievements of financial and macroeconomic theory and using rich legal and statistical data. The main axis of the analysis is the controversy between VAT unification and the remaining differences in various countries. Special attention is paid on Eastern European countries (mainly EU-11) including Bulgaria.

JEL: F36; H25

VAT emergence and development in Western Europe

“Value added is the value that a producer (or distributor)… adds to his raw materials or purchases (other than labor) before selling the new or improved product or service.”[1] This way value added could be presented through addition of its components (wages + profits) or through subtraction (output – input). Besides, in each of the two approaches the tax could be calculated directly or indirectly.

In practice the method used in the EU (and almost everywhere else) is the subtractive-indirect approach, also called invoice or credit method. According to it the VAT amount due on outputs is subtracted from the one, due on inputs. There are three principal reasons for the subtractive-indirect method to be preferred: *first*, the invoice method attaches the tax liability to the transaction (operation), making it legally and technically far superior than others; *second*, this method creates a good audit trail; *third*, it allows for different tax rates on sales while considering company accounting and seasonal fluctuations of purchases, sales and inventories.

The most significant reason for the experimentation and the adoption of VAT in different countries with market economy is the dissatisfaction with the existing before it taxes on sales (turnover) which are mainly divided into two types. The first are cascade (multilevel) type of taxes – they take a straightforward percentage of all business turnover. As a taxed product passes from manufacturer to wholesaler to retailer, tax on tax occurs. It is estimated that the effective rate of a cascade tax to the retail stage is approximately 2.5 times the nominal rate (i.e. a turnover tax of 4% is equivalent to a retail sales tax of 10%).

Tax liability differs depending on the degree of vertical industrial integration, thus the tax deforms the production structure. Difficulties occur also in assessing the amount of cascade tax to be rebated on exports and imposed on imports. It was namely the disadvantages of this type of tax that persuaded the French to allow a credit for the tax content of purchases of raw materials against tax liability,

[1] Tait, 1988, p. 4 and following.

as well as for the tax content of capital purchases, which logically lead to the emergence of VAT.

The second type of turnover tax is the single-stage tax levied on manufacturers, wholesalers or retailers. Some cascading can be found here too whenever taxable goods are produced using taxed inputs. Logically, the problem is more frequently found when the point of impact of the tax is far from the retail stage. Numerous tax exemptions and multiple tax rates usually complicate the tax structure and undermine the tax base and politicians' populism only contributes to this.

A second reason for the adoption of VAT is the creation of the Customs Union (Common Market) originally by the six founding countries aiming at the abolition of discriminating border taxes. The member states acknowledge that VAT is the best way to increase neutrality and uniformity of tax burden as fair competition provides incentives for increased productivity and industrialization. A third reason to introduce VAT is that it aims at reducing, i.e. replacing other taxes (e.g. corporate or personal income tax or customs duties). Fourth, the tax system evolution is supposed to keep pace with the development of the economy. As trade becomes more complex countries are pushed as far as indirect taxes are concerned, toward introducing a truly general sales tax for its lower or lack of proportion distortions.

Value added tax (VAT), also known as net turnover tax, is firstly introduced in France in 1954, of course – in a different from its current form.[2] In 1962 the EEC Fiscal and Financial Committee recommends all member countries (6) to shift towards VAT. In 1963 a specially created in it commission chaired by professor F. Neumark presents a report on the ways for tax harmonization aiming to equalize competition conditions. According to this report tax harmonization should not affect the structure of tax systems, but only the influence of taxation in each country on the processes of integration and economic growth, i.e. tax neutrality with respect to the market of goods and services, as well as labor and capital. The Neumark Commission recommends the harmonization of indirect taxes on the basis of French VAT. Practical measures are only taken in 1967, in particular Directive 67/227 EEC Council of April 11, 1967 on the harmonization of the laws of the member states relating to turnover taxes. The main principles of the individual elements are specified as well as the mechanism of taxation. Export exemptions from taxation and import duties are set. A gradual convergence of rates is also implied. The adoption of VAT becomes compulsory for each new member state. This somewhat consentient VAT was adopted by member states between 1968 (France and Germany) and 1973 (Italy).

On June 29th 1973 the EEC Commission makes proposals for further harmonization of VAT, which after a long four-year dispute are adopted by Council Directive 77/388/EEC of May 17th 1977. It makes the most important step towards building a common VAT system with a uniform tax basis. Established are common

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[2] For more details on the main stages of the distribution of VAT see Tait, 1988; Bashkatova, 1988, p. 44-52; Keen…, WP/07/142.

rules defining the tax object, the method for determining the tax amount, the place of taxation. Listed are taxable goods and services; basic rules on tax rates (size) application; goods and services free of charge; rules for the return of tax charged in previous stages. The Directive extends the rules on services, agriculture and small enterprises, allowing the removal of double taxation in these specific areas. Moreover, the uniform tax base for VAT calculation facilitates strengthening the financial basis of the general budget of the EEC (EU) – since 1979 countries party deduct 1% of their proceedings for it.

The successful implementation of VAT in mutual trade of the original member states of the EU, as well as the recognition by the GATT (WTO) of zero taxation on exports makes their close partners also to introduce this tax at the same methodological basis. A number of future EU members introduce it before becoming members (Denmark, Sweden, Austria, Finland). VAT is introduced by European countries that persistently remained out of the EU (Norway, Iceland and Switzerland). Only Greece, despite its membership of 1981 slows the adoption of VAT up to 1987 against the rules, the main reason for this being the large influence of retailers and manufacturers on policies as well as the low tax morale.

After three decades of implementation and multiple partial Council Directive 77/388/EEC of 17 May 1977 is replaced by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax effective from 1 January 2007. The new directive does not bring radical changes compared to its predecessor Directive 77/388. In the interest of clarity and rationality, its text and structure have been redesigned to comply with the principle of better regulation. Numerous terms are précised. It provides for a gradual and more complete unification of VAT in different countries. For instance it confirms a minimum standard rate of 15% (Article 96) and a minimum reduced rate of 5% (Article 99). Countries may apply one or two reduced rates (Article 98). A special VAT Committee is created to implement the provisions of VAT and for consultation (Article 398).

However, the complete unification of the common VAT system in the EU is still far away. Both the main and reduced rates are different as well as their number, discharge thresholds and scope. There are differences in some special schemes for farmer taxation and other special occasions. Moreover, Directive 2006/112 allows for the conservation of many so called exemptions – a legal term meaning revocation and exclusion of the effects of certain terms, including individually by country, albeit temporarily (Article 370-396). However, Article 403 provides that the VAT Committee in accordance with Article 93 of the EC Treaty adopts appropriate for this purpose directives supplementing the common system of VAT and, in particular, progressive restriction or abolition of derogations from that system. Article 402 of Directive 2006/112 declares the VAT system as *transitional* as at a higher degree of integration of the member states it might be replaced by a final, "based on the principle of taxation of goods and services in the member states *of origin*" (instead of the current principle of *destination*). In the foreseeable future, however, this will probably remain ad lib.

Transformation of turnover tax into VAT in the Eastern European countries

Of course there is a common reason for the desire to introduce VAT instead of gross sales taxes – this is the strive to introduce a more perfect tax form that distorts economic proportions less while providing different secure and increasing in time budget revenues. Transformation with the introduction of VAT in Western European countries (and other industrialized countries)[3] is meaningful, takes place for over 45 years, but these countries are far from the adoption of the so-called final regime. Changes in Eastern Europe are far larger in scope, because they are an integral part of the change of the economic system – from planning-directive to market economy. The fact, that these former socialist countries could use the already “proved” in Western Europe "samples" and avoid some of the mistakes and ramblings, is not irrelevant. For the already applied (and now applying) for EU membership countries VAT is a part of the required for their adoption reforms.

However, the scope of the changes is really bigger and more complex. In the planning-directive economy major decisions are made by one center with the idea being that this way of determining the rates and proportions and resource allocation is more perfect than the market, including its modern modifications. Market (commodity-money) relations and mechanisms play only a passive "accountancy" role. They are subject to the plan.[4] Thus, there are no reasonable criteria for soundness of one or another decision, for whether certain costs and prices are high or low, and for incentives for reducing costs and improving and innovating production. Economy develops according to volitional impulses of the plan, with virtual primacy of natural-material indicators, inefficiently and largely – autarchicaly.

With the depletion of extensive factors, the complication of relationships in the economy and the increase of the need for a variety of goods and services for final consumption this high degree of centralization becomes increasingly inadequate. So in the 60[-ies] in all Socialist countries in Europe ways are sought to improve the management of the economy by partially increasing the independence of enterprises. A certain percentage of profit is set in the prices of the manufacturer as part of them, and the majority of depreciation costs remain for the enterprise. Thus, the state budget becomes basically two-channel, i.e. apart from turnover tax, a significant proportion of revenue derives from profits. Moreover, some companies get certain amount of autonomy in making specific decisions.

Turnover tax is a margin ("buffer") between the wholesale price (retail price without trade discount) and producer price (most often manufacturer's suggested retail price MSRP because 90-95% of the tax is paid by the industry). Its size is

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[3] Until the beginning of 1990 only 51 countries have adopted VAT, including Hungary. In 2007 the countries applying VAT are over 130, including all OECD member states (except USA) and all Eastern European Countries (see Keen…, WP/07/142, p. 3; Tait, 1988).

[4] This suggests "a direct (central) definition not only of general, but also of specific proportions of the volume, assortment and prices of goods and of the direction of their implementation" (Petrov, 1976, p.164).

highly variable and changes because the two sets of prices vary independently. This breaks the link between production and consumption and distorts the optimal (from the market point of view) proportions. Theorists of this model see its economic role (beyond purely fiscal) precisely in being a regulator of profitability (through transformation of the profit to turnover tax and vice versa). However, turnover tax adjusts profitability by sectors and industries, but not by enterprises. Furthermore, the subtraction method kills the incentives for technical progress. Outdated (and long utilized) products have lowering costs of production (worth) and respectively – growing profitability (at constant prices), while new products have lower profitability. These disadvantages of the subtraction method and the "two levels" of prices are well known in the economic literature.[5]

Economic thought in Bulgaria and other countries sees the outcome of these contradictions in transforming subtraction VAT in percentage as gradually the multiple (several hundred or even 2-3 thousand) rates are transformed into a percentage of the wholesale price (retail price without discounts). By gradually averaging within commodity groups, rates should have been reduced to several. All this could only be done gradually over a relatively long period, as it comes to significant changes in relative prices. For socio-political reasons, however, significant changes in consumer prices are undesirable. Attempts to transform the subtraction rates of turnover tax to percentage and their gradual consolidation in the 70s (in Bulgaria, Poland, Czechoslovakia and Hungary) meet certain difficulties and generally are ceased.

The conversion of the price difference in percentage technically is just a simple operation. The point of transition to percentage is for it to be related to the liberalization of prices, so that the tax becomes a pricing element. However, if the turnover tax is a legally defined percentage of the price, it no longer serves as a regulator of profitability. It becomes more differentiated. In the end-user prices, which are supposed to remain constant, it is necessary to increase funding from the budget. For the other consumer prices, problems concerning their stability arise, leading repeatedly to administrative prohibitions.

Ultimately, it is no coincidence that Hungary, which, albeit with fluctuations, reduces fixed costs by 75-80% in 1968 to 55% in the early 70ies, 45% in 1980 and only 15-16% in 1990,[6] first of the Eastern European countries introduces VAT, albeit with many compromises. Conversely, in countries with predominantly fixed prices the subtraction method is retained. Thus, in Bulgaria in the early 80s the turnover tax as the difference in prices takes 80%, the one as absolute amount for product – 15% and as a percentage of the price – only 5%.[7] Similarly, in the USSR in 1981, as price difference it is 86% of the turnover tax, as a fixed amount for product – 9% and as a percentage of the price - 6%.[8]

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[5] Butakov, 1973, p. 85-87; Butakov, 1976.
[6] Bodoci, 1990.
[7] Stoyanov, 1982, p. 167.
[8] Sorokin, 1983, p. 56.

"Pros and cons of turnover tax in the form of an absolute amount and in percentage form are also relative and not absolute ... For example, in terms of the pre-reform business mechanism with its unavoidable weak mobility in wholesale and retail, the percentage tax would become either a mere formality or a serious obstacle to the functioning of this business mechanism. Namely the latter makes the arguments for turnover tax in the form of an absolute amount real and those in favor of the percentage turnover tax – abstract and formal. Changes in the economic mechanism accordingly affect the "advantages" and "disadvantages" of each of these types ... but ... to introduce a percentage turnover tax suddenly on a mass scale is impossible. Such measures would cause a rapid change in the structure of the solvent demand of the population."[9]

Turnover tax contains many heterogeneous elements except for the "standard" sales tax – these are mainly excise duties (on luxury and health products) as well as the so called import price differences. This heterogeneity further enhances differentiation of rates. Due to the relative immobility of consumer prices a wide range of end-subsidized prices is formed – the so called red, i.e. negative turnover tax. For example, after January 1st 1980 in Bulgaria the range of rates on sale price is from minus 50-150% to plus 80-90%.[10] Similarly, in Hungary in 1980 rates fluctuate from plus 88% (vodka) and 62% (tobacco products) to minus 134-178% (children's furniture). Thus, for 1980 the expected revenues from turnover tax are about 65 billion HUF while grants are about 50 billion HUF.[11]

The experience of Hungary, Czechoslovakia and Bulgaria in the 70s - 80s of the last century shows that in many cases the low rate of profit is accompanied by a low rate of turnover tax and large grants. Hence, they cannot have a normal (average) rate of turnover tax without sensitive changes to the whole system of prices, including the end prices. The reason is that mainly prices of food products and other goods and essential services are subsidized while turnover tax exists on secondary or excisable goods.[12]

In order to avoid "cascading", i.e. accumulation of tax on tax, in the classical system of turnover tax as the difference in prices, taxation focuses on consumption goods (and services) while capital goods are exempt from it (hence the term "two price levels"). In the last years of the command-administrative system in Bulgaria, however, there is a significant increase of the share of taxes on certain capital goods (which, however, are "with dual purpose", i.e. they can be used for final consumption) – mainly petroleum and construction materials. Similarly, in Hungary the taxation of means of production in the early 80s gives about half of the total amount of turnover tax, and in the USSR – about 1/3. All this shows how artificial is the differentiation of "first and second division" and how complex are the problems of the transformation from a command-administrative to a market system of economic management, even in a particular field.

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[9] Aristov, 1980, p. 124 and 126.

[10] Economic Mechanism of Functioning and Management of the National Economy. Sofia,1981, p.138.

[11] Vincze, 1981, p. 14.

[12] Aristov, 1980, p. 125.

Ultimately, VAT in most Eastern European countries is introduced as part of the changes in general economic liberalization, including in predominantly market determined prices. Liberalization of prices and higher inflation facilitates the gradual consolidation of the rates to some, and then it is easier to introduce VAT. In most countries in Eastern Europe that takes place in a relatively short period – between 1991 and 1994, and in the countries of former Yugoslavia, because of the special conditions – in 1998-2005.

According to A. Tate[13] the normal period for the introduction of VAT is 21 months including the last three months for "fine tuning" of the already released functioning mechanism of VAT. To this end (typically using IMF) a detailed schedule is created. At approximately the eleventh month a bill should be adopted by the council of ministers, and at the twelfth – by the parliament. This allows to proceed to a specific propaganda to give voice to the act (a brochure with 30-50 pages with main data; manuals, lectures and meetings with stakeholders; development of forms and other documentation; specific training of personnel; registration of taxable persons; preparation of computer systems, taking into account the VAT in real time, recording devices, etc.).[14] It should be borne in mind that both the complex legislation terminology and accounting personnel with appropriate qualifications are completely new to Eastern Europe. As a consequence of "planning reflexes" tax authorities in these countries often underestimate the problems associated with informing the general public and the preparation of materials related to it. Problems and resources in terms of staff training are also traditionally overlooked as well as the complex and responsible administrative task of drafting instructions to apply the VAT Act.

At first glance, if it collects as much revenue as the taxes it replaces, VAT should not raise the overall level of end-user prices. Of course, relative prices vary, but in addition to goods with increased prices, there should be those with reduced prices. In fact, all the changes in relative prices in transition economies release the inflation suppressed by administrative means before. It is therefore difficult to distinguish inflation as a fruit particular to the introduction of VAT. Unlike its predecessor – the turnover tax, the introduction of "full" VAT includes the numerous retailers as well. Since there is usually insufficient clarity regarding the specific and general changes in prices, often retailers are trying to insure by raising prices. Sometimes this is quite deliberately done to make profit. When unions manage to advocate for an increase in nominal income as compensation, the inflationary spiral can be rotated.

In the *Czech Republic* with the introduction of VAT in January 1993 the government plans to increase prices by 7%. In reality, however, a small "price shock" occurs – prices jump by 10-20%. In response, the government introduces controls over them. For the full year inflation is 16.5%, with some goods' prices

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[13] Tait, 1988, p. 409-416.

[14] For more details on the schedule, content issues and characteristics of the introduction of VAT, including in the countries in the former planned-directive economy see Tait, 1988, p. 172-187 and 409-416; Fiscal Policies in Economies in Transition…, p. 226-232; Vucheva, 1989.

increasing less, and others more than expected. In a study, the Czech trade inspection shows that 25% of the retailers claim they do not know the principles of VAT, and another 25% – that they have a vague idea about them. Hence, the conclusion is that the campaign was not sufficient and active.[15]

In *Hungary*, VAT is introduced in relatively calm conditions, including previously released prices. It is accompanied by a decrease in producer prices by an average of 5%. However, considering the increase in 1986 it is expected to increase retail prices in 1988 by about 12-14%. Or, if one takes into account the change of producer prices, the overall increase in two years is about 17-19%.[16]

In *Bulgaria*, VAT is introduced (after a delay) from April 1st 1994 in a complex macroeconomic situation – quickly depreciating BGN, "floating" dollar and centralized price increase of electricity and heating, plus pressure from trade unions for wage increases, regardless of the financial performance of companies. In this inflationary environment and with poor visibility, transparency and control, merchants use the introduction of VAT for speculative price increases. Instead of 4 to 8% the increase in prices due to tax introduction reached 31.0% (about 29% of the total for the year).[17] However, the introduction of the VAT and the harmonized with it excise duties increase their revenue in 1994 from 7.3 to 10.8% of GDP, i.e. with 48%. Furthermore, according to calculations of the World Bank, that led to the increase in the share of indirect taxes paid by the private sector from 16.2% in 1993 to 43.2% in 1994.[18]

At first glance, VAT is presented as a universal tax on final consumption. A closer analysis shows that there are many legal restrictions (tax avoidance) which reduce the tax base and tax revenues. These are the mandatory registration thresholds and other forms and areas of exemptions, zero rate (except for exports), and reduced rates (including the so-called specific schemes, particularly with regard to agriculture). This is compounded by various tax frauds (tax evasion).

Mandatory registration thresholds, exemptions and zero rate

Mandatory VAT registration thresholds over certain amounts are actually three types: exemptions for small businesses (most important); mandatory registration in intra-Community acquisition; remote sales. Practically below these thresholds small businesses are exempt from the obligation to register for VAT purposes. But there are mixed results. According to Article 289 of Council Directive 2006/112 /EU "taxable payers exempt from VAT shall not be entitled to deduct VAT ... and may not show the VAT on their invoices". The amounts of the thresholds are VAT excluded. The most important of these thresholds – for the so-called small businesses, is only valid for companies registered in an individual country. The threshold (limit) should be set at such a level as to exclude merchants whose registration costs more than the revenue

[15] Ministry of Finance. The Budget, 1994…, p. 55-58.
[16] Vucheva, 1989, p. 8-9.
[17] According to Plan Econ report. – Pari newspaper, July 29, 1994.
[18] Privatization of Public Companies' Profits in Bulgaria. - Pari newspaper, May 30, 1995.

that they would give. This includes not only small retailers, but all small businesses regardless of their industry affiliation. Usually the threshold is determined for the last 12 months.

Besides the relatively high administrative costs to register and control small businesses, there are reasons for exemption on their side. For example, small retailers, especially those who deal in cash, in more or less "street" conditions without using the cash counters and appliances, are struggling to keep a record of their gross revenues. If there are different rates of taxable goods (or one positive and a zero rate) there is an additional difficulty to separate the goods subject to different rates of purchases (input) according to the ratios. All small businesses claim that their allowance for tax consent is higher than that of large firms. For example in the UK 1 Million small businesses (76% of all registered) have paid in 1983-1984 only 7% of the total revenue from VAT, so the alleviation of the system would be good not only for the merchants, but also for the tax authorities.[19]

Furthermore, in small businesses accumulated stocks fluctuate significantly. The so-called own consumption is widely used. Although it is a taxable transaction for VAT, it is difficult to tax in practice. Relatively high thresholds protect small businesses from artificial fragmentation. On the contrary, a small business should strive to exceed the mandatory registration threshold in order to allow customers to use tax credit.

An important and essential addition to mandatory registration is the voluntary registration.[20] Small enterprises (mostly small merchants) have an incentive to register voluntarily if: *first*, most customers are taxable and would like to receive invoices for their inflow (input), to deduct it from their payable tax; *second*, they deal with regular export trade (including intra-Community) and want to reap the benefits of a zero rate, i.e. the full return of the accumulated tax.

When selling to unregistered persons, a merchant with a larger element of his selling price represented by its own value added (labor and profits) is likely to be better off not registering. If he sells to registered persons, it comes down to a trade off between the increase of costs and the preference of his registered customers for invoices showing VAT.[21] Among other things the existence of a threshold below which registration is not mandatory allows in some cases to avoid special schemes. For example, in Bulgaria the threshold of 50 thousand Leva (25 565 EUR as an equal value)[22] for 12 months, should satisfy normal farms (farmers).

Despite the recommendations of Directive 77/388 to unify the thresholds for small businesses, the prescription to gradually reach 5 thousand EUR for 12 months for the old Member States (those that entered the EU before January 1st 1978 – the six founding countries plus the UK, Ireland and Denmark) has not been realized. Directive 2006/112/EC of November 28th 2006 on the common system of VAT

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[19] Tait, 1988, p. 117.

[20] In the former Bulgarian VAT Act of 22.10.1993 – Article 14, in VAT Act, effective of 1.01.2007 – Article 100.

[21] Tait, 1988, p. 132.

[22] VAT Act, effective since 1.01.2007 with amendments until 26.03.2013, Article 96.

confirms this threshold, allowing to administratively support its actual value or to reach it, if it was lower (Article 284 (2)). In fact, even among the three new countries over the period 1982-1987 there were polar differences. The threshold for Denmark is 10 thousand DKK (1576 USD); Ireland – 15 thousand IEP on services (24 136 USD) and 30 thousand IEP (48 273 USD) for goods; in the UK - 20,500 GBP (11 386 USD).[23] The other countries (27 up to 2007) are allowed to release different amounts declared on the date of accession (according to Article 287). The amounts updated up to 2013 (according the change in exchange rates), including those in some non-EU countries, are shown in the left side of Table 1.

Table 1

Thresholds for mandatory VAT registration in selected European countries (2013)

Country	Mandatory registration thresholds (exemptions for small businesses)		Mandatory registration thresholds in intra-Community acquisitions	
	National currency	EUR equivalent	National currency	EUR equivalent
1. Belgium	5800 EUR	-	11 200 EUR	-
2. Bulgaria	50 000 BGN	25 565	20 000 BGN	10 226
3. Czech Republic	1 000 000 CZK	40 851	326 000 CZK	12 998
4. Denmark	50 000 DKK	6707	80 000 DKK	10 729
5. Germany	17 500 EUR	-	12 500 EUR	-
6. Estonia	15 978 EUR	-	10 226 EUR	-
7. Ireland	75 000 or 37 500 EUR	-	41 000 EUR	-
8. Greece	10 000 or 5000 EUR	-	10 000 EUR	-
9. Spain	none	none	10 000 EUR	-
10. France	81 500 or 32 600 EUR	-	10 000 EUR	-
11. Italy	30 000 EUR	-	10 000 EUR	-
12.Cyprus	15 600 EUR	-	10 251 EUR	-
13. Latvia	35 000 LVL	49 659	7000 LVL	10 043
14. Lithuania	100 000 LTL	28 962	35 000 LTL	10 137
15. Luxemburg	10 000 EUR	-	10000 EUR	-
16. Hungary	5 000 000 HUF	18 328	2 500 000 HUF	9164
17. Malta	35 000, 24 000 or 14 000 EUR	-	10 000 EUR	-
18. Netherlands	none	none	10 000 EUR	-
19. Austria	30 000 EUR	-	11 000 EUR	-
20. Poland	150 000P LN	37 774	50 000 PLN	12 591
21. Portugal	10 000 или 12 500 EUR	-	10 000 EUR	-
22. Romania	119 000 RON	28 249	33 800RON	8024
23. Slovenia	25 000 EUR	-	10 000 EUR	-
24. Slovakia	49 790 EUR	-	13 941 EUR	-
25. Finland	8500 EUR	-	10 000 EUR	-
26. Sweden	none	none	90 000 SEK	10 622
27. United Kingdom	70 000 GBP	81 843	70 000 GBP	81 863
28. Croatia	…	…	…	…
29. Ukraine	38 000 USD	28 172	…	…
30. Montenegro	…	18 000	…	…
31. Georgia	100 000 CEL	…	…	…
Directive 77/388/EEC		5000 EUR	-	-

Source: www.ekspertis.net/document/view/other/137955/0/; Official Journal of the European Union 1.10.2012- Euro Exchange Rates at 10 Oct.2012; individual countries' websites.

[23] Tait, 1988, p. 122-132.

Obviously Article 287 is based on the actual failure to implement identical or at least similar thresholds for individual countries given the different national conditions. If we consider even the 11 member states from Eastern Europe, for which there are data, amounts fluctuate from 49 790 EUR (Slovakia) and 49 659 EUR (Latvia) – maximum, down to 15 978 EUR (Estonia) and 18 328 EUR (Hungary), i.e. over 3 times as absolute amounts. Bulgaria, with its unchanging (due to the currency board) 25 565 EUR threshold, falls within the "golden mean" along with Lithuania (28 962 EUR), Romania (28 249 EUR) and Slovenia (25 000 EUR). It is also interesting that the non-EU countries belong either to the lower limit (Montenegro – 18 000 EUR), or the medium one (Ukraine – 28 172 EUR).

This difference, however, pales in comparison to the much larger differences among the old member states (EU-17). Some of them (Spain, the Netherlands and Sweden) have thresholds for exempting small businesses. Other (Ireland, Greece, France, Malta and Portugal) have two thresholds (Malta – even three) depending on the direction of the small enterprise (usually goods or services). Only in some cases the thresholds are close to the prescribed 5000 EUR. The highest are the thresholds in the UK (81 843 EUR) and the differences between the absolute amounts are about 20 times. Furthermore, one cannot establish any logical difference between the member states of Eastern Europe and the rest. For example, there are countries in Western Europe with lower thresholds than that in a number of Eastern European states (Belgium, Finland, Luxembourg and even Germany), and vice versa.

The second type of thresholds applies to intra-Community acquisitions (i.e. imports from another Member State). In this case, all countries have certain thresholds. Usually they are lower than those for mandatory registration of small businesses, but in some cases the thresholds are equal (in the UK, Luxembourg), and in Belgium, Denmark and Finland they are higher. Distinctive in this case is that in all member states of Eastern Europe this threshold is significantly lower (2, 3 or more times) than that for small businesses. Furthermore, the exemption thresholds (except in the UK) have a relatively small range (between 8024 and 13 941 EUR).

There is a third size of a threshold for mandatory VAT registration – for the so-called distance sales as a special case of intra-Community supply. The most common forms of distance sales are the globally rapidly growing catalog marketing and mail sales when a VAT registered person in a member state delivers goods to a non-registered for the purposes of VAT person in another member state. Because these supplies are irregular and are for unregistered persons the laws of each country shall determine the so-called threshold for distance sales, which ranges from 35 000 to 100 000 EUR (Article 34 of Directive 2006/112). Accordingly, the Bulgarian VAT Act (in force since 1 January 2007) in Article 20, paragraph 2, item 2 sets a minimum threshold for sales in the country in terms of distance sales (as defined in Article 14 of the Act of 70 000 BGN, which is approximately the equivalent of the minimum recommended amount of 35 000 EUR according to the EU Directive).

As one can see, in terms of thresholds there are significant differences not only between Eastern, but even more between Western European countries. As stated by A. Tait[24] "the broad latitude described above, has lead to market divergences between Member States" contrary to the wishes of euro-bureaucrats. Obviously these differences have a deeper reason related to national specificities.

Thresholds for mandatory registration, especially those for small businesses, must change together with significant changes in economic conditions, and above all when there is a sharp increase in the price level. The normal percentage of small businesses exceeding the threshold for mandatory registration should be around 20-30%, making up for about 85% of the turnover. A good example of the consequences of the failure to comply with this requirement is Bulgaria. According to Article 13 of the original VAT Act (effective from April 15th 1994), those with a turnover of over 1.5 Million BGL are required to register and those below this threshold are entitled to voluntary registration. Just in the period October 1993 - April 1994, i.e. from the adoption of the law by the National Assembly until the entry into force the BGL devalues and the number of mandatory registration is double than expected. With a floating exchange rate of the dollar and earlier centralized price increases of electricity and heating merchants additionally and speculatively increase prices. The threshold is updated to 7.5 Million BGL in July 1996, which again corresponds to the initial level (the equivalent of 50 000 USD). The ensuing hyperinflation leads to a state in March 1997 in which about 80% of the companies pass the threshold of compulsory registration. This literally „clogs" the system and strongly hampers fiscal control. With some delay from the beginning of 1998 the registration threshold is raised to 75 Million BGL (again about 50 000 USD). Voluntary registration is canceled, and the deadline for return of the tax credit is increased to six months, in order before it a mandatory audit could be done. The deadline for return of the tax credit is reduced from 6 to 4 months in 2001 and to three months in 2002 (for exports it is 45 days). Since the beginning of 2003, the threshold drops from 75 to 50 thousand BGN. Elements of voluntary registration are restored.

Registration thresholds for small businesses do not remain unchanged in other countries of Eastern Europe. In the Czech Republic with the introduction of VAT in 1973 the threshold is 750 thousand CZK (about 25 thousand USD) for the preceding 3 months, i.e. conditionally 3 Million CZK (100 thousand. USD) per year, while now it is 1 million CZK (40 851 EUR). In Poland with the introduction of the VAT the threshold is 1.2 Billion old PLN, and now it is 150 thousand new PLN equivalent to about 37 774 EUR. In Slovakia, before the beginning of 2004, the annual turnover for VAT registration is 3 million SKK (approximately 70 thousand EUR), and then it is cut in half to 1.5 million SKK (35 thousand EUR). Now it is 49 790 EUR, i.e. an average of those amounts. In principle, the reduction of the thresholds can be considered a success that expands the tax base and increases tax revenues.

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[24] Tait, 1988, p. 123.

There is some discrepancy in linguistic terms. "*Exemption*" actually means that the freed merchant has to pay tax on his inflow (resource) without being able to claim a credit for the tax. "*Zero tax*" (zero rate) means that the merchant is completely gratuitous in any VAT they pay on the inflow, i.e. in fact he really is exempt from VAT. The exempted merchant pays VAT on his purchases, but it is impossible for him to deduct this tax indebtedness as a credit against his tax indebtedness on products, because he cannot impose tax on his exempt sales. This merchant is outside the VAT system and is treated as an end buyer. Conversely, a merchant at a zero rate is liable for the actual rate of VAT. Therefore, he is entirely part of the VAT system and makes full return in the normal way. When this merchant applies the tax rate to his sales, he closes the indebtedness as zero VAT, but he may deduct the entire tax indebtedness on his inflow, receiving compensation (complement) of the tax by the government. The zero rate merchant recovers all the VAT on his input stream and applies no tax on the output, so that the buyer of such sales buys goods or services without VAT.[25]

Exemption regimes generally do not provide for full exemption from tax dealings. They are created to help the release of the added value of merchants under VAT but all their purchases, including capital goods, are taxed. Exemptions also help to simplify VAT administration, but they introduce tax injustice. If the goods, sold by the merchants that are exempted, are not necessarily for final consumption, but are used as inflow in further production of other goods and services, then the VAT arising on the exempted inflow of the merchant is built in the price and forms a part of the cost of each merchant who buys goods for further production. This manufacturer cannot claim tax credit for VAT on is inflow because it was tax exempt. This means that part of the added-value is taxed more than once, i.e. the VAT system introduces a cascade "tax on tax". VAT is designed and implemented in order to eliminate this effect. Moreover, the more the exemptions, the more other persons are tempted to claim for themselves, thereby undermining the tax base.

Therefore, both from a theoretical and practical perspective, exemptions have to be kept to a minimum. Such is the policy of the EU. According to the Second Directive "for a limited period" and " well-defined reasons of social interest and for the benefit of end users" "reduced rates or exemptions" are allowed, however, if the total relief does not exceed the reliefs on previous sales taxes.

Actually, there are three grounds for the use of exemptions and zero rates: *first*, improving the progressivity of VAT; *second*, the claim that "merit" supplies exist, i.e. particularly useful for the public goods and services, that should be taxed, exempt on this basis; *third*, some goods and services are difficult to tax with VAT. There are products, such as food, to which all three specified grounds apply.

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[25] For details see Tait, 1988, Chapter 3.

Directive 2006/112/EU reserves generally the wording of Directive 77/388/EEC on exempt transactions. Exempt are mainly a number of public interest services referred to in Article 132-134. In the Bulgarian VAT Act of 2007 they are listed in Articles 39 to 44 and in Article 49. These are supplies related to health, social care and insurance, education, sport and physical education. Such are also deliveries related to culture, religion, charity, as well as post services (including post stamps). Difficult for taxing goods and services are set mainly in Article 135 of Directive 2006/116 and are reproduced in Articles 45 to 48 and Article 50 of the Bulgarian VAT Act of 2007. These are supplies relating to land and buildings, supplies of financial services (loans, foreign exchange operations, investment schemes management, investment companies and pension funds, leasing operations, insurance), the organization of gambling and supply of goods for which no tax credit is used.

This format of VAT exempt goods and services can be considered minimal and acceptable. Along with them in the various national laws some other supplies are exempted. For example, in the original Bulgarian VAT Act "transactions for carrying out legal activities under the Bar Act" are exempted.[26] The strong attorney lobby manages to keep this perfectly unjust provision until 2009. Moreover, for a period of three years after the law was released, 11 groups of goods were exempted (bread, milk, yogurt, cheese, electricity and heat, water, wood and coal - all for the population), officially approved textbooks and medications.[27] In 1999, 9 of these groups become taxable, which increases the tax base of VAT with around 3.5% of GDP. Since 2002 drugs are taxed, and since 2007 – textbooks. Since September 15th 2009 approved curricula textbooks and plans again become an exempt supply.[28]

In Poland (in 2013) supplies of dairy products are exempt, in Denmark – passenger transport and travel agencies, in France – some medical supplies. Outside the EU there are other unusual exemptions. In Albania, for example (2007) those are the drugs. In Ukraine as a tax incentive from 1 January 2013 for 10 years are exempt supply of software (according to an approved list), and certain drugs and medical products, local baby food, periodicals, school notebooks, textbooks and books.[29]

Overall, it can be considered that the "additional" exemptions (outside the "merit" and difficult to tax supplies) are not much for two main reasons: *first*, the essential characteristics of exempt supplies (complications, deprivation of tax credit, rules for issuing invoices); *second*, competition from other types of tax expenditures – zero rate and especially reduced rates.

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[26] VAT Act – State Gazette, N 90, October 22, 1993, Article 9, p. 10.

[27] Ibid., Transitional and Final Provisions, Par. 14.

[28] VAT Act, effective since 1.01.2007, Article 41, p. 3.

[29] According to KPMG's Corporate and Indirect Tax Rate…, 2007; KPMG Tax News; Deloitte International Tax.

When a zero rate is applied, goods and services actually are exempt from the accumulated VAT. Therefore it is used for exports to third countries of goods, international transport of passengers and goods, and supplies related to international transport, delivery of gold to central banks and supplies of duty-free trade.[30] Furthermore, subject to a zero rate of VAT are intra-Community supplies, i.e. those between member states.[31] These are, so to speak, the "standard" cases of zero taxation enshrined in the legislation of all countries applying VAT and in WTO rules.

Here, as in exemptions, there are additional zero taxed transactions. For example, in the UK and Ireland the wide application of the zero rate in domestic consumption is an extension to the traditional tax policy pursued for historical, political and social reasons. At the end of the 80-ies of the last century, i.e. 15 years after the countries entered the EU, 35% of household consumption in the UK and 33% in Ireland are zero taxed. By 2007, the situation is not very different. In the UK, a zero rate is applied to food and livestock food, books and newspapers, prescription drugs, children's clothes and passenger transport, and in Ireland – to most foods and beverages, medicines and medical equipment. In Malta zero-supplies include pharmaceutical supplies and food, and in Denmark – newspapers, sales and rental of water and air vessels.

In Eastern Europe, in Hungary with the introduction of VAT in 1988 42% of household consumption is zero taxed. This includes most foods, fuels, pharmaceuticals, services and heating of households, some cultural goods and services. Originally VAT does not cover imports of individuals, including cars, which leads to massive imports. These tax costs are too generous for a poor country in transition. In 1993, a zero rate remains only on domestic energy and pharmaceuticals.[32] In Montenegro (2012) with zero rate are taxed medicines and medical devices. In Croatia (2007), a zero rate (outside conventional) is applied to supplies of bread, milk, some books and magazines, medicines and medical devices.[33]

The European Commission recommends that zero rates should not be used for intermediate goods, but only for the benefit of the end user. It is also underlined that maintaining zero rates (outside the conventional ones) leads to a request for introduction of other for similar supplies. Moreover, the expansion of the application of such rates undermines the tax base and causes distortion. It requires a higher rate in the taxable sector to compensate for the tax costs. Also, the system for VAT refund, accompanying the zero rate, has high administrative costs, while invested funds to counter them do not bring additional revenue, but serve only to compensate the merchants. As a result of the pressure from the European Commission and the special Committee on VAT established

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[30] VAT Act, effective since 1.01.2007, Article 28-35.

[31] Ibid., Article 53(1).

[32] Tax Policy in Central Europe. –San Francisco: International Center for Economic Growth, 1995, p. 41-42.

[33] Bratic, 2006, p. 9.

in recent years, zero rates are still significantly limited (outside their generally accepted application). Most often, however, they "mimic" into the low reduced rates, which are close to them.

Number of tax rates and their changes

Although in 1990-2007 the countries with adopted VAT have increased from 51 to over 130, those with a single rate remain around 20.[34] Therefore multiple tax rates dominate in the world, including the EU and Europe. VAT to some extent inherits the differentiated tax rates. Politicians also believe that society will accept VAT easier if the products consumed by low income households are taxed at lower tax rates than those consumed by the wealthy. They even seek to have three rates – standard (normal), one above it and (at least) one reduced. Ironically speaking it seems that "the basic rule is simple: use as few tax rates as will satisfy the preferences of politicians".[35] At the same time all tax administrators prefer to use a single positive rate.

The main justification is the desire to achieve vertical tax equity, i.e. progressiveness. VAT (as well as the total gross sales tax) is regressive, if connected to the amount of income, because when income grows, the rate of consumption declines and that of savings increases. [36] In order to reduce the regressiveness of VAT, reduced rates are applied to certain groups of goods of mass consumption, basic foods, purchase or rental of housing, children's foods and clothes, passenger transport, medicines as well as newspapers and books (see Table. 2).

Those goods and services generally have a wider range in the early adoption of VAT and before the countries become members of the EU (Hungary, Slovakia). But for example in Montenegro the reduced rate of 7% applies to 12 groups of goods and services (2012), which fully comply with the requirements of Directive 2006/112/EU, without the country being a member-state. Article 97 the Directive indicates, that the standard rate cannot be less than 15%. In view of the complex and costly administration of the VAT system it is believed that the lowest limit at which its introduction is economically feasible, is 10%, in which 1-2% of the proceeds go towards its upkeep. According to Article 98 member states may apply one or two reduced rates, only for goods and services listed in Annex III, containing 22 sets of goods and services. In addition, reduced rates may not be less than 5% under the tax base (Article 99, 1). Obviously, this is done in order to prevent "mimicking" a zero tax rate by taxation of 1-2%, while suggesting a move towards a standard rate. Moreover, each reduced rate shall be so fixed that the amount of VAT resulting from its application is such that the VAT deductible could be normally deducted in full (Article 99, 2).

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[34] Tait, 1988, p. 38-45; KPMG'S Corporate and Indirect Tax Rate…, 2007.
[35] Tait, 1988, p. 42.
[36] Musgrave et al., 1988, p. 314.

Table 2

Change in VAT tax rates in Europe (%)

Country	2007	April 2012	July 2013	February 2014	Difference 2007/2014 (percentage points)
Bulgaria	**20.0;** 7.0	**20.0;** 9.0	**20.0;** 9.0	**20.0**	0
Czech Republic	**19.0;** 5.0; 0	**20.0;** 9.0	**21.0**	**21.0**	2.0
Estonia	**18.0;** 5.0; 0	**20.0**	20.0	**20.0**	2.0
Hungary	**20.0;** 5.0; 0	**27.0;** 18.0; 5.0	**27.0;** 18.0; 5.0	**27.0**	7.0
Latvia	**18.0;** 5.0; 0	**22.0**	**21.0**	**21.0**	3.0
Lithuania	**18.0;** 5.0; 0(9;6)	**21.0;** 9.0; 5.0	**21.0;** 9.0; 5.0	**21.0**	3.0
Poland	**22.0;** 7.0; 3.0	**23.0**	**23.0;** 8.0; 5.0	**23.0**	1.0
Romania	**19.0;** 9.0	**24.0;** 9.0; 5.0	**24.0;** 9.0	**24.0**	5.0
Slovakia	**19.0;** 10.0; 0	**20.0;** 10.0	**20.0**	**20.0**	1.0
Slovenia	**20.0;** 8.5	**20.0**	**22.0**	**22.0**	2.0
Croatia	**22.0;** 10.0; 0	**23.0**	**25.0**	**25.0**	3.0
Austria	**20.0 ;**10.0 ;0	**20.0**	**20.0**	**20.0**	0
Belgium	**21.0;**	**21.0**	**21.0**	**21.0**	0
Cyprus	**15.0;** 8.0; 5.0; 0	**17.0**	**17.0**	**19.0**	4.0
Denmark	**25.0;** 0	**25.0**	**25.0**	**25.0**	0
Finland	**22.0;** 17.0;8.0; 0	**23.0**	**23.0**	**24.0**	2.0
France	**19.6;** 5.5; 2.1	**19.6**	**19.6**	**20.0**	0.4
Germany	**19.0;** 7.0	**19.0**	**19.0**	**19.0**	0
Greece	**19.0;** 9.0; 4.5	**23.0**	**23.0**	**23.0**	4.0
Ireland	**21.0;** 13.5; 4.8; 0	**23.0**	23.0	23.0	2.0
Italy	**20.0;** 10.0; 4.0	**21.0**	**21.0**	**21.0**	1.0
Luxemburg	**15.0;** 6.0;3.0	**15.0**	**15.0**	**15.0**	0
Malta	**18.0; 5.0; 0**	**18.0**	**18.0**	**18.0**	0
Netherlands	**19.0;** 6.0	**19.0**	**19.0**	**21.0**	2.0
Portugal	**21.0;** 12.0; 5.0	**23.0**	**23.0**	**23.0**	2.0
Spain	**16.0;** 7.0; 4.0	**18.0**	**18.0**	**21.0**	5.0
Sweden	**25.0;** 12.0; 6.0	**25.0**	**25.0**	**25.0**	0
United Kingdom	**17.5;** 5.0; 0	**20.0**	**20.0**	**20.0**	1.5
Georgia	**20.0; 10.0**	**18.0**	**18.0**	**18.0**	-2.0
Moldova	**20.0; 5.0**	**20.0**	**20.0**	**20.0**	0
Russia	**18.0; 10.0**	**18.0**	**18.0**	**18.0**	0
Serbia	**18.0; 8.0; 0**	**18.0;8.0**	**20.0; 8.0**	**20.0**	2.0
Montenegro	**17.0; 7.0; 0**	**17.0; 7.0; 0**		**19.0**	2.0
Ukraine	**20.0**	**20.0**	**20.0**	**17.0**	-3.0
Belarus	**…**	**20.0**	**20.0**	**20.0**	0
EU-28	**19.7**	**21.1**	**21.4**	**21.5**	1.8
EU-17	**20.6**	**20.6**	**...**	**21.1**	0.5
EU-4 (Germany, France, Italy and U.K.)	**19.0**	**19.9**	**19.9**	**20.0**	1.0
EU-11 (Eastern European countries, incl. Croatia)	**19.5**	**21.8**	**22.2**	**22.2**	2.7

Notes: 1. Averages are on basic rates that are in bold; 2. The "0" tax rate is given only when used outside the range of products and services under Directive 77/388 EC; 3. Data for 2014 are only for the basic rates.

Source: KDMG'S Corporate and Indirect Tax Rate Surwey; Key Data on World Taxes; www.worldwide tax.com/European Commision Excise Duty Tables; individual countries' websites.

The cons of using multiple tax rates are many and significant. *First,* the administrative costs increase as well as the compliance costs that "eat up" a significant amount of the income. To run the simplest practical VAT (one positive rate, a zero rate and some exemptions) requires at least 9 pieces of information from each taxpayer, while for a VAT with three positive rates, zero rate and exemptions – at least 17.[37] As the number of tax rates increases, the potential for frauds increases as fast as the potential of both tax officials and taxpayers.

Second, multiple tax rates distort both consumer and producer choices.

Third, low rates of VAT do not necessarily benefit the final consumer. Merchants aim to recoup a certain amount of VAT from consumers. They adjust their prices in line with what the market would bear regardless of the rate of tax prescribed for individual items. That is, given multiple rates, merchants will juggle their prices to what the market will bear and items with low VAT rates could end up cross-subsidizing the higher-rated items.

Fourth, not just low-income households benefit from the lower tax rate. Such differential rates are "a very blunt instrument for favoring particular households". "Indirect taxes could reallocate tax burden between individuals with a certain degree of justness, but in a rough and inconclusive way".[38] Very often, a reduced VAT rate benefits greater the wealthy due to their greater purchasing power. "Direct taxation is intended for balancing purposes, while indirect – to effective receipts... Direct taxes may be adjusted to the individual characteristics of the taxpayer, while with indirect transactions are taxed regardless of the characteristics of the seller and buyer."[39] Because of that economic science has detected a century ago that "no general duty can affect the tax forces of the wealthy as affluent as this is done by direct taxation, especially on income".[40] It is believed that unless there is an appropriate design of the system of income tax (progressive, with tax breaks for children, deduction of interest on mortgages for housing, some of the costs, etc.), direct transfers to income or coupon schemes (for food) as well as the extension of the range of duties are better targeted to assist the poor.

Fifth, many countries subsidize essential goods and services (food, electricity, fuels) taxing a special low rate on an adjusted price, rather than the standard rate. The favoring treatment creates dissatisfied merchants and consumers who argue that their products are at the dividing line of definition. Therefore staff (time and money) is needed to define different categories of goods, assessing borderline cases and explaining decisions to merchants and public interest groups. Such staff is highly qualified and can be employed much more efficiently on administering the VAT.

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[37] Tait, 1988, p. 42 and following.

[38] Kaldor, 1955.

[39] Atkinson and Stiglitz, 1993, p. 576-577.

[40] Gurev, 1910, p. 52.

Sixth, successful arguments for lower VAT rates erode tax base. Using a general equilibrium model it has been proven that rates differentiation leads to significant reduction (about 60% of sales tax) in welfare gains of adopting equalized tax rates.[41]

Seventh, high VAT rates typically (except for automobiles) apply to goods that account for a relatively small proportion of total consumption. The revenue at issue is small, and the administrative cost is high. Frequently, consumers avoid sumptuary rates by adjusting their consumption. Given the small segment of the population involved, the effect on distributive burden cannot be much.

Eight, whatever multiple rates are chosen and whatever the subsequent changes, they rarely reflect genuine changes in consumer or government preferences.

Ninth, with any complication in rate structure the pattern of uniformity flies apart completely. Even with a simple single rate of 15% and a zero rate with some exemptions, the effective rates on value added in the United Kingdom ranged from 24% (on food) to 37% (on leather goods and furs). These effective rates are not apparent to the consumer or, usually, to the merchant. The disparity in effective tax rates occurs because merchants are unable to claim full credit for some inputs, yet the VAT is applied to the full value of their sale. Therefore, the actual value added in that particular trade is taxed effectively at a much higher rate. For example, a VAT of 10% on a restaurant meal, where inputs represent 40% of the final value with no credit (because they are exempt), is transformed into an effective rate of over 16%.[42]

To summarize, the VAT system is as effective as it is simple – with a single rate and minimal exemptions. This applies particularly to the conditions of the countries in transition and developing countries, where tax administration is facing radically changed conditions. In a planning-directive economy tax authorities usually deal with a few hundred or a few thousand large enterprises. They have difficulties in understanding the concept of a thriving, rapidly changing private sector with a large number of industries in the service sector, with many financial offices, and competitive distributive trade, including in many cases larger enterprises, which can be found and closed too often, thus creating a large volume of registration activities. Tax collection, tax audits and controls do not match to any extent the administrative system of the Western model. So along with the deep transformations in the political and economic structures, these countries have to amend the entire administrative structure of the sales tax.[43] Therefore, the IMF recommends to these countries “a strong support on sales tax with a broad base like a VAT with a single tax rate and minimal exemptions".[44]

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[41] Bollard et al. Cited according to Tait, 1988, p. 43-44.

[42] Tait, 1988, p. 44.

[43] Fiscal Pollicies in Economies in Transition…,1993, Ch. 9.

[44] Stepanyan…, IMF, WP/03/173, p. 4.

None of this means that tax expenditures (tax privilege) do not have a place in achieving these goals. Rather, their role is undervalued and should be unfolded. Their place, however, as in the experience of developed countries with a market economy, is primarily in direct taxes and in particular in the system of personal income taxation.

Bulgaria, as opposed to all the countries of Eastern Europe (and the EU), introduced a single VAT rate (18%) on 1 April 1994. This decision is reached, however, not due to the particularly high competence of the government or its long-term thinking. Here too a fierce debate arises about whether to have a single or two rates (maybe even three). Moreover, compared with the four existing rates of turnover tax (0, 2, 10 and 22%) introducing a single rate means regressiveness of tax and price amendments. All calculations (both of the IMF experts and international practice) that two rates (normal and reduced), however, show that collectability would fall sharply (below 50%) due to increased opportunities for abuse in the specific conditions. Tax on goods at a reduced rate will largely be paid by the consumer at the "normal" size, but will be hidden from manufacturers and retailers, rather than joining the treasury. As stated, the reduced rates benefit not as much the poor as the middle class. In the particular conditions of diminished internal consumption it also turns out that if food is taxed at a zero rate, for the other goods it needs to be extremely high – 33.5% to achieve the same income. Similar would be the situation with rates of 10 and 24%.[45] It should not be forgotten that the share of food expenditure in the cash expenditure of households in Bulgaria in years is as follows: 1990 – 30.2%; 1991 – 39.3%; 1992 – 38.0%; 1993 – 36.8%; 1994 – 38.8%; 1995 – 39.8% and 1996 – 43.0 percent. In comparison, in the UK (a zero rate on food and some other supplies) the share of food expenditure in household expenditure was 15.1% in 1983 and 11.4% in 1993, i.e. 3.5 – 4 times lower.[46]

The *basic* tax rate of VAT in the EU in general varies from 15 to 27%, and in the member states from Eastern Europe – from 20 to 27% (see Table 2). Even in Eastern European countries outside the EU the lowest rate is 17%. Thence basic rates in this region are higher. There is nothing illogical if one takes into account the weakness of the income tax. The revenues from personal income tax are significantly lower, not bigger are the receipts from corporations as low rates are kept to attract foreign capital. As to the degree of uniformity in the VAT system, it is not less and probably even higher than in the old member states. The general trend in the basic rates is upwards. In the long run it exists in Western Europe too. In Eastern Europe, however, it is particularly rapid, mainly in the crisis years, i.e. after 2007-2008. For the period from 2007 to 2013-2014, the basic rate in the region increased as follows: Czech Republic – from 19 to 21%, Estonia –

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[45] Ministry of Finance. The Budget, 1993…, p. 48-50; Parliament. Materials to the draft…, 1992.

[46] Household Budgets in the Republic of Bulgaria…,1996, p. 6. Britain 1995..., p. 153.

from 18 to 20%, Hungary – from 20 to 27%, Lithuania – from 18 to 21-22%, Poland – from 22 to 23%, Romania – from 19 to 24%, Slovakia – from 19 to 20%, Slovenia – from 20 to 22%, Croatia – from 22 to 25% (non-EU: Serbia – from 18 to 20% and Montenegro – from 17 to 19%). In general, for 2007-2014, the EU-28 average rate increased from 19.7 to 21.5%. While for the old member states the increase is from 20.6 to 21.1% (plus 0.5 percentage points), for the new member states of Eastern Europe it is from 19.5 to 22.2% (plus 2.7 percentage points), while in the four largest countries it is from 19.0 to 20.0%. Since they have about ½ of the EU-28 population, their rate (with some qualifications) can be considered a "weighted average".

In fact all new member countries have serious difficulties (especially Romania and Hungary), as well as many old member states (Greece, Ireland and Spain). It is undisputed, however, that the countries of Western Europe generally have larger budgets and greater opportunities to finance budget deficits. But one should not forget that the increase in the base rates and the changes in national VAT systems in general are affected by an additional factor – the substitution of direct taxes, partly consciously. For example, for 8 of the first countries having "flat" personal income tax (Estonia, Georgia, Lithuania, Latvia, Romania, Slovakia, Russia and Ukraine) revenue from personal income tax after its transformation into "flat" dropped from an average of 4.4 to 4.1% of GDP, for the 5 EU member states – from 5.0 to 4.8%; those from the corporate income tax – from 3.7 to 3.2%, for the 5 EU member states – from 3.5 to 2.7%. At the same time revenue from indirect taxes increases by an average of 9.4 to 10.5% of GDP, for the 5 EU member states remaining 10.0 percent of GDP.[47] Similarly, in the Czech Republic the reform in 2008 provides for a decreasing share of both income tax (personal and corporate) with a total of 0.8% of GDP in 2008, 1.3 percent in 2009 and 1.6% in 2010. However, the increase in reduced VAT rate of 5 to 9% and the increase in excise duty and "environmental" excise should give a total 0.9-1.0% of GDP additional annual revenue. In fact, as a result of the crisis, changes compared to the base in 2007 in direct taxes are: in 2008 minus 1.4%, in 2009 minus 2.1% and in 2010 minus 2.3% of GDP. Changes in indirect taxes are: in 2008 minus 0.2%, in 2009 plus 0.2%, in 2010 plus 0.3% of GDP. Due mainly to this the consolidated budget deficit increased from 1.3 percent of GDP in 2007 to 3.0 percent in 2008, 5.9 percent in 2009 and 4.7% in 2010.[48]

As for Bulgaria, its basic rate has not changed since the beginning of 1999, i.e. for 14 years. And if in the pre-crisis 2007 it is slightly above the EU average, and the average in the 11 countries of Eastern Europe (19.6%), in 2014 it lags behind the average EU-28 by 1.5 percentage points, behind EU-17

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[47] According to Keen et al…, IMF, WP/06/218, p. 46.

[48] See Botman et al…, WP/08/125; Statistical Yearbook of the Czech Republic, p. 48-49, 182-187; http//epp.eurostat.ec.europa.eu

by 1.1 percentage points, and behind the average level of the member states from Eastern Europe (EU-11) by 2.2 percentage points. In the event that Bulgaria takes a course towards an average EU rate of revenue – about 42-45% of GDP (with 33.7% in 2011), with a view to fully finance the budgetary sector (mainly for investment) it will become necessary after exhausting other options to proceed with the gradual permanent increase in the basic rate of VAT. If the ultimate goal is to achieve a rate of 25%, this would give additional income of around 2.5 – 2.7% of GDP, i.e. about 25-30% of the desired increase. Before that social contributions and partly – income taxes, should increase.

VAT rates in different Eastern European countries often change without strictly defined direction, including in terms of the number of tax rates. Thus, in 1988 Hungary introduces the VAT system that taxes with 25% only 40% of consumer spending, which makes 95% of all revenues from VAT, 15% – for most services and a zero rate for 42% of the costs. In the beginning of 1993 zero taxation is limited, a six percent interim rate is introduced, while the 25% one remains. Since the middle of 1993 at the request of the IMF the reduced rate is reduced to 10% and the zero one is reserved solely for pharmaceutical products (except exports). The base rate of 25% is maintained until 2005. In 2006-2008 and by mid-2009 it drops down to 20% (with a reduced rate of 5%). From July 1st 2009 the basic rate is 25% again, a new reduced rate of 18% for basic food and hotels is introduced, and the rate of 5% is reserved for books, newspapers and drugs. From January 1st 2012 the base rate is increased from 25 to 27% and is the highest in the EU.

On April 1st 1994 Bulgaria introduces a VAT with a single rate of 18%, with 11 groups temporarily exempted supplies (levied primarily from 1999). From August 1st 1996 it was increased to 22% to stabilize revenue and in 1999 was reduced to 20% with some expansion of the tax base. As of 2002 a reduced rate of 7% is introduced (in 2011 it increased to 9% and was expanded).

In Slovakia, in 2002 there are two rates – 23% (basic) and 10% (reduced), which in 2003 are "approximated" to 20 and 14%. The reduced rate applies to a wide range of goods – food, electricity, heating oil, coal, pharmaceuticals and aid to incapacitated people. With the entry into the EU in 2004, a single 19% rate is introduced, and by 2007 there is again a reduced rate of 10% for drugs and other medical products. For 2012, the basic rate is 20%.

In some cases, high rates of individual commodity groups lead to the increase of illegal tax evasion. In this sense the "ideal" of an absolutely uniform size that does not distort competition is impracticable. But "pure" competition is an abstraction on level of producer prices too. These and other similar examples can be better understood in light of the overall macroeconomic development and the need to flexibly take into account local characteristics.

Table 3

VAT revenues in the EU-27, Croatia and Serbia (% of GDP)

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Difference 1995/2011 p.p.	EC-27 (2011) N on size
Belgium	6.6	7.2	6.9	6.9	6.8	6.9	7.0	7.1	7.1	7.0	6.9	7.1	7.0	0.4	20
Bulgaria	7.0	8.3	8.4	7.3	8.6	9.9	10.2	10.7	10.4	10.9	9.0	9.2	8.7	1.8	4
Czech Republic	6.0	6.2	6.1	6.0	6.1	7.0	6.9	6.4	6.3	6.8	6.9	6.9	7.0	1.1	18
Denmark	9.4	9.6	9.6	9.6	9.6	9.8	10.1	10.3	10.4	10.1	10.2	9.8	9.9	0.5	1
Germany	6.5	6.8	6.6	6.4	6.4	6.3	6.3	6.4	7.0	7.1	7.5	7.2	7.3	0.8	16
Estonia	9.6	8.4	8.2	8.4	8.2	7.7	8.7	9.1	8.9	7.9	8.9	8.8	8.5	-1.1	6
Ireland	6.2	7.2	6.8	7.0	7.0	7.3	7.6	7.8	7.6	7.3	6.4	6.4	6.2	-0.8	26
Greece	6.1	7.2	7.5	7.6	7.0	6.8	6.9	7.1	7.4	7.3	6.5	7.3	7.2	1.1	17
Spain	5.2	6.2	6.0	5.8	6.0	6.2	6.5	6.5	6.0	5.4	4.1	5.6	5.4	0.2	27
France	7.5	7.4	7.3	7.2	7.2	7.3	7.4	7.3	7.2	7.1	6.9	7.0	7.0	-0.4	19
Italy	5.5	6.5	6.2	6.2	5.9	5.8	5.9	6.2	6.2	5.9	5.7	6.3	6.2	0.7	25
Cyprus	4.6	5.5	5.7	6.6	7.8	8.4	9.1	9.7	10.2	10.6	9.2	9.2	8.4	3.8	8
Latvia	9.2	7.1	6.8	6.7	7.2	7.0	7.8	8.6	8.2	6.7	6.0	6.6	6.8	-2.4	23
Lithuania	7.4	7.5	7.3	7.3	6.7	6.4	7.1	7.6	8.1	8.0	7.4	7.9	7.9	0.5	13
Luxemburg	5.2	5.6	5.8	5.8	5.7	6.1	6.2	5.8	5.7	6.3	6.7	6.3	6.3	1.1	24
Hungary	7.5	8.9	8.1	7.8	8.2	8.9	8.4	7.6	8.1	7.8	8.6	8.7	8.5	1.0	7
Malta	6.1	5.7	6.1	6.2	6.3	7.1	8.0	7.9	7.5	7.7	7.6	7.6	7.9	1.9	12
Netherlands	6.5	6.9	7.3	7.2	7.3	7.3	7.2	7.4	7.5	7.3	7.0	7.2	6.9	0.4	21
Austria	7.7	8.1	8.1	8.1	8.0	7.9	7.9	7.6	7.7	7.8	8.0	7.9	7.8	0.1	14
Poland	6.2	6.9	6.8	7.2	7.1	7.2	7.7	8.1	8.3	8.0	7.4	7.8	8.1	1.8	11
Portugal	6.9	7.6	7.5	7.6	7.7	7.7	8.4	8.6	8.5	8.4	7.1	7.8	8.3	1.4	10
Romania	4.9	6.5	6.2	7.1	7.2	6.7	8.1	7.9	8.1	7.9	6.6	7.6	8.7	3.8	5
Slovenia	4.7	8.6	8.3	8.5	8.5	8.5	8.6	8.5	8.4	8.5	8.4	8.6	8.4	3.7	9
Slovakia	8.4	7.0	7.2	7.0	7.5	7.8	7.9	7.5	6.7	6.9	6.7	6.3	6.8	-1.5	22
Finland	7.9	8.2	8.0	8.1	8.6	8.5	8.7	8.7	8.4	8.4	8.7	8.5	8.9	1.0	3
Sweden	9.1	8.6	8.7	8.8	8.8	8.8	9.0	8.9	9.0	9.3	9.6	9.7	9.4	0.4	2
27. U.K.	6.4	6.6	6.6	6.7	6.8	6.8	6.6	6.6	6.5	6.4	5.7	6.5	7.3	1.0	15
EU-27 - weighted	6.6	7.0	6.9	6.8	6.8	6.8	6.9	7.0	7.0	6.9	6.7	7.0	7.1	0.5	-
EU-27 - arithmetic	6.8	7.3	7.2	7.2	7.3	7.5	7.8	7.8	7.8	7.7	7.4	7.6	7.7	0.9	-
EU-17 - arithmetic	6.7	7.1	7.1	7.2	7.2	7.4	7.6	7.6	7.6	7.6	7.3	7.5	7.5	0.8	-
EU-10 - arithmetic	7.1	7.5	7.3	7.3	7.5	7.7	8.1	8.2	8.2	7.9	7.6	7.8	7.9	0.8	-
Croatia	…	…	…	…	…	12.2	12.2	12.2	12.0	12.1	…	…	…	-	-
Serbia	…	…	…	…	…	…	8.8	9.8	11.5	10.2	10.8	11.0	10.7	-	-

Source: http://ec.europa.eu/taxacion-customs/index en.htm; Statistical Yearbook of Serbia 2006-2012; Annual Report of the Finance of Croatia for 2008.

Dynamics of VAT revenues

VAT revenues (as % of GDP) in the EU-27 and Europe as a whole are the highest in the world. In 2011 in EU-27 they are 7.7% of GDP on arithmetic average and on weighted average – 7.1% (see Table 3). For the period 1995-2011 they increase by about 0.9 percentage points on arithmetic average. Only in 5 of the 27 countries revenues decreased: Estonia, Ireland, France, Latvia and Slovakia. In the ten member states of Eastern Europe the arithmetic average revenues are 7.1% of GDP in 1995, increasing with some fluctuations to 7.9% in 2011. Respectively, for the countries of Western Europe (EU-17) the revenues are slightly lower – 6,7% in 1995, increasing roughly the same way to 7.5% of GDP in 2011. However, large differences exist within the two groups of countries. They are significantly lower in the EU-10 – from 6.8% (Slovakia, Latvia) to 8.7% in Bulgaria, while in the EU-17 they vary from 5.4% (Spain) to 9.9% of GDP (Denmark). Significantly more pronounced is the difference between the member states from Eastern Europe (EU-10) and those from Western Europe on the indicator share of VAT revenues to total tax revenue. For EU-10 this share in 2011 averaged 25.8%: from 20.0% in the Czech Republic to 32.0% in Bulgaria. In EU-17 the arithmetic average is about 19.7% – from 14.7% (Italy) to 25.1% (Portugal). Accordingly, for EU-27 this share is 22.0%. The reasons are mainly in the smaller budgets (as a share of GDP) in Eastern Europe, as well as in the relatively small revenues from personal income tax.

VAT receipts in Bulgaria (as a share of GDP) in 2011 – 8.7%, are the highest in the member states of Eastern Europe and fourth in the EU27 (after those of Denmark, Sweden and Finland). In the difference in revenues (in percentage points) for 1995-2011 – plus 1.8, Bulgaria ranks fourth after Romania and Cyprus (3.8) and Slovenia (3.7). Bulgarian VAT revenues are significantly greater in the pre-crisis period of 2004-2008, when they vary between 9.9 and 10.9% of GDP and on this share the country is first in the EU-27 (in 2007 it shares the first place with Denmark). These record earnings, however, are due to the too high share of final consumption and in particular to the growing negative balance of exports minus imports of goods and services. For the period 2004-2008 it increases from minus 11.5% to minus 20.5% of GDP. The financial and economic crisis since 2009 normalizes this balance, which leads to a decrease in VAT revenues. The relatively good revenues from it now (despite the moderate base rate – 20%) are due to the wide tax base. The only significant exception is the relaxed 9% taxation of touristic packages. Here should be added the inclusion of revenues from excise duties amounting in 2011 to 5.1% of GDP – first place in EU-27 (the arithmetic average being 3.2% and the weighted average – 2.7% of GDP). The high prices of imported energy carriers are also a factor in this regard. However, the picture looks quite different in terms of absolute numbers. Bulgaria's VAT revenue in 2011 is about 3352 Million EUR. This is about 0.37% of the tax revenue of the EU-27. At the same time Bulgaria's population is approximately 1.5% of that of the Community, or with about four times higher share. The explanation is in the low nominal per capita GDP in Bulgaria.

However, data from the national statistics of other countries in Eastern Europe in many cases show even higher data for VAT revenues as a percentage of GDP. In Croatia in 2004-2008 they are between 12 and 12.2% of GDP, while in Serbia in 2005-2011 they fluctuate between 8.8 and 11.5% of GDP. Also in the Ukraine in 1993-1994, they are about 11.4 to 11.5%, while in Macedonia (1994 -1995) – up to 9.3% of GDP. Iceland in 2000-2008 collects between 9.4 and 11.1% of GDP. In this sense, Bulgarian, or even "Scandinavian" revenue is not something extraordinary.

In conclusion, the broader contradictions between Europe as a "super-state" and one accounting for the real difference in the terms and interests of individual member states reflect both in the achieved VAT unification within the EU-28 and in the persistent considerable differences between countries. The excessive ambition for rapid and complete harmonization can lead to a distinct outline of "Europe on two (or more) speeds".

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