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**THE PROBLEM OF VAT GAP AND POSSIBLE SOLUTIONS TO THIS
PROBLEM**

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Abstract

European Union Member States are losing billions of euros in value-added tax (VAT) revenues because of tax fraud and inadequate tax collection systems. The Value added tax {VAT Gap}, is defined as the difference between the amount of VAT actually collected the VAT Total Tax Liability. The VAT Total Tax Liability is an estimated amount of VAT that is theoretically collectable based on the VAT legislation and ancillary regulations.

VAT gap also happens due to financial insolvencies or miscalculations and bankruptcies. VAT gap shows how much vat one country losses it depends on top –down approach. In this case means of calculation is on board the main problem of vat gap is fraud due to this reason member states losing billions of euro in Value added tax revenue. In my working paper I briefly describe of VAT gap and possible solution to the problem.

Keywords: Tax evasion, tax gap, estimates, determinants of VAT gap, theoretical VAT liability, problem of VAT gap and possible solution.

ÖZET

Avrupa Birliđi Üyesi Devletler, vergi sahtekarlıđı ve yetersiz vergi toplama sistemleri nedeniyle katma deđer vergisi (KDV) gelirlerinde milyarlarca euro kaybediyor. Katma Deđer Vergisi {KDV Farkı}, fiilen tahsil edilen KDV'nin toplamı ve KDV'nin toplamı KDV'dir. KDV tarafından verilen ÖDÜL, teorik olarak KDV düzenlemeleri ve tüm düzenlemelerden ayrı olarak düzenlenebilir.

KDV açığı ayrıca finansal iflaslar veya yanlış hesaplamalar ve iflaslar nedeniyle olmaktadır. KDV açığı, bir ülkenin zararını ne kadar kaybettiđini yukarıdan aşağıya yaklaşıma bađlı olduđunu göstermektedir.

Bu durumda hesaplama araçları gemide olup, KDV farkının asıl sorunu, bu nedenle üye devletlerin Katma Deđer Vergisi geliri olarak milyarlarca Euro kaybedilmesi nedeniyle dolandırıcılıktır. Çalışma kitabımda kısaca KDV açığını ve soruna olası çözümü açıklarım.

Anahtar Kelimeler: Vergi kaçakçılığı, vergi açığı, tahminler, KDV açığı belirleyicileri, teorik KDV yükümlülüđü, KDV açığı sorunu ve olası çözüm.

THE PROBLEM OF VAT GAP AND POSSIBLE SOLUTIONS TO THIS PROBLEM

1.1 INTRODUCTION

In this working paper , I briefly describe the problems of VAT gap and possible solution to the problem subsequently. I start this discussion with a simply definition of what does VAT gap means. The VAT Gap is defined as the difference between the amount of VAT actually collected and the VAT Total Tax Liability (Michael, 2013). The VAT Total Tax Liability is an estimated amount of VAT that is theoretically collectable based on the VAT legislation and ancillary regulations. It is often expressed in relative terms as a percentage of unpaid VAT from the theoretical VAT that would be collected if all taxpayers report and pay VAT in full. The high value of this indicator may imply problems with tax evasion and inefficiency within the tax system (Michael, 2007). Thus, the VAT Gap is an indicator of the effectiveness of VAT enforcement and compliance measures, as it provides an estimate of revenue loss due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies as well as miscalculations (Grzegorz, et al., 2016). The Policy Gap is also an indicator of the additional VAT revenue that a country could theoretically collect if it applied standard rate to all consumption of goods and services supplied for consideration (Borselli, et al., 2012). The Policy Gap as defined above can in turn be broken down into the Rate Gap and the Exemption Gap (Michael, 2013). As the terminology suggests, the Rate Gap represents the

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potential revenue loss due to the existence of reduced rates, whereas the Exemptions Gap represents the potential revenue loss due to the existence of exempted supplies of goods and services (Borselli, et al., 2012).

1.2 THE PROBLEM OF VAT GAP AND ITS POSSIBLE SOLUTIONS

There are several reasons for VAT revenue loss. Some of the reasons relate to tax evasion and fraud, while other possible reasons include tax avoidance, bankruptcies, insolvencies, errors in determining tax liability, as well as cancelled or deferred VAT debts (Williams, 1996). It is therefore important to understand that the above defined VAT gap captures more than only deliberate non-compliance by taxpayers (Agha & Jonathan, 1996). Like all taxes, VAT is subject to vulnerable to evasion and fraud. For example, traders may fail to register for the tax, they may under-report sales or, where different goods are subject to tax at different rates, they may reduce their tax payments by misclassifying sales into the category subject to a lower rate (or zero rate) of tax (Crawford, et al., 2010). In some respects, the particular structure of VAT may reduce its exposure compared with other systems of sales taxation (Borselli, et al., 2012). In particular, the gradual cumulation of the tax at each stage of the chain of production and distribution may reduce the amount of tax at stake at each stage, and hence the gains to be made from making untaxed sales. This does not make the VAT 'self-enforcing', as sometimes claimed, but it does reduce its exposure to evasion compared with alternative single-stage sales taxes levied at a comparable rate, such as the retail sales taxes (Crawford, et al., 2010).

In other respects, however, VAT offers distinctive opportunities for evasion and fraud, especially through abuse of the credit and refund mechanism (Smith & Michael, 2007). Revenue may be lost through exaggerated claims for credit for VAT paid on inputs to production. Moreover, the opportunity exists for outright

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fraud through the construction of business activities with the sole purpose of defrauding the exchequer, because some categories of business can be entitled to net refunds of VAT from the revenue authorities (Crawford, et al., 2010). These can include firms selling predominantly zero-rated goods while claiming credit for significant amounts of VAT paid on standard-rated production inputs. While zero-rated domestic sales can create opportunities of this sort, the main point of vulnerability in the current system arises because of the VAT zero-rating of exports (Keen & Smith, 1996). With regard to the solutions to the problems of VAT gaps, many studies indicate that tackling the problems related to VAT gap calls for urgent action on three fronts: i) enhancing administrative cooperation, ii) improving the performance of tax administrations and iii) improving voluntary compliance (Smith & Michael, 2007).

i) Enhancing administrative cooperation

Enhancing administrative cooperation at all levels can help to continually measure the VAT gap; and this would allow detecting fraud in early stages and ultimately prevent a missing trader fraud (Pashev, 2008). It would enable to make better use of the information available within the network, and support deeper cooperation between different authorities. On one hand, taking advantage of today's technological advancement, fraudsters exploit emerging technologies and new business models to avoid the payment of VAT (Crawford, et al., 2010). On the other hand, legal and technological tools and policies at the disposal of tax administrations to combat fraud and evasion are lagging behind and insufficient to address the emerging risks (Michael, 2013). Hence, it would be essential to work on a set of compliance measures including anti-fraud tools for tax administrations, on a communication campaign addressed to companies and citizens and on proposals for parties involved to supply targeted information to tax administrations to allow the latter to cope with the new

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emerging economy business models. It also helps strengthen mutual assistance for the recovery of tax debts (Michael, 2007). This enhances cooperation in the area of VAT by negotiating agreements on administrative cooperation and mutual assistance in recovery of VAT claims. Generally, enhanced administrative cooperation enable tax administrations to obtain more information on non-established traders liable for VAT and fight VAT fraud more effectively. It would also help to build synergies with different organizations in the area of tax compliance and contribute to establish a system of administrative cooperation (Williams, 1996).

ii) Improve the performance of tax administrations

There are differences in the way tax administrations work, which affects the proper collection of the tax and the business environment. There is a need to build trust and improve the level of performance of tax administrations to strengthen the tax system and fight against VAT fraud (Bird & Milka, 1992). Providing a strategic discussion between the organs of tax administrations and with customs help to build a common agenda, exchange views and coordinate mutual actions in the area of managing the tax system (Borselli, et al., 2012). Facilitating agreement on minimum quality standards for core tax administration functions and evaluation based on good practices & support for peer reviews and independent assessments of the standard help to strengthen the tax system and fight against VAT fraud (Pashev, 2008). Moreover, development of human competence through a platforms of knowledge and experience sharing and technical assistance on topics of tax administration and fight against fraud for tax officials help to collectively enhance the tax administration capacity (Agha & Jonathan, 1996).

iii) Improving voluntary compliance

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Reinforcing the cooperation between businesses and tax authorities is important to improve VAT compliance. Bridging the gap between businesses and tax administrations by promoting dialogue and joint projects is necessary to improve voluntary compliance (Grzegorz, et al., 2016). There should be concrete projects such as effective dispute prevention and resolution mechanisms or agreements between tax administrations and business sectors to fight fraud. Periodic study need to be launched on the impact of administrative penalties on compliance and competition to identify good practices and adverse effects; and education and communication should be enhanced to raise citizens' and companies' awareness of the importance of paying taxes (Ibid).

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Conclusion

The above working paper focused on the definition of VAT and VAT gap, factors affecting vat gap and possible solution. VAT gap means the difference between the amount actually collected and what expected revenue in any country and in any year. revenue loss in case of tax fraud, tax evation,tax avoidance and bankruptcy and financial insolvency and miscalculation.VAT

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gap shows how much vat one country losses it depends on top –down approach. In this case means of calculation is on board the main problem of vat gap is fraud due to this reason member states losing billions of euro in Value added tax revenue because of fraud and inadequate tax collection system.

Tax fraud means a kind of tax evection it happens when business doesn't pay tax it means paying cash to avoid paying vat on sale or job, paying to someone rather than businessman or somebody else, un registered vat, using false vat number vat and using somebody's vat number. For example An electrician does some work on your house. They offer to accept a cash-in-hand payment to save you VAT on the cost of the job. Accepting cash to avoid VAT is tax evasion, which is against the law. In this case payer and electrician is also they committed crime since Vat is duty for every citizen they should make the payment according to VAT in this case not only government but also for the party who made the payment is disadvantage because this kind of payment has no effect before the court this kind of things brings tax gap.

In the fight against vat fraud it important to collect data as evidence on the scale of tax revenue losses in this case vat gap is the best indicator effectiveness of vat enforcement and compliance. It shows us more needs to be done to lower VAT. VAT gap measured based on top-bottom approach this relies on national account data own resource submission these figure are used to estimate the vat liability generated by different sub aggregate of the economy. in addition tax gap group was established in 2020 under fiscal program this group published the most important thing on calculation of vat gap in order to bring better understanding on estimation metrology to share information for the public.

RECOMMENDATIONS

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We believe that the findings of this study will have several implications on vat gap and its possible solution Countries should therefore focus on increasing their VAT revenues by better collection of VAT, rather than increasing the standard VAT rate. From our models, it can be derived that it is not recommendable to use a reduced rate significantly lower than the standard rate. That reduce rates are important tax policy instruments protecting socially weak groups or encouraging certain fields of business.the other method of reduce vat gap which means if the main Cause of vat gap is fraud how can we reduce vat gap fraud immediate action is very important, collective effort is also concentrated on better concentration. The main solution for vat fraud is technology the three leading technology are real time vat(RELVAT), vat locator number /VTL/,and digital vat /D- VAT/ this are technological solution for vat fraud now we will outline how this technological solution reduces fraud one by one as bellow.

Real time vat/RTVAT/ means it is essentially moves point of taxation from invoice data to the settlement data. It is cash basis system that mandates debit cards and wire transfers of tax amounts in real time directly to the tax authorities when payments are made. All EU member can connected with server then they will reduce fraud of vat in this case with holding and vat remit element of vat system has been effectively removed. VLT the VAT Locator Number system is the simplest of the three solutions to adopt. It's also the least disruptive to the current VAT system. Statutory changes would be minimal .Its creator, Michael Cheeta, proposed it at the May 25, 2007, House of Lords hearings. It applies to all transaction in vat system. It prevents only MTIC fraud.

In case of MTIC fraud is eliminated and commercial chain is also uninterrupted the merchant sold without VLT has sanction the two examples of VLT are standard cross border sale with EU and the second one shows that the result of

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selling without VLT this brings the seller should pay all the tax for authority to secure VLT allow him reselling the purchase this is all about VLT in my opinion this one is much better than the rest. The third one is D-VAT it same with the VLT the only difference is it uses certified software.it applied for selectively suspect class of supplier. It is the only solution extended to cover B2 transaction.

Generally vat gap means the difference between the amount of expected revenue and what actually collected in any country and in any year. The main problem of vat gap is fraud and fraud can be easily prevented by means of technology.

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