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**REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN  
PARLIAMENT**

**Sixth report under Article 12 of Regulation (EEC, Euratom) n° 1553/89 on VAT  
collection and control procedures**

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## TABLE OF CONTENTS

1.	EXECUTIVE SUMMARY .....	3
1.	Chapter 1: Introduction & SCOPE.....	4
1.1.	What is an Article 12 Report?.....	4
1.2.	What are the sources of the information in the Reports?.....	4
1.3.	Previous Article 12 Reports .....	4
1.4.	Purpose of the Report.....	4
1.5.	Scope of this Report .....	4
2.	Chapter 2: Follow-up to the recommendations.....	5
2.1.	Why look at the past recommendations .....	5
2.2.	Gathering the evidence.....	5
2.3.	Analysing the responses.....	5
2.4.	Results .....	6
2.5.	Evaluation .....	6
3.	Chapter 3: Operational conclusions from the seminar.....	7
3.1.	Introduction.....	7
3.2.	VAT gap.....	7
3.3.	Evaluation .....	8
4.	Chapter 4: Conclusions .....	9
4.1.	Context and objectives .....	9
4.2.	Indicators of success .....	9
4.3.	Overall evaluation .....	9

## **1. EXECUTIVE SUMMARY**

This is the sixth in a series of reports the Commission provides to the budgetary authority at three-yearly intervals concerning Member States' VAT collection and control procedures. Past reports have covered all the subject areas proposed by Regulation 1553/89 and have made recommendations designed to obtain improvements concerning almost all of them. This edition of the report is a little different. It takes a realistic look at what has been achieved as a result of the previous five reports – trying to evaluate whether the reporting process can be shown to have been effective.

In earlier reports, the question of the underlying purpose of Article 12 reports had been aired. Although there are very detailed uniform procedures concerning calculating the amount (the VAT base) from which the Commission's VAT own resources is derived, this process starts with the amount of VAT Member States actually collect. In the context of own resources controls the Commission verifies the accuracy of Member States' calculations but does not inspect Member States' arrangements for managing, controlling and collecting VAT. The information in the reports is collected from Member States - usually by questionnaire. Their arrangements and procedures can be very diverse - this is not an area where there is only one correct method and certainly no "one-size-fits-all" solutions.

The Commission considers that the Article 12 reports should be a driver for change. This change might be achieved by precipitating debate in the European Parliament and in Council or by triggering change in Member States as a result of a recommendation made in the reports. This report summarises the findings of how successful the reporting process has been when measured against these two yardsticks.

The results are not encouraging. None of the previous reports has elicited any identifiable response from the European Parliament or the Council, much less generate debate. A survey of all Member States asking about the activity they had initiated because of Article 12 reports did not provide extensive or convincing evidence that any specific action had been made as a result of the reports.

The absence of reaction from the budgetary authority does put into question whether there is any continuing requirement for the report beyond simply fulfilling a regulatory obligation and the Commission has numerous other opportunities to enhance VAT collection and to contribute to reducing VAT fraud. Nonetheless the Commission considers it important that the debate on VAT control, collection and management should continue at all useful levels. The Commission will therefore continue to use the Article 12 arrangements to provide an impetus for reflection and change in Member States by providing a platform for discussions, exchange of ideas and for pooling experiences in the VAT field among Member States and between Member States and the Commission.

## **1. CHAPTER 1: INTRODUCTION & SCOPE**

### **1.1. What is an Article 12 Report?**

Article 12 of Regulation 1553/89<sup>1</sup> requires the Commission to report to the budgetary authority (the European Parliament and the Council) every three years on the procedures applied by Member States to register taxable persons and to determine and collect VAT, as well as on the modalities and results of their VAT control systems. The report should also consider whether improvements to procedures can be contemplated.

### **1.2. What are the sources of the information in the Reports?**

The information in the reports is collected from Member States. The usual collection method has been to compile and issue questionnaires focusing on particular areas of Member States' VAT administration and collection arrangements. Their replies are collated to form the report. For the fifth report (published in early 2005) this approach was supplemented by visits to all the then Member States to clarify and elaborate the replies they had made in response to the questionnaire. As well as replies to a specially-prepared questionnaire this report draws on the findings of a seminar involving all Member States which the Commission organised in 2006<sup>2</sup>.

### **1.3. Previous Article 12 Reports**

This report is the sixth in the series<sup>3</sup>. Past reports have covered all the subject areas proposed by the regulations and have made recommendations concerning almost all of them.

### **1.4. Purpose of the Report**

What the underlying purpose of such a report is might be questioned as, after all, Article 3 of the same Regulation makes it clear that the VAT resources base is derived from the total net revenue actually collected by a Member State during the year in question. When the Council approved the relevant regulatory provisions it took the view that the reporting procedure would contribute to strengthening measures combating fraud. For the Commission, the report provides a vehicle for it to comment publicly on the efficiency and effectiveness of Member States' management of VAT and should be a driver for change. The reports also contribute to the exchange of best practice and reflect the concern that all Member States be treated equally in respect of their contributions to the Community budget.

### **1.5. Scope of this Report**

This report covers the period 2003 to 2006 and deals with two main areas. The first is a realistic look at what has been achieved as a result of the recommendations made in the previous five reports. The second is to build upon the seminar the Commission organised in 2006, the year after the publication of the fifth report. The seminar showed that voluntary compliance and the use and importance of evaluation - major topics underlying recommendations in the VAT field - had been very differently interpreted by various administrations. The opportunity has been taken to present the conclusions the Tallinn seminar drew about voluntary compliance and evaluation.

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<sup>1</sup> Council Regulation (EEC, EURATOM) No 1553/89 of 29 May 1989 OJ L155, 7.6.89 on the definitive uniform arrangements for the collection of own resources accruing from value added tax

<sup>2</sup> The seminar took place in Tallinn, Estonia the 11<sup>th</sup> – 13<sup>th</sup> October 2006 under the Community's administrative co-operation programme for tax administrations and their officials – Fiscalis 2007.

<sup>3</sup> 5<sup>th</sup> Report: COM/2004/0855 final + Annexe SEC (20004) 1721

4<sup>th</sup> Report: COM/00/0028 final

3<sup>rd</sup> Report: COM/98/0490 final

2<sup>nd</sup> Report: COM/95/354 final

1<sup>st</sup> Report: SEC(92) 280 final

## **2. CHAPTER 2: FOLLOW-UP TO THE RECOMMENDATIONS**

### **2.1. Why look at the past recommendations**

As explained in the introduction this is the sixth report in this series that the Commission has prepared based on information supplied by Member States. The previous Article 12 reports presented to the budgetary authority had not generated any debate. This lack of reaction poses questions about the effectiveness of the reporting process. However Member States might themselves be using the findings of the reports as a basis for taking action to improve their own administrative arrangements. After the publication of the fifth report the Commission organised a seminar with the idea of exploring whether or not this was the case. While the seminar was hailed as successful by participating Member States and certainly proved a useful vehicle for them to network, to exchange best practice and explain initiatives that they were taking to other Member States the seminar did not in the end provide the most suitable forum for charting progress in implementing recommendations. This could partly have been because of the timing of the seminar - not long after the EU-10 enlargement – around one-third of the attendees came from countries which had been members of the EU for only two years and would thus have had very little time to react to the recommendations.

The recommendations had provided the structure of the seminar and influenced its content. However, the gritty issues of how far the action needed to implement them had progressed or whether Member States intended to take action on them had not been addressed systematically across all Member States for the full spectrum of recommendations. By returning to the issue for the next report and once again utilising the questionnaire approach the discussions at the seminar which had ensured all Member States had been reminded of or acquainted with the recommendations could be built upon. The Commission would gain evidence to make a realistic assessment of the degree of improvement the recommendations had triggered and thus obtain an evaluation of how far the reports had been drivers for change.

### **2.2. Gathering the evidence**

A questionnaire was devised to gather information for this report using the distillation of the recommendations made in all the previous reports. This distillation originally drawn up for the seminar had eleven items. Some items were specific, others more abstract. The full list appears in an annexe to this report but the primary areas covered were the following: improving voluntary compliance together with recovery and enforcement; use of IT; feedback and other evaluation arrangements; plus improving records and information flows.

The questionnaire asked Member States to:

- describe any developments that had taken place in relation to each of the eleven recommendations since the beginning of 2003;
- state whether there had been any evaluation of the impact of those developments;
- explain the reasons for no action having been taken if that was the case; and finally
- outline any alternative action they had undertaken to remedy potential shortcomings in the areas covered by the recommendations and the results that had been achieved.

### **2.3. Analysing the responses**

All Member States replied to the questionnaire. Their responses were collated and an analysis made for each recommendation of what action had been taken, whether its success had been evaluated and, where appropriate what had prevented action. The analysis was difficult as

Member States were not always specific in their responses. Most Member States had replied by describing the system they operated in the area concerned by the recommendation but much less frequently gave time-based information and almost never linked any innovations to a specific recommendation.

The second-stage question concerning whether or not a particular activity had been evaluated was even more difficult to examine. Few Member States responded other than in general terms. Explanations for not taking action or alternative choices (the final two questions) were rarely provided.

#### **2.4. Results**

A table listing all eleven recommendations together with a brief description of Member States' responses and a short evaluation of progress towards implementation was prepared and has been annexed to this report.

Looking overall at the results achieved the initial outcome looks positive. Almost all Member States have reported some activity in areas corresponding to those specified by the recommendations. However there were some exceptions such as the use of VAT control plans plus the importance of central risk assessment. In both of these areas significant numbers of Member States reported different views from those embodied in the recommendations. For example a group of Member States were convinced that VAT control plans should be incorporated in control plans for other taxes rather than being stand-alone entities. This seems a plausible response to another subject discussed in previous Article 12 reports: that of the benefits of VAT being part of a single large revenue collecting department rather than operating separately. Similarly some Member States were firmly of the belief that local risk assessment was the preferred model although the central level should be kept informed. A third area where there was little apparent activity was individual official performance evaluation. Here most Member States simply described the evaluation process made for human resources and career planning reasons. Only one Member State described any further evaluation tailored to the success or otherwise of its VAT control activities.

It was found that few Member States had related their activity to the period since 2003 (save those Member States who had joined since that date). In fact some 'old' Member States specifically observed that particular activities had taken place or goals had been achieved before the Article 12 recommendations had been made.

When it came to answering the subsequent questions posed: the results of any evaluation of the impact of the developments or action taken; the reasons for any lack of action; and commenting on any alternative action preferred it was very difficult indeed to glean any really clear response except in very isolated instances.

#### **2.5. Evaluation**

The objective of the evaluation was to assess whether the recommendations made in Article 12 reports had been drivers for change. Little evidence was found that this was the case. The results did provide reassurance that the recommendations were in the main in line with initiatives Member States had pursued or were pursuing. However it was difficult to find any evidence tying Member State action specifically to the report recommendations.

The next focus was on the results Member States reported of activity in evaluating the success of their initiatives. This would be a key indicator of the influence and importance of the Article 12 reporting process because of the stress that the questionnaire had put on this aspect coupled with the importance that had been assigned to it at the seminar in 2006. The outcome

of this part of the evaluation was disappointing with hardly any Member States commenting on any assessment or ongoing measurement and review processes.

### **3. CHAPTER 3: OPERATIONAL CONCLUSIONS FROM THE SEMINAR**

#### **3.1. Introduction**

The seminar was built around a mix of presentations from national administrations and from external experts, together with workshops and a panel discussion.

The seminar was aimed at officials working at a strategic level in the participating countries rather than those working with VAT based own resources. Those involved in setting the overall direction of control of VAT, making control policy, and in evaluating VAT control, collection, and enforcement were the target audience.

This Commission-organised seminar was a welcome opportunity to bring the subject matters of an Article 12 report into a discussion arena, for the exchange of ideas and the pooling of experience. This Commission initiative was much appreciated by the participating countries irrespective of their accession date.

Focus was not only placed on following-up previous recommendations, but also on the qualitative aspects of the VAT gap coupled with voluntary compliance, and to the role of evaluation cycles in a modern administration.

#### **3.2. VAT gap**

The VAT gap is the difference between the expected or anticipated revenue from VAT and the revenue that is in fact actually collected. The gap arises largely as a consequence of revenue loss through cases of fraud, insolvency, tax evasion and tax avoidance. From a narrow viewpoint this might seem a surprising subject for a VAT own resources seminar as the arrangements for calculating VAT own resources deliberately exclude the VAT gap. The starting point for calculating the VAT base is the revenue actually collected, not the amount that should have been<sup>4</sup>. However there is a clear link between devising measures to improve voluntary compliance, which can encompass customer service and expectation issues, and the process of qualifying rather than merely quantifying the VAT gap.

During the seminar it became clear that Member States had different understandings of the utility of estimating the size of the VAT gap. There were also many different approaches to the estimation process, with some placing greatest emphasis on quantifying the gap and the need for a standard method of calculation. However, once the gap size has been quantified, there is little a Member State can do with that discernment. Mere knowledge of its size does not itself remedy the situation.

A qualitative analysis of the VAT gap based on techniques for identifying those economic operators who constitute the VAT gap is therefore essential in order to reduce the number of traders that do not fully comply. The particularities of each segment of traders that populate the gap needs to be investigated and established and thereafter the correct compliance methods – ranging from targeted voluntary compliance measures to criminal prosecution for that particular segment need to be devised and applied.

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<sup>4</sup> - save for various adjustments and compensations required because VAT law provides Member States with some options and the VAT base is calculated as if the law was fully harmonised.

As this brief summary shows the issue was thoroughly ventilated during the seminar no consensus was reached: stakeholders, although all recognising the importance of the concept, did not identify any remedial action that all could agree.

### **3.3. Evaluation**

In its fifth Article 12 report the Commission placed emphasis on the importance of proper evaluation by Member States of the functioning of their VAT collection activities, as it was noted that evaluation had not received the level of attention that it deserved in every Member State's tax administration.

Evaluation has become more important because of decentralisation of management and other tasks, as well because of the increased importance attributed to efficiency, effectiveness and quality of service. This tendency has been further accentuated in the face of budget cuts or more active scrutiny of how allocated funds have been spent.

A proper evaluation should include an assessment of the situation before and after the implementation of the actions concerned and use indicators to monitor progress from period to period.

It became clear from the seminar that the distinction between the concepts of monitoring and evaluation was not entirely clear in many Member States. The Commission considers that both are needed to improve performance and to make sure that "the right things are done in the right way". However it was apparent that Member States did not all attach the same value to evaluation techniques when developing and improving their VAT control policies and strategies.

## **4. CHAPTER 4: CONCLUSIONS**

### **4.1. Context and objectives**

Regulation 1553/89 which deals with the arrangements for the collection of own resources arising from value added tax requires the Commission to report to the budgetary authority every three years. The reports are compiled from information supplied by Member States. The regulatory provisions envisage that the report process will focus on Member States' procedures for registering taxable persons, calculating and collecting VAT due together with their control and verification systems.

It is important to observe that although there are uniform procedures set up concerning how to calculate the amount (the VAT base) from which the amount to be made available to the Commission is derived, Member States have much more latitude<sup>5</sup> when it comes to fixing registration limits and processes, tax rates and control arrangements. So this is not an area where there is only one correct answer and certainly one-size-fits-all options are unlikely to be available.

Recognising those constraints the Commission nevertheless has made in past reports a variety of recommendations aimed at securing improvements in Member States' methods of working. In this particular report the issue of evaluating whether the preceding reports and the recommendations therein had indeed been drivers for change is explored.

### **4.2. Indicators of success**

Two potential indicators which could be used to measure the success of the reports were identified. The most positive feedback would be evidence that the reports triggered debate by the budgetary authority and in turn that that debate had resulted in improvements in the arrangements for managing and collecting VAT. No such evidence was found.

Feedback was also sought from Member States about what action they had taken to implement the recommendations. The Commission starting laying the foundations for this report after the publication of the last one in 2005 by arranging a seminar to which all Member States were invited to consider the wider issues which had generated earlier recommendations. It was intended that this should trigger analysis and evaluation in Member States of how far they had implemented the recommended action or, if they had not, why not or what alternatives they had pursued. The fruits of this activity would then be harvested in the questionnaires for this report.

As the results described in Chapter 2 and the annexe show, the realistic and deliberately rigorous evaluation performed of what has been achieved as a result of the recommendations made in the previous five reports provides little evidence for taking a positive view. It provides reassurance that the majority of the recommendations were apposite and that Member States have or had taken action on similar themes but not that the recommendations themselves provided the trigger.

### **4.3. Overall evaluation**

Given the arrangements for the VAT own resource the question arises as to what is the underlying purpose of producing Article 12 reports. It could be argued that to fulfil a truly

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<sup>5</sup> Within the constraints of the VAT Directive – Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L 347, 11.12.2006. Directive as last amended by Council Directive 2008/8/EC of 12 February 2008, OJ L 44, 20.2.2008, p.11.

useful purpose the reports should be a driver for change and the Member States' view that they might have a contribution to make in the fight against VAT fraud is also worthy of note.

This report describes how an attempt was made to measure the contribution the reports have made towards securing beneficial change or improvements in the methods Member States use to manage VAT. One measure examined was whether the Article 12 reports published in the past had been catalysts precipitating debate in the European Parliament or in Council. As the reports had not elicited any response from the European Parliament or the Council there was no success to point to there. Member States were also asked about the activity they had initiated because of Article 12 reports. Although they provided some positive feedback it would be difficult to point to any specific action that incontrovertibly would not have happened save for an Article 12 report. The Commission therefore will initiate a discussion between the relevant players from Member States within the forum of the Advisory Committee on Own Resources on the matters addressed under Article 12 of Regulation 1553/89 including the conclusions that can be drawn from this report.