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*Annex to the*

**Fifth report under article 12 of Regulation (EEC, Euratom) No 1553/89 on VAT  
collection and control procedures**

{COM(2004) 855 final}

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## 1. BACKGROUND

### 1.1 The own resources system

#### 1.1.1. Introduction

The Treaty of Rome of 1957 provided for the European Economic Community to be financed by national contributions for a transitional period, pending the introduction of a system of own resources. Article 201 of the Treaty stated: “*Without prejudice to other revenue, the budget shall be financed wholly from own resources*”. Own resources mean a source of finance separate from and independent of the Member States’ budgets, consisting of revenue assigned once-and-for-all to the Community to fund its actions. The Member States are required to make payments available to the Community for its budget.

On 21<sup>st</sup> April 1970 the Council adopted a decision assigning to the Community own resources to cover all its expenditure. The decision marked the end of the previous national contributions, which might be thought to give the Member States some scope for controlling the policies undertaken by the Community, and the beginning of an autonomous system of financing by own resources based on agricultural levies and customs duties, as well as foreseeing a resource based on value added tax.

The VAT own resource was introduced together with traditional own resources when the system of national contributions from Member States was abolished. However, the need to harmonise the VAT base meant more delay, with the result that this resource did not come into use until 1979. Its amount is obtained by applying a given rate (sometimes called “rate of call”) to a tax base determined in a uniform manner. The base may not exceed a certain percentage of the Member States’ gross national income (GNI). The present “capping” percentage is 50% of GNI.

The 1970 decision limited the maximum rate of call of VAT to 1% of the base. The second own resources decision of 7<sup>th</sup> May 1985 raised this ceiling to 1.4% to coincide with the accession of Spain and Portugal. This increase was intended to meet the costs of enlargement. The fourth own resources decision of 31<sup>st</sup> October 1994, however, provided for a gradual return to the 1% limit.

In 1984, the European Council decided to introduce a correction for budgetary imbalances. This was based on the doctrine that “*any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*” but was introduced only in favour of the United Kingdom. Although the situation relative to the underlying doctrine has changed substantially over these last 20 years, this mechanism still gives the United Kingdom a rebate based on its net balance. The cost of financing this rebate is shared between the other 24 Member States<sup>1</sup>. Meanwhile, faced with the growing insufficiency of the VAT-based resource, in 1988 the Council decided to

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<sup>1</sup> The number of Member States that financed the so-called United Kingdom’s correction were 14 during the reference period of the present report. The number in the text refers to the present post-enlargement situation.

introduce a fourth own resource, based on a percentage of gross national product/income<sup>2</sup>, to meet any shortfall in revenue.

The existence of own resources sets the European Union apart from other international bodies, which all rely for funding on contributions from their members. The European Union's Member States may not withhold their contributions at will. Moreover, interest will be charged on late payments.

The budget of the European Union is thus now financed from the following sources:

- Traditional own resources;
- The VAT-based own resource;
- The GNI-based own resource; and
- Other revenue.

#### *1.1.2. Traditional own resources*

The European Union's traditional own resources consist of customs duties, agricultural duties and sugar levies. They are collected on behalf of the European Union by the Member States, which keep 25% to cover their collection costs.

Customs duties are levied on imports of non-agricultural products from third countries, at rates set out in the common customs tariff. These rates have been steadily reduced as a result of agreements in the framework of the World Trade Organisation (WTO), and arrangements granting preferential tariffs to many trading partners or products. Successive accessions and proliferating free-trade agreements have also reduced income from these duties. Agricultural duties are charged on imports of agricultural products from third countries. Producers of sugar and related products pay levies on production to finance the export refunds for sugar.

#### *1.1.3. VAT-based own resource*

The VAT-based own resource is calculated by applying the rate of call to the harmonised national VAT bases, which are determined in accordance with Community rules. Furthermore, Member States' VAT bases are capped at 50% of their GNI. In 2003, six Member States (Greece, Spain, Ireland, Luxembourg, Netherlands, and Portugal) benefited from this limit.

In accordance with the own resources decision currently in force (2000/597/EC, EURATOM), the maximum rate of call was set at 0.75% of the harmonised capped VAT bases in 2002 and 2003 and 0.5% from 2004 onwards. The true uniform rate, after deduction of the United Kingdom's correction, amounted in practice to approximately 0.53% (and is about 0.3% in 2004 owing to the lower maximum rate). In 2003, the VAT resource amounted to 21 260.1 million euros.

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<sup>2</sup> The concept of Gross National Product (ESA79 GNP) has been replaced by the concept of Gross National Income (ESA95 GNI) in the EU budgetary and own resources area as from the year 2002, in accordance with Council Decision N° 2000/597.

#### 1.1.4. GNI-based own resource

A new resource based on GNP was introduced in 1988 to balance budget revenue and expenditure, i.e. to finance the part of the budget not covered by other revenue sources. It consists of a uniform rate applied to the sum of all Member States' GNP (now GNI) established in accordance with Community rules.

#### 1.1.5. The correction in favour of the United Kingdom

The correction<sup>3</sup> was introduced to correct the imbalance between the United Kingdom's share in payments to the Community budget and its share in Community expenditure. This imbalance is calculated according to complex rules and the United Kingdom is reimbursed for 66% of the difference.

The cost of the correction is borne by the other Member States according to their share in Community GNI. However, certain Member States enjoy a reduction in their financing share, the cost of which is assumed by the remaining Member States.

The total amount of the United Kingdom correction in 2003 amounted to 5 194.7 million euros.

#### 1.1.6. Other revenues

The general budget is also financed by other revenue, including the balance from the previous exercise, tax and other deductions from EU staff remunerations, bank interest, contributions from non-member States to certain Community programmes (e.g. in the research area, and from EEA countries), repayments of unused Community financial assistance and interest on late payments.

In 2003 other revenue amounted to 9 836.1 million euros, of which 7 676.8 million euros corresponded to the surplus carried over from 2002.

#### 1.1.7. Relative shares

The VAT-based own resource's relative share of total revenues has diminished over the years, as has the share of traditional own resources, whilst the GNI-based resource has increased correspondingly. The absolute amount of VAT-based own resources, however, has remained fairly stable until a substantial decrease in 2002. In 2003 the VAT own resource corresponded to just less than one quarter of total revenues, whilst the GNI-based resource just about 55%. Traditional own resources accounted for just over one tenth of the Union's revenue, and the remainder consists of the *other revenues* described above. The Union's budget has in the same period increased to meet its various obligations. Over the ten years from 1992 to 2002 the increase was close to 50%, from approximately 65 billion to almost 95 billion euros.

## 1.2. Legislative framework of this report

Article 12 of Council Regulation N° 1553/89 requires the Commission to present a report every three years to the European Parliament and the Council. This report should analyse the procedures applied by Member States for registering taxable persons, and for determining and

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<sup>3</sup> Refer to the fifth paragraph under heading 1.1.1 for a short background to this mechanism.

collecting VAT, as well as the modalities and results of their VAT control systems. The report should also contemplate possible improvements. The relevant data are collected from Member States under the provisions of Article 12(1) of the Regulation.

It might legitimately be wondered why Article 12 of the Council Regulation provides for a report of this kind. After all, Article 3 of the same Regulation makes it clear that the VAT resources base is derived from the total net VAT revenue actually collected by a Member State during the year in question. There is no legal requirement to maximise VAT revenue. Neither this Regulation nor the Sixth VAT Directive and its related measures prescribe particular procedures for registration of taxpayers, for VAT control or for recovery of fiscal debts. Nevertheless, the structure of the own resources system is such that any deficiencies in the organisation of these procedures by any Member State that reduce the revenue from the VAT-based resource will necessarily lead to an increase in contributions by **all** Member States to the fourth resource, based on GNI. It is therefore important that all Member States make the greatest possible effort to identify and tax all taxable transactions in order to ensure equal treatment of all Member States and to fulfil the intention of the legislator, who provided that the fourth resource should complete the revenue needed to meet agreed budget expenditure only when all the other resources have been fully exploited.

### **1.3. Previous reports**

To date, the Commission has produced four reports. The first was published in February 1992<sup>4</sup>, the second in July 1995<sup>5</sup>, the third in September 1998<sup>6</sup> and the fourth in January 2000<sup>7</sup>. As the fourth report was combined with a report under Article 14 of Regulation N° 218/92<sup>8</sup> on administrative cooperation in the field of indirect taxation, it dealt only partially with issues related to Article 12 of Regulation N° 1553/89. This is also why its publication took place earlier than required.

The first report dealt mainly with the concept of voluntary compliance by taxpayers. It discussed the factors influencing voluntary compliance and suggested measures to promote such compliance.

That report – as well as the second – also dealt extensively with the characteristics of the taxpayer population as well as with the tax administrations' resources and organisational structures, in order to make recommendations for improving the administrative processes. The second report also touched upon the subject of VAT-debt management.

In the third report, a section was devoted to different types of fraud; it also examined certain sectors that are more widely exposed to the risk of fraudulent behaviour than others.

The last three reports all focused to a degree on the planning and carrying out of VAT controls. The following subjects were discussed in more detail in that context:

- Gathering intelligence;

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<sup>4</sup> SEC(92) 280 final, 24<sup>th</sup> February 1992

<sup>5</sup> COM(95) 354 final, 20<sup>th</sup> July 1995

<sup>6</sup> COM(1998) 490 final, 3<sup>rd</sup> September 1998

<sup>7</sup> COM(2000) 28 final, 28<sup>th</sup> January 2000

<sup>8</sup> OJ L024, 01.02.1992

- Preventing fraud;
- Implementing risk analysis;
- Determining control objectives and methodologies; and
- Monitoring and evaluating VAT controls.

Finally, it should be noted that, unlike the second report, which contained a follow-up to the first report, the third and the fourth reports did not take stock of achievements in relation to the recommendations put forward in the previous reports.

#### **1.4. Organisation of the work**

Article 12 of Regulation N° 1553/89 gives the Commission a narrow but well-defined mandate (see point 1.2). The fifth report offers an opportunity to review recommendations made in previous reports and assess what has been achieved in those areas. The principal angle of approach has been to assess what Member States have done in a particular area since a recommendation was originally made and what results have emerged from that implementation.

In preparation for the fifth report, the Commission distributed a detailed questionnaire to all Member States' VAT administrations at the beginning of 2003. The deadline for returning the completed questionnaire to the Commission was set for the 31<sup>st</sup> March 2003. The completed questionnaires from Member States actually arrived over a period that ran from March to October 2003.

In order to validate the information and make it comparable, Commission officials visited each Member State. These visits, which took place between April and December 2003, concentrated on clarifying and elaborating on the replies to the questionnaire, which highlighted the areas that the fifth report would cover. Member States were also invited to describe how they had implemented the recommendations made in previous reports. The Commission takes this opportunity to thank the Member States for their cooperation and is particularly grateful to those that accepted to work with documents not written in their own languages. This helpful and pro-active approach shortened considerably the time needed for the work.

Following the visits, the Commission sent an amended set of replies to each Member State. The amendments took account of the outcome of the above-mentioned visits. Member States were invited to validate the amendments and, if necessary, correct the information. In some cases, Member States had to elaborate on and complete the information already given. Together with the validation, Member States were also required to furnish information concerning the implementation of the recommendations formulated in the previous reports. They should, for each recommendation, answer the following questions:

- (1) Has the recommendation been implemented?
- (2) What experiences were encountered?
- (3) If the recommendation was not implemented, why not?
- (4) What was done instead?

- (5) What experiences were encountered from implementing any alternative solution?

Once all the processes mentioned above had been completed, it would be possible to use coherent information to make comparative analyses and to draw conclusions. The drafting of the report started in 2004.

The present report has been written during a period that included the 2004 enlargement. The information collected concerns only the Member States of the European Union before the 1<sup>st</sup> May 2004. Consequently, when in the text, reference is made e.g. to “two thirds of the Member States”, that should be understood as ten out of fifteen Member States.

### **1.5. Statistical data**

Member States were asked to complete statistical annexes relating to the various sections of the survey. Owing to the inconsistent quality of the data provided, which often resulted from organisational differences, it has been difficult to draw any conclusions based on the submitted material. It was possible to improve the quality of these data only marginally during the follow-up visits that were conducted during 2003.

The information requested by the Commission was not available in all Member States, resulting in a completion percentage for each annexed table that seldom exceeded 60%. Even though this rate was more or less constant among the tables, there was nevertheless a high degree of variation as regards which Member States submitted which tables. In consequence, the data could often not be consolidated between Member States. In this case, the exploitability rate of the aggregated data did not exceed 40%.

Furthermore, the information transmitted by Member States was not presented in such a way that sufficient comparability could be ensured. Indeed, the diverse structures of VAT administrations in Member States contributed to making the answers far less comparable than was desired. A further complicating factor arises from the rather limited use of evaluation tools to fine-tune national administrations' activities. Reliable and exhaustive statistical data are of key importance to any serious attempt at evaluation. One positive outcome is the fact that Member States have now indirectly acquired new ideas about additional statistical data that they can collect to learn more about their own administration.

These elements therefore prevented the Commission from making a more extensive use and analysis of the statistical data attached to the questionnaires received from Member States. The analysis was consequently limited to two main areas, on the one hand regarding the consistency between statistical data provided and the information contained in the replies to the questionnaire and on the other hand concerning the consistency of the evolution over time of the individual data for each Member State. In its intended follow-up to this report, the Commission will seek to encourage Member States' VAT administrations to undertake a better statistical analysis of their own activities.

## 2. STRUCTURE AND CONTENT OF THE REPORT

This report contains two main parts: first, a reflection on existing procedures and significant administrative and other changes that have recently taken place in Member States' VAT administrations and, second, an identification and evaluation of the Member States' implementation of the previous reports' recommendations. Administrative cooperation between Member States, carousel fraud and risk analysis will not be dealt with in this report as these have already been discussed in the recent report<sup>9</sup> by the Commission to the Council and the European Parliament under Article 14 of Regulation N° 218/92 on administrative cooperation in the field of indirect taxation. It will be recalled that the fourth Article 12 report was combined with the previous report produced under Article 14 of Regulation N° 218/92. The Commission has this time opted to produce, as in the past, two separate reports – even though they both deal with matters that overlap to a considerable extent and are thus closely related. As the matters in question, both at the Commission and in Member States, are dealt with by the same departments or by departments that cooperate closely, it has been necessary to draw a clear distinction between the two reports.

The reports under Regulation N° 1553/89 contemplate the VAT collection and control procedures applied in Member States. Perhaps the main difference is that the reports under Regulation N° 218/92 deal – from a VAT perspective – with the relation *between* Member States, whilst the reports under Article 12 are concerned with treatment of VAT *within* the Member States. Obviously, the distinctions between the two reports are more complex than that. However, this demarcation line not only provides a clear and understandable boundary, but also helps to focus on the core issues of the reports made under Article 12.

The present report is divided into an executive summary and an annex with 6 chapters, dealing with the above-mentioned items. Chapter 4 gives an overview of the most important changes and developments in the administrative organisation of the tax administrations. That chapter also assesses the functioning of the VAT collection and control systems. Chapter 5 gives a review of the implementation of the recommendations of previous reports by the national administrations. Finally, chapter 6 provides an overview of the conclusions and puts forward suggestions for improvements. The earlier chapters basically provide background for and support the content of these three later chapters.

An important distinction must be drawn between the data capture under chapters 4 and 5. The former is based on the replies to the Commission's questionnaire that cover only the period since the drafting of the previous report. The data captured for chapter 5 describe the implementation of the previous recommendations and cover the entire period up to and beyond the previous report.

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<sup>9</sup> COM (2004) 260 final, 16<sup>th</sup> April 2004

### **3. DEVELOPMENTS SINCE THE FOURTH ARTICLE 12 REPORT**

#### **3.1. Reactions to the Fourth Report**

##### *3.1.1. Introduction*

As already explained, the fourth Article 12 report was unusual in so far as it was published jointly with the Commission's third report on administrative cooperation in the field of indirect taxation (VAT) presented to the European Parliament and the Council under Article 14 of Council Regulation (EEC) N° 218/92. For this reason, the fourth Article 12 report devoted less attention than it might otherwise have done to the matters discussed in previous Article 12 reports and did not contain a detailed analysis of the follow-up given to the recommendations of these earlier reports by the national tax administrations. Probably as a result, reactions were muted.

##### *3.1.2. European Court of Auditors*

The break with previous practice that this joint report represented was duly noted by the European Court of Auditors in its Annual Report for 2000<sup>10</sup>. In paragraph 1.82 the Court pointed out that the report did not analyse and evaluate Member State's inspection systems, which the Commission had undertaken to do in reply to one of the Court's special reports<sup>11</sup>. In its reply to this observation, the Commission pointed out that it had in fact made a comprehensive examination of every Member State's VAT control system in a report on the matter. Among the recommendations made in this annual report, the Court of Auditors urged that the Commission's reports should focus more on its monitoring of the performance and development of national VAT control systems. Since the Community legislation relating to own resources controls does not provide an explicit legal basis for such monitoring, the Commission interprets this recommendation as one concerning the future content of Article 12 reports rather than the substance of its regular own resources control reports.

The Court of Auditors has addressed several sector letters to the Commission concerning aspects of the latter's management of VAT-based own resources, in particular Sector Letter N° 295/00, addressed to the Commission on 11<sup>th</sup> December 2000, which rehearsed some of the criticisms of the Commission's monitoring of Member States' VAT procedures subsequently found in the above-mentioned annual report. The Court also regularly examines these questions in its annual reports, although there have been no special reports by the Court on VAT resources since 2000. Since the publication of the last Article 12 report, the Court of Auditors has conducted a series of audits in Member States' VAT administrations with the intention of evaluating aspects of the way in which annual VAT statements are drawn up, including matters relating to control and recovery procedures. In sector letters addressed to the relevant national audit institutions, the Court has drawn attention to certain shortcomings. These letters are also communicated to the Commission, which notes their contents for use in its own controls.

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<sup>10</sup> OJ C359, 15.12.2001

<sup>11</sup> Special Report N° 9/98, OJ C356, 20.11.1998

### 3.1.3. Council and the European Parliament

The recommendations made in the fourth report were noted by the Council and referred to the ad hoc group on tax fraud that the ECOFIN Council had already established in 1999. Finally, the European Parliament chose not to discuss the fourth report.

### 3.2. Actions taken at Member State level

All Member States have taken steps to implement at least a part of the recommendations made in the fourth and earlier Article 12 reports. At a number of appropriate places in this report, reference is made to the measures adopted by national administrations in response to these previous reports.

### 3.3. Actions taken at Community level

The recommendations made in the fourth report provided an important contribution to the already ongoing discussions in the Council's ad hoc group on tax fraud. Unsurprisingly, in view of the legal limitations on action at Community level in the field of fiscal fraud, the discussions relating to VAT concentrated mainly on questions of administrative cooperation and mutual assistance, thus echoing the main thrust of the fourth report. Community VAT provisions do not provide for common action on the questions of registration, control and recovery that are the proper subject of Article 12 reports. Nevertheless, in the fourth report the Commission expressed its disquiet at the unacceptable level of VAT fraud and this concern was echoed by the ECOFIN Council meeting on 5<sup>th</sup> June 2000. The Council exhorted the Member States to take stronger measures to combat VAT fraud and this has led to a reinforcement of the legal framework for mutual assistance, as well as strengthened efforts by the Commission, using the opportunities offered by its structure of committees and the *FISCALIS* programme, approved by the Council to run until at least 2007, to encourage all national VAT administrations to adopt recognised best practices identified as effective in the fight against fraud. These include the fullest possible computerisation of procedures, including computerised audit, systematic use of risk analysis, active follow-up of debts with a view to their recovery, strengthened dedicated anti-fraud services, enhanced administrative cooperation, etc. All Member States have taken note of these recommendations and have made efforts to implement at least some of them.

## **4. VAT CONTROL IN MEMBER STATES**

### **4.1. Introduction**

It has emerged from the Commission's enquiry into the organisation of VAT services and VAT procedures in the Member States, carried out for the purpose of this report, that despite the adoption of some recommendations made in earlier reports and despite what might be considered pressures to conform to a more harmonized model, there is still a wide variety of approaches both to the structure of national VAT administrations and to the procedures that they use. For the Commission, the most important point is to ensure that despite these differences, all Member States deliver comparable levels of efficiency and effectiveness in collecting VAT.

### **4.2. Administration**

#### *4.2.1. Introduction*

Although legislation to make VAT the universal tax on sales of goods and services in the then European Economic Community was first enacted almost forty years ago and has been developed and refined regularly ever since, legislative harmonisation, such as it is, has left the organisational structure of national VAT administrations generally untouched. Some degree of organisational convergence has inevitably resulted from such Community initiatives as the establishment and reinforcement of mutual administrative assistance, cooperation on training in the framework of successive *FISCALIS* programmes and the creation of VIES<sup>12</sup>, all examples of Community actions that require Member States to put in place certain structures. However, in general Member States' administrations have remained free to organise their VAT services responsible for managing the tax itself according to their own requirements and perceptions and this has resulted in the maintenance of a wide variety of organisational forms.

#### *4.2.2. Organisation*

Historically, different taxes were usually managed by different services. Even where a single department was responsible for several taxes, it was not rare for each tax to have its own dedicated organisational entity, with minimal relations between the separate units. However, it is reasonable to assume that whereas compliant VAT taxpayers may be compliant across the board, those who defraud taxes will not usually scruple to limit their fraudulent activities to one or two of their fiscal obligations. This is why previous reports recommended closer integration or at least greater cooperation between staff responsible for different taxes. As well as making it more likely that irregularities in various areas will be discovered, such integration can also yield benefits for both taxpayers and the administration in as much as the same information will not have to be provided several times and held in different parts of the administration. This is sometimes described as a "customer-oriented" approach because of the advantages for the taxpayer but differences of tradition and culture among national administrations have made some Member States resist such terminology.

The VAT administrations of four Member States have undergone substantial reorganisation since the publication of the fourth report. Less extensive reorganisation has occurred in four

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<sup>12</sup> The VAT Information Exchange System used in the framework of intra-Community transactions.

others. The remainder have undergone little or no significant organisational change in recent years. Nevertheless, the Commission has a general impression that even those Member States that reported little or no change are constantly assessing the performance of current structures and are ready to make new modifications where it seems appropriate.

No doubt tax administrations are subject to the pressures found throughout present-day public services to reduce costs and optimise the use of resources. Nonetheless, some of the measures of reorganisation may be seen as a response to the recommendations of earlier reports, for example by ensuring a fuller integration of the various fiscal departments grouped under national ministries of finance. In the most highly integrated structures, found in a minority of Member States, not only indirect taxes but also direct taxes, sometimes customs duties and in certain cases even some social contributions are all under the responsibility of a single administration. Other Member States are currently moving towards a similar form of organisation. In other cases, all taxes but not other kinds of payment are within a single organisation and some recent reforms have clearly been intended to promote such an approach. Where such integration represents the fusion of previously distinct services, elements within the administration may retain some traces of this former separation but there are clear signs that several Member States are striving to foster real integration, for example by training staff to be able to deal with a wider variety of fiscal and related tasks and also by creating integrated management structures covering the various taxes, duties and other charges involved.

Whereas some of the reorganisations undertaken in the period covered by this report concerned essentially a move towards closer integration and **no** Member State moved in the direction of disaggregation of different taxes now managed together, the situation is less clear-cut when it comes to questions of geographical centralisation and decentralisation. In this area, some Member States have taken measures to reduce local and regional autonomy in order to ensure a more uniform treatment of taxpayers and prevent traders from registering their business in the place where they judge that they will perhaps receive the most favourable interpretation of the law. At the opposite extreme, some Member States are committed by federal or regional constitutional arrangements to a significant degree of decentralisation, with each of the entities managing taxation in its own territory. Between these two extremes, Member States have experimented with varying degrees of local autonomy in the search for a structure that does not permit undesirable variations in standards and policies but equally does not attempt the impossible by seeking to manage every detail of VAT control from the centre. In certain cases, regional tax administrations have a contract that gives them resources in return for meeting specific targets that may be based on amounts of revenue or levels of activity. Unlike the clear trend towards integration of all taxes in a single administration, it is impossible to identify a uniform trend in the choice between centralisation and decentralisation, with both approaches finding favour and some movement in both directions. This subject would merit careful evaluation and further discussion at European Union level.

#### *4.2.3. Role and responsibilities of VAT administrations*

Whether or not they are responsible for other taxes, VAT administrations are normally responsible for the registration of taxpayers (including the identification of potential taxpayers who are not yet registered), for controls and for recovery. However, the responsibility for the closely related activities of uncovering and investigating fraud, while sometimes also entrusted to the VAT administration, is, in a few Member States, performed by a special corps attached to the ministry of finance or even, in certain cases, by a branch of the police.

It is not the Commission's role to make recommendations in favour of or against the form of organisation and allocation of responsibilities chosen by each Member State. It should nevertheless be noted that the distribution of responsibilities among two or more services necessarily requires efficient coordination and willing cooperation among these services in order to ensure that every task is carried out by one of the services and equally that different services do not simply duplicate the same work. Finally, it must be noted that in at least one Member State it was clearly believed that the VAT administration should stand alone on the grounds that if a number of taxes are managed and controlled together there is the risk that one or other tax will be neglected in favour of other taxes. For example, the emphasis may be placed on income tax or corporation tax to the detriment of VAT. For the Commission, however, this is not so much a question of structure as one of how controls are planned, executed and followed up.

#### 4.2.4. *Human resources*

The varying structure of VAT and other tax services in the different Member States often makes it difficult for national authorities to determine precisely how many officials are essentially concerned with implementing VAT. This in turn makes it difficult for the Commission to compare the levels of staffing in Member States, which appear to vary substantially from one administration to another. It does not seem to be the case that Member States' authorities see investment in information technology and changes in staffing levels as closely related matters, since there appears to be no correlation between the development and extent of computerisation and increases or reductions in staff numbers. These numbers are often driven by considerations other than maximisation of VAT receipts or facilitation of business activity. It has been accepted since the introduction of Community VAT that the Commission would leave it to Member States to determine the size and structure of their VAT administrations, provided that there appeared to be adequate safeguards to ensure the correct application of the tax.

The statistical information submitted with the answers to the questionnaire, such as it was, shows that staff numbers in Member States' tax administrations, as well as the numbers of officials working specifically on VAT, have remained relatively static over the period from 1999 to 2002. There have been minor increases or decreases in individual administrations during this time but these hardly provide evidence of a significant trend. As regards training, although all national administrations are committed to continuous training to improve staff performance and despite the undoubted impulsion received from the *FISCALIS* programmes and the resulting agreements to adopt certain policies and priorities at European Union level, it appears from the enquiry that the numbers of staff following courses and the numbers of days devoted to training fluctuate from year to year in most Member States, with no discernable tendency in any particular direction.

### 4.3. **Registration**

#### 4.3.1. *Introduction*

The first step in becoming a taxable person for VAT purposes is to register. There are basically two approaches in Member States to the issue of registration:

- Either it is seen as important to include without prior scrutiny as many traders as possible in the system, potentially fraudulent and compliant ones alike.

- The other approach, which is favoured by a majority of Member States, implies a thorough examination prior to registration and the use of gathered information to conduct risk assessments.

That Member States mainly handle this issue by using the latter approach is confirmed by the length of time devoted to the task of issuing a VAT number and the intensity of the associated control activity.

The first approach is favoured by only a few Member States and at least two of them are in the process of re-assessing their approach. They both consider, in the light of experience, that the possibility of obtaining a valid VAT number without any previous scrutiny has produced undesirable effects on the VAT collection system.

#### 4.3.2. *Voluntary compliance*

Member States were questioned about how they promote voluntary compliance with regard to registration procedures. Voluntary compliance is a vast and difficult subject; it has a bearing not only on the behaviour of the tax administration but also, for example, on the degree or even the existence of budgetary discipline. Studies suggest that it is important whether the system that uses budgetary resources derived from the collected tax is perceived as equitable or not. It is widely considered likely that if the perception of the overall management of the taxes is positive, taxpayers will tend to be more compliant than would otherwise be the case.

The answers to the questionnaire in this respect show that the tax administrations in almost all Member States believe that it is worth spending resources to foster increased voluntary compliance among taxpayers. This is mainly done by making it easier to obtain relevant information and also by making it easier to become a taxpayer. The replies submitted by most Member States provide evidence of a variety of ways in which taxpayers' lives may be simplified. This is done for example by extending office hours, organising information meetings, establishing a one-stop registration for new businesses, but also by increasing the number of audits and/or by being more targeted when controlling economic operators. All Member States make use of the possibilities offered by the use of the Internet, albeit to varying degrees, and all of them report positive results.

However, more than two thirds of the Member States have not engaged in any qualitative evaluation of the measures taken. Many Member States indicate that their appraisal of the impact of measures to improve voluntary compliance is either limited to a quantitative analysis, such as an increased number of registrations in a given period, or to what could be characterised as an institutionalised but possibly subjective perception of a positive feeling that the measures were correct and adequate at that point in time. A qualitative evaluation might examine whether the information provided on a website and the instructions for completing a downloadable form led to an increase in the percentage of correct applications to register.

#### 4.3.3. *Procedures*

The questions posed under this heading focused on four aspects. These are the time it normally takes to receive a valid VAT registration number, the controls undertaken before a VAT number is issued, how unregistered traders are identified and possible improvements to the national systems.

The average time needed to issue a valid VAT number varies widely among Member States, ranging from immediately to over a month in one isolated case. It is understandable that the time may vary somewhat when one takes into account the implications of the two approaches described above. Member States that conceptually favour the inclusion of all economic operators in the system issue the VAT number immediately or at the latest within a few days. The Member States that prefer the second thesis typically apply a higher level of control before registering the applicant and consequently need more time to perform the additional work. The average time that a taxpayer has to wait for a VAT number in the second group of Member States is between one and two weeks from the date of application. Although many Member States announce a willingness to grant access to the system only to potentially compliant economic operators, they are aware that it is virtually impossible to refuse a trader who declares the intention to trade a VAT number. Extensive controls allow them instead to identify the traders that constitute a potential risk in order to monitor their behaviour more closely.

Thus the time needed correlates closely with the number and the type of controls performed prior to issuing a VAT number. The controls undertaken normally start with a verification of the registration information provided in the application. This is done as a desk control and an on-the-spot visit is in many cases carried out only when the result of the desk control warrants it. On-the-spot controls are inevitably more time consuming and contribute greatly to a more extensive lead-time.

The problem of the so-called non-filers (unregistered traders) is perceived differently in Member States. One Member State does not believe it to be a problem at all and consequently does little to identify those traders that wish to remain incognito to the VAT system. Other Member States make use of a vast array of measures to identify the non-filers. They range from roadblocks at which physical movements of goods are controlled to national administrative cooperation and the use of IT-based intelligence systems. Again, a common denominator is that no conclusions are drawn by Member States from the use of the chosen method. Only three Member States declared that they perform evaluation activities in this area.

The main areas for improvement that have been identified by Member States are primarily measures stepping up the control aspects of registration. Another prominent area is to achieve a better use of information technology. Only marginally have increased administrative cooperation or trade-facilitation measures been mentioned as means of possible improvement.

#### **4.4. The control framework**

##### *4.4.1. Introduction*

This section relates to the general control framework existing in national administrations, especially with regard to control powers, control procedures, VAT declarations, control programmes and penalty systems.

##### *4.4.2. Control powers*

Member States are aware that, on the one hand, it is important that auditors have extensive control powers in order to perform a thorough and efficient control and that, on the other hand, it is also essential that the taxpayers' rights are safeguarded. Therefore they try to strike the optimum balance between control requirements and these rights.

Leaving some exceptions aside, most control powers are similar in the various Member States. Entering the premises of a taxable person unannounced is usually allowed; access to the private residence or the search for records generally requires some kind of legal authorisation; taking copies of records and computer files and seeking information from employees and other taxable persons with whom the trader being controlled is associated are generally accepted.

Only a few administrations have direct access to financial information such as movements in taxpayers' bank accounts and the identity of beneficiaries in order to have an overview of the taxpayer's economic situation. In most cases, a prior authorisation from a senior official or a court is still necessary before a bank enquiry may be started. In order to obtain such an authorisation it must be shown that the financial institution has relevant information and that all the other legal means to obtain the desired information have been exhausted. As a consequence, in practice, this control power will be used only as a last resort or in limited cases, such as serious suspicion of irregularity or fraud and a refusal of the taxpayer to cooperate. Some Member States have, or are developing, a database including all the bank accounts of the taxpayers, which makes such inquiries easier and more efficient, but in Member States with more restrictive rules on banking secrecy this would not be possible.

It should be noted that a few Member States have tried to extend their powers or enhance their anti-fraud legislation by introducing new schemes in order to fight against fraud. Measures include:

- joint and several liability, by which traders other than the principal may be held jointly and severally liable for VAT due by a co-contractor;
- increased security powers, involving the right to require security, e.g. a bond, for potential tax debts in high-risk cases; and
- stricter rules for evidence of the right to deduct input VAT.

#### 4.4.3. *Control procedures*

Member States implement most of the control procedures mentioned in the tables annexed to the questionnaire. Naturally, not all the procedures are used for all audits, but are selected according to their usefulness in the particular case.

A slight majority of Member States can give a rough estimation of the time consumption pattern of the different elements of a VAT audit (selection, preparation, audit and closure). There are however some variations in these percentages. The trend is that most of the time (50% or more) is used for the control itself.

No exact figures could be given for the average duration of control visits as this varies greatly depending on the type of audit, complexity of the file and the size of the taxpayer. For standard VAT controls of small and medium enterprises the control lasts between 1 and 5 working days. The number of days for comprehensive audits covering all taxes is between 10 and 20 days. For fraud audits and large traders, the time spent may amount to several months.

#### 4.4.4. VAT declarations

Taking into account advantages such as the reduction of submission time, unnecessary errors and administrative costs, more efficient processing of the collected data, early detection of non-compliance and the possibility of giving taxpayers access to their accounts; the facility to submit a VAT return by electronic means is generally accepted by all the Member States at least in theory. However, in most cases this is still just an option complementing the usual paper-based submission method. An intermediate possibility is the submission of a VAT return on diskette rather than on-line, which may facilitate verification but lacks the other advantages. Only a few Member States make electronic submission mandatory for all taxpayers or for a specific category of taxpayers, e.g. large enterprises, although several Member States would like to increase the proportion of voluntary electronic declarants.

When a VAT declaration is not submitted, most Member States apply a similar procedure where, first of all, the taxpayer is reminded of his obligation to submit the declaration. This can be done automatically, by telephone or by letter and then, if the taxpayer does not react to this reminder, an on-the-spot control is carried out in order to collect the necessary information. If no data are available, the administration tries to make an estimation of the VAT to be paid, taking into account preceding VAT returns, an average of turnover from a comparable trader group or professional estimations by a controller, etc. In most cases a penalty will also be imposed. Very few Member States could give exact figures for the VAT collected by the procedure used for non-filers.

#### 4.4.5. Control programme

In order to be able to perform tax audits, an administration should have a control programme with objectives. However, it seems that not all the Member States have a specific VAT control programme because of the integrated structure of the administration or because the number of VAT-taxable persons is limited.

When there is a VAT control programme, it is usually based on time-based selection, on risk analysis, which often implies that taxpayers are split up among risk groups by using various risk parameters, in order to target the efforts and define control priorities, and on knowledge held by local and/or regional tax offices. Sometimes special attention is paid to defined areas such as sectors considered at risk, refund control, carousel fraud<sup>13</sup>, etc. The risk indicators used for the selection are monitored and changed if necessary. For example, some Member States make sample visits to unselected traders in order to check whether these traders have been rightly omitted in the selection procedure.

Although some Member States set targets such as improving selection and audit quality, treating all regions and sectors on an equal footing, improving consideration and respect for taxpayers and increasing voluntary compliance by taxpayers, it appears that quantitative audit

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<sup>13</sup> During the last five years, a significant change has taken place in Member States' control approach as they have become fully aware of the carousel fraud mechanisms and have developed specific control strategies to target this challenge. The Commission has supported this work by helping Member States to disseminate best practices. The progress achieved in this field is set out in the Commission's report on the use of administrative co-operation arrangements in the fight against VAT fraud, COM(2004)260. A new Regulation on Administrative Co-operation (Council Regulation 1798 of 7 October 2003) gives Member States new legal means to share information on cross-border frauds and make the fight against fraud more efficient.

results such as the number of controls per official per day and the fiscal results obtained are still the most important objectives. Consequently, the control programme is also evaluated primarily on a quantity rather than quality basis.

Some Member States have recognized that the feedback mechanism should be improved and have therefore started to develop new feedback techniques.

#### *4.4.6. Penalties/interest*

The quality of statistics on VAT penalties and interest seems to be fairly limited in most Member States. Only global figures can be given without any breakdown into different categories.

For an overview of the evaluation of the penalty system, reference is made to the implementation of the recommendations (heading 5.9).

### **4.5. Before the on-the-spot control**

#### *4.5.1. Introduction*

There are certain things that auditors need to do or to have before they carry out their control visits. This section of the report discusses matters such as which taxes are controlled, which firms are selected for control and on what grounds. It also describes the data and technical support available to auditors and how auditors are evaluated for their performance.

#### *4.5.2. Co-ordination of controls*

Most Member States make some efforts to carry out integrated controls, so that VAT and other taxes, notably income tax, are controlled at the same time and possibly by the same officials. Sometimes this integrated approach is partial, e.g. it concerns bigger firms that may require a control team including some specialists. Those Member States that do not have a fully integrated approach normally try to coordinate their actions in other ways, e.g. through meetings and other contacts between different services or by charging one official with overall management of controls on a number of firms and covering all forms of taxes.

#### *4.5.3. Special control targets*

Almost all Member States claim to give special attention to large enterprises and in most cases there are special departments for their auditing. With a few exceptions, much less attention is given to groups of firms trading as a single entity for VAT purposes and mixed taxable persons (combining taxed and non-taxed activities), two categories which, in the Commission's view, also merit special attention.

#### *4.5.4. Use of selection criteria*

The Member States were asked what proportion of firms audited is selected for control according to the control programme and what proportion according to other criteria. It is striking that most Member States are unable to report these proportions. The general design of control planning seems to be that the central level gives broad guidelines for selection of audit targets and the regional level executes them. In this execution, the regional level has significant autonomy. This pattern is doubtless reasonable, because local knowledge is very important when selecting firms for audit. However, in this situation, it would appear

important that the central level should at least know which criteria the regions have used when making their selections. In practice, it is clear that this knowledge is generally missing.

#### *4.5.5. Data available for controllers*

Member States were asked what data are available before the control visit. Not surprisingly, a large variety of different items of information was mentioned in their replies. To mention one interesting approach to data collection, several Member States explained computerised collection and analysis of control information as follows: control information is gathered during audits or during data comparison audits; the system compares the data in the taxpayer's information system with the data available in the tax administration's databases, in order to find out whether persons or companies found in the taxpayer's information system are also in the administration's registers and whether they have submitted tax returns and paid taxes. This technique may help to reveal firms that operate outside the official economy.

#### *4.5.6. Staff matters*

So far as evaluation of the performance of individual control officials is concerned, it was noted that most Member States use both quantitative and qualitative criteria of evaluation. Quantitative means items such as the number of audits, their duration and the amount of additional assessments. Qualitative refers to items such as professional and technical competence, ability to maintain human relations and to cooperate in the working community.

In the field of evaluation, some interesting approaches were reported. One Member State has a system where identified and agreed targets are set for each official for one year. After that year, there is then a check to see whether the official missed, met or exceeded these targets. Another Member State carries out evaluation after each audit and this evaluation is in fact an integral part of the computer software used for recording the results of the audit. There were also two Member States that admitted that they do not have any formal evaluation at the moment.

All Member States, except one, recognise learning on the job as a useful induction method for new officials.

#### *4.5.7. Support for controllers*

It was noted that two Member States do not provide their auditors with the indispensable IT tools. For these two countries, a specialised IT audit function was also missing, although computerised auditing is a necessary response to the increasing use by businesses of electronic media for transmitting and storing accounting data. This matter, i.e. sufficient computerisation, has already been raised in previous reports. Availability of usable computer tools is important for the effectiveness of the control activity.

## **4.6 Control visits**

### *4.6.1. Introduction*

This section examines the guidelines that auditors have for their control visits and the statistics that have been collected in respect of those visits.

#### 4.6.2. *Guidelines for controllers*

In general, Member States have introduced guidelines for auditors, setting out the procedures to be followed. Sometimes they take the form of handbooks and sometimes the stipulations have been written into the law. In some Member States, the instructions appear in a less formal guise, e.g. as an obligation for the auditors to study and follow certain common values of the tax administration.

#### 4.6.3. *Control statistics*

Member States were requested to present a number of statistics in respect of their control activities. Almost all replies to this request, as mentioned above under heading 1.5, were characterised by a lack of hard data.

Four Member States could not even give the number of control visits carried out. Most others had partial but not complete data. Some Member States also noted that they do not classify their data in a way that would permit a proper response to this question. All of this, of course, hampers the interpretation of data received from the Member States.

An attempt was, however, made to analyse the data available. Some simple ratios were calculated, such as the evolution of the coverage of controls and the development of the number and value of assessments in the years from 1999 to 2002. The results are these:

- For many Member States, these ratios could not be calculated, owing to lack of data.
- One Member State had a particularly high control coverage, which might imply an error in the source figures or a different manner of keeping statistics.
- For certain Member States, variations over time in control coverage could be noted, while for one Member State in particular the coverage displayed a downward trend during the years under examination.

As a conclusion it may be noted that the Member States could pay greater attention to their statistics. It makes sense that the central tax authorities in Member States should be interested in knowing how many control visits their services have made, how much the control visits produced as additional assessments and how much of these assessments that were actually collected. The same notion applies to penalties and interest.

### **4.7. After the control**

#### 4.7.1. *Introduction*

This section examines the methods used to produce and archive data after a control and to make them accessible in order to improve the quality of subsequent controls.

#### 4.7.2. *Recording information*

Although there are differences, all Member States have some kind of formal procedure to archive their data, documents and information. There are, however, still some Member States who archive documents such as control reports and records of investigation only in paper

format and this information is therefore usually only available to the local tax office holding the file.

Some of these Member States intend (or have begun) to introduce an electronic archiving system, including scanned documents, a system already in use in other Member States. This greatly increases the availability of information to other controllers.

#### *4.7.3. Data collection*

In general, the information obtained during the control visit does not differ much among Member States.

Most Member States agree that the information collected can be used in subsequent control visits and during control visits to other taxpayers in their capacity as suppliers and customers. Member States that possess an electronic filing system can furthermore use the database to identify control subjects and include the assessment of certain risks.

Moreover, the information may be used for standardised templates, which allow the extraction of certain statistics. Finally, it can also help to elaborate the control planning system, e.g. make it possible to redefine the control strategy.

Without exception, all Member States make some use of cross-checking both during desk and on-the-spot audits. Some Member States oblige taxpayers to list customers and/or suppliers, providing data that are put into the electronic information system in order to facilitate a comparison between supplies and purchases. Other Member States have the possibility during the control visit to make copies of invoices, which can then be cross-checked with the supplier's or purchaser's records. Although this control procedure can be resource- and time-consuming, all Member States confirm that it is very useful in order to detect omissions in the accounts, carousel fraud and other fraudulent transaction mechanisms.

#### *4.7.4. Records of tax evasion*

Approximately half of the Member States have a special register listing taxable persons who are suspected to be or have been engaged in tax evasion. Some Member States include all the persons who have been convicted for tax evasion; others limit the register to specific tax convictions such as involvement in carousel fraud. In all cases, access to the database is restricted. The information is mostly used for risk analysis or during the registration phase, for example.

Where Member States do not have such a register, it is usually because of data protection law. Member States recognize the usefulness of such a record, in particular as fraudsters regularly start new businesses to continue their fraudulent behaviour and several would therefore like to be in a position to create such a register.

As already noticed in previous reports, the sectors that are most exposed to fraud are: construction, hotel and catering, transport, services to final consumption, all sectors involved in so-called carousel fraud (mobile telephones, computers and computer components, cars, mineral oils, electronic components, precious metals, textiles and others).

A few Member States have made agreements with the economic operators or trade organisations in order to exchange information, to improve legislation in the specific sector

and to identify ways of combating the shadow economy. There is evidence that such agreements really can contribute to the fight against VAT fraud.

The most common anti-fraud measures taken are better collaboration between different administrations and in particular with police services, international exchanges of information, targeted investigations, special control programmes in specific sectors and risk analysis.

A large majority of the Member States' tax administrations did not measure the gap between theoretical VAT and their real receipts. A few Member States have made a survey of the shadow economy and only one had made a full study of the so-called "VAT gap". This Member State used two approaches. The first was based on a comparison of the estimated theoretical tax liability (using national accounts data) with the actual receipts. The second approach used operational and intelligence data to produce estimates of revenue losses attributable to specific problems such as VAT avoidance, missing trader fraud, failure to register, general non-compliance, etc. It was concluded that about 14% of the theoretical VAT liability is not collected. This is a higher figure than the estimates made by a few other Member States that have not undertaken such detailed analysis.

#### *4.7.5. Control periodicity*

In general it can be noted that for large enterprises the Member States try to carry out both desk and on-the-spot audits on a regular basis, which on average implies a control at least every three years. For small and medium-sized taxpayers there are in most cases no rules governing the periodicity of on-site controls. This depends mostly on the outcome of risk assessment, local knowledge, previous controls, etc. Of course, less compliant businesses will normally be visited more frequently.

Some Member States maintain a control cycle, i.e. they expect to control a taxpayer every certain number of years, control all taxpayers within the prescription period or control each year a certain percentage of taxpayers. However, in practise, Member States report that it is sometimes difficult to reach these targets.

#### *4.7.6. Evaluation*

In this area, Member States again give the impression that they mostly evaluate the quantity aspects of their work. That is to say, they compare results with planned objectives with regard to the number of audits, time taken by tax audits, costs of auditing, audit results, number of appeals, penalties imposed, etc., rather than focusing on quality aspects. In only a few cases, the hierarchy performs quality controls of the completed audits. In most Member States there are internal and/or external auditors verifying the applied procedures.

The results of the evaluation are often communicated to the ministry of finance and also to tax boards, commissions or similar bodies and to supervising controllers. These results are in many cases used as an input when amending the control programme. Global figures are usually published in an annual report. On a regular basis, senior managers meet to examine improvements in the control and selection programmes and may issue guidance on control methods if necessary.

Taking into account their evaluations, some Member States have started to introduce management techniques used in the private sector, such as public management based on a balanced score card, i.e. not sticking to a one-dimensional orientation but building up a

strategic orientation at several levels going beyond the financial impact of a specific procedure. Such techniques have been adopted in an attempt to ensure a better follow-up to control visits. Other Member States strive for further development of risk analysis, e.g. by setting up working groups or by stepping up intelligence efforts at local level. Some Member States focus on electronic solutions to consolidate control results, automatic selection of cases for control or improvement in the timeliness of data transmission. An important place is also given to the exchange of information between Member States and between the European Union and third countries.

## **4.8. Recovery and enforcement**

### *4.8.1. Introduction*

Successful recovery and enforcement depend on adequate information and procedures to manage large volumes of data and quickly select and deal with cases where payment is late.

Voluntary compliance should guarantee that a maximum amount of debt is recovered without additional enforcement measures, if necessary accompanied by facilities to pay debt in instalments or by deferred payment.

Various means and methods are applied under enforcement proceedings to safeguard the collection of outstanding debts and to try to minimise debt write-off.

### *4.8.2. Recovery*

Most Member States aim to recover a maximum of the VAT debt as soon as possible. Improvement of communication with taxpayers and the active follow-up of their degree of compliance are intended to encourage voluntary compliance.

Several Member States reported recent improvements in their information systems and better collaboration between the different departments of the taxation service. Improvements include better classification of tax debts and debtors according to size and type so that a targeted approach may be followed, electronic data-exchange between Member States, reduced time-limits for the recovery of tax debts and use of bailiffs and other external collectors.

All Member States have arrangements that, in defined and justified circumstances, permit deferral of the tax payment or payment by instalments, so long as the payment as such is not endangered by a weak financial position of the taxpayer or his possible unwillingness to pay. Among circumstances justifying deferral are the personal circumstances of the taxpayer<sup>14</sup>, the presence of an economic recovery plan and a pending appeal against a tax decision. Exceptional general circumstances mentioned in replies to the enquiry were natural disasters and the BSE crisis. Some Member States require a security from the taxpayer who benefits from such facilities<sup>15</sup>. Some Member States charge interest on deferred payments.

The monitoring of recovery activities is assisted by the use of performance indicators. Indicators used by Member States typically relate to the debt that is recovered within the standard procedural time-limit and the debt collected outside this limit. Some Member States

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<sup>14</sup> Health problems, death and unemployment

<sup>15</sup> A personal guarantee, a bank guarantee or a mortgage

referred to statistics used to monitor the debt collection, without however specifying the kind of statistics.

The available statistics show that for VAT debt two groups of Member States may be distinguished. Member States where the debt is below 15% of the net annual VAT receipts and Member States with a higher percentage. Only those with a debt percentage above 15% show an increasing trend over the period covering the years 1999 – 2003 in their debt percentage. Two Member State have an annual debt “loss” due to write-offs of more than 50% of debts, but, at the same time have low percentages of outstanding debt, at between 1% and 3%. This means that the outstanding debt as such is an indicator that should be considered together with the level of debt write-offs. For instance, unrecovered debts over the past years may be higher in some Member States as they have a conservative write-off policy, whereas other Member States have lower debts but higher annual debt write-offs.

#### 4.8.3. *Enforcement*

The tax departments in Member States dispose, for enforcement purposes, of widely varying levels of information regarding taxpayers. This includes salary data, bank and other accounts, real property and stocks and shares. Added to this is the information in various public registers such as the land and real estate registers, population, company, legal and vehicle registers or information from private organisations<sup>16</sup>. Limitations sometimes exist because of rules on privacy<sup>17</sup> or because third parties do not have administrative obligations<sup>18</sup>.

Enforcement is necessary when the tax debt is not paid in time. Enforcement always concerns attachment of movable and immovable property of taxpayers and also of third parties to the extent that they may be held accountable for the tax debt. The movable property includes any credit due to the taxpayer for other taxes and amounts owed by third parties to the taxpayer. One Member State publishes the tax arrears of individual taxpayers.

Enforcement is ensured via different procedures including transmission of reminders, forced sales, bankruptcy proceedings, constraints, mortgage, etc. Other methods involve cooperation between different kinds of authorities such as notaries, bailiffs, courts and financial institutions. Seven Member States listed courts, bailiffs, enforcement authorities and financial institutions as external debt collectors. In general these institutions do not have the right to write off debts. One Member State has a system of private tax collectors, again not entitled to write off. Their remuneration is a part of the tax collected. Six Member States observe that no external agencies or other governmental bodies are involved in tax collection. Most Member States probably use bailiffs to recover money in enforcement procedures, but did not mention this as the question appeared more related to private collection of VAT debts.

Precedence of tax debts over other debts would increase the successful recovery of unpaid VAT via enforcement. In eight Member States tax debts do not have precedence over other debts in case of insolvency of a taxpayer. In the others, tax debts have precedence and only mortgages, pledges and securities have precedence over tax debts. Independently of the degree of precedence of taxes, costs related to the administration of an insolvent company go before tax debts. In recent years, three Member States have switched from precedence for tax debts to equal treatment of tax debts and other debts. There are signs that an increasing

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<sup>16</sup> Financial institutions and central credit register

<sup>17</sup> E.g. medical secrecy

<sup>18</sup> For instance private persons

number of national tax administrations have misgivings about enjoying precedence over creditors such as employees and suppliers, especially where the latter are small businesses.

In order to limit the consequences of insolvency, Member States report procedures aimed at recovering VAT quickly in a general sense and at stimulating compliance in the first place to prevent problems. Several have procedures to generate rapid information on bad payers and taxpayers with solvency problems or at the bankrupt stage. Subsequently, the administration aims to act as quickly as possible in order to safeguard the payment of the amounts due, thus in certain cases applying for the taxpayer's insolvency itself. Some Member States remark that they are careful in granting VAT numbers and in particular cases can ask for guarantees or shortening of declaration and payment deadlines to reduce the risk of potential insolvency. Another Member State argues that schemes of deferred payment also contribute to optimal recovery.

Member States report that the principal and interest will be written off where recovery is impossible or would be inequitable, but limit this to exceptional circumstances. Sometimes the principal may not be written off but interest or fines may, if sufficiently justified. Member States write off debts after completion of an insolvency procedure, a debt settlement or bankruptcy in so far as no other means exist to recover the debt from one of the parties involved, including third parties. In so far as no creditor settlement has been made, one Member State still records written off debt in case payment might eventually come in for such debts. In another Member State, the writing-off of debts enables the administration to call on subsidiarily liable persons to pay.

One Member State remarked that writing-off is also possible without enforcement if it is assessed that the amount involved does not justify the cost of enforcement. Two other Member States also mentioned the relationship between the cost of recovery and the amount to be recovered as a factor in a decision to write off debts. Some Member States remark that procedural measures guarantee that careful use is made of writing-off (proposals and decisions by one official are checked by another official).

Three Member States mention a period of five years after the tax assessment as the term for debt write-off, one of them making an exception for recovery by means of attached property, which can go beyond the five year period. A fourth Member State applies a four-year rule. However, it seems that these periods can be shortened or extended in specific circumstances. The remaining Member States do not give specific indications of time; it depends on the circumstances of the case.

Seven Member States indicate that they are contemplating changes to their recovery procedures, while the others expect their present system to remain in force. Likely future adjustments include on the one hand procedures such as insolvency proceedings, lower precedence for tax debt and extending the group from which tax can be recovered, and on the other hand techniques such as improvement of information flows, associated with changes in automated data processing and internet data exchanges with taxpayers.

## **5. FOLLOW-UP TO THE RECOMMENDATIONS**

### **5.1. Introduction**

The recommendations made in earlier Article 12 reports reflected a general determination to optimise compliance by taxpayers with their obligations and to prevent fraud through an effective control strategy using risk analysis for the selection of taxpayers to be inspected. Such a strategy calls for immediate access to relevant information and for the use of appropriate and flexible controls and recovery methods designed to minimise tax fraud. Improved expertise in the field of fraud, appropriate use of the powers of law enforcement authorities and greater cooperation between Member States were seen as essential if fraud was to be countered. The principal recommendations of the earlier reports are summarised in point 1.3 of the executive summary.

It can be seen from the preceding chapters that Member States have indeed adopted some of these earlier recommendations. However, there is scope for further progress and the main conclusion that is beginning to emerge from this report is that there remains more to be done in areas already identified, without the need for wholly new recommendations and objectives to be established.

The Commission envisaged the implementation of the approach set out in these earlier reports by improvements in the following fields.

### **5.2. Enhance voluntary compliance**

The promotion of voluntary compliance should be a primary concern of a tax administration, primarily by means of self-assessment, unprompted submission of tax returns and correct payment of the tax without prior administrative intervention. Tax collection through voluntary compliance is, after all, less costly and time-consuming than tax collection by enforcement.

Voluntary compliance may be hampered, however, by, among other things, high compliance costs, a perception of inequity and a poor appreciation of the administration's enforcement effectiveness.

In order to improve voluntary compliance it was recommended to reduce compliance costs, to improve the image of equity and to enhance the taxpayers' perception of the administration's enforcement activities.

It may be seen that Member States generally implemented this recommendation, especially with regard to the reduction of compliance costs.

#### *5.2.1. Reducing compliance costs*

Voluntary compliance may first be improved by clear, simple and "user-friendly" administrative systems and procedures.

Complex and unstable tax legislation and procedures are major sources of high compliance costs as they reinforce the need for taxpayers and staff to study their rights and obligations. The effort of making tax legislation and procedures understood creates first of all a costly

burden on taxpayers, who may be either unable or unwilling to bear it. Secondly, it also increases the administration's internal costs for training staff and adjusting procedures.

In a majority of Member States, compliance costs have indeed been reduced by improving access to tax information, both internally using Intranet, databases and manuals and externally via information campaigns, call centres, leaflets, the Internet and extended opening hours for offices. Extensive use has been made of the possibilities for cost reduction provided by information technology and telecommunication tools.

#### *5.2.2. Equity enhancement and improving taxpayers' perception of enforcement effectiveness*

A perception of fiscal inequity may easily discourage voluntary compliance. A tax administration can influence taxpayers' perception of the equity of a tax system by providing equal treatment to all groups of taxpayers, i.e. by designing the control strategy to cover as broad a taxpayer sample as possible in terms of the number of sectors and regions.

It should be stressed, however, that differences in treatment may also reflect differences in information available to audit staff or in the audit techniques that they use.

The performance of the tax administration as perceived by the taxpayer also affects compliance. Taxpayers who receive fair and efficient treatment are more willing to comply.

Furthermore, an effective administration acts as a deterrent to non-compliance because it increases the likelihood of detecting and sanctioning non-compliers. In other words, the risk of a tax control remains a fundamental deterrent in order to maintain an acceptable level of compliance with tax obligations.

Member States have paid attention to the enhancement of equity and the improvement in taxpayers' perception of enforcement effectiveness by guaranteeing an audit strategy that provides more equal treatment to all groups of taxpayers. The increased use of risk analysis has not meant that random selections have been entirely neglected. The objective has also been achieved by maintaining a certain level of tax audits in order to ensure an acceptable level of compliance with tax obligations, e.g. regarding follow-up of non-compliers, and by improving the image of the tax administration. Examples of the latter are implementing a performance contract, using modern technologies, drawing up a charter of the administration's rights and obligations, introducing a "one-stop shop" for all tax obligations, and points of contact. If the European Commission has a role here, it is that of disseminating the best, most effective techniques and practices that Member States have developed to the other national administrations.

### **5.3. Computerisation**

All Member States now apply computerisation to at least some procedures along the chain from registration of the taxpayer to collection of the tax, in order to improve service levels, ease human resources constraints, increase control efficiency and lower control costs. Wherever possible, administrative systems have become more user-friendly e.g. by permitting electronic submission of VAT returns and other documents and by facilitating payment.

In fact, given that most enterprises now manage their accounts, stock, personnel, relations with suppliers and customers and almost everything else by electronic means, there would in

any case have been pressure on administrations to provide a computerised interface for taxpayers. What is important from the administration's point of view is to be able to benefit from business's use of information technology in order to facilitate tax control – or indeed to make control in the traditional sense of the word unnecessary. In some cases, a Member State's tax administration may conclude an agreement with an enterprise that gives the administration a significant right to examine business computer systems and extract control information in return for relative freedom from compliance costs for the enterprise.

However, there are areas where the capacity to adopt new technology has lagged behind in some Member States, in particular where public investment in new information technology equipment has been modest. It was therefore suggested in earlier reports to evaluate the potential impact of the extension of computerisation to those areas in which it had not yet been introduced and, in particular, to resource allocation and monitoring, networks linking central and local offices, audit tools and recovery. All of the information collected in the latest enquiry suggests that the further development of computerisation in these areas will produce increased benefits both for the administration and for taxpayers and this development should therefore be encouraged.

Computerisation is, of course, not an objective in itself and should be seen as a tool for achieving specific objectives, relating in particular to voluntary compliance and more efficient controls. Now that information technology can no longer be referred to as “new”, computers are used to handle a variety of tasks. They are particularly useful for dealing with large volumes of information, which any tax administration must do. Other more recent uses of information technology include in most cases an increased control capacity based on the use of laptop computers and data-analysis software and automated risk-analysis systems, as well as making information and certain functionalities available to taxpayers over the Internet.

As the technology has evolved over time, computers have been used to help specialised computer auditors to treat large amounts of data captured during an audit. This use of computers is a standing ingredient in many Member States. In some administrations, computer audit skills are considered to be a normal requirement of every auditor. These Member States have consequently abandoned the concept of specialist computer auditors. In other cases, controllers may call on the advice of such specialists. At the other end of the scale we find two Member States that so far have not made use of computers as an ordinary audit tool. Such a capability is particularly important since the entry into force of the VAT directive on electronic invoicing. On a positive note, it should be said that the problem has in fact been identified in these two Member States and that initial steps are being taken to remedy this shortcoming.

The second major use of information technology relates to dissemination of information. If the Internet was originally simply viewed as a way of informing the public of telephone numbers, office hours and similar basic information, its use has now evolved in many cases into a virtual tax office. This development is inevitable as the entire society moves in the same direction and taxpayers will demand the same level of service from the tax administration as they are increasingly accustomed to receive from other sectors.

At the present time, all Member States make certain information available over the Internet. In many cases, the taxpayer can download forms and information leaflets. Other functionalities that have been implemented are the possibility to view and query one's own tax liability and account situation, the possibility to file VAT returns electronically and to query intra-Community VAT numbers. Other possibilities include electronic submission of VAT

returns and even payment over the Internet. Some Member States have clearly devoted substantial resources to making their website easy to find and to use. Of course, simply making these functionalities available to taxpayers is not enough. A certain effort may be needed to promote the use of these facilities and to induce taxpayers to prefer the virtual tax office to the traditional one, although as the information society develops, the administration is increasingly pushing at an open door.

Some Member States make available alternative solutions to those offered over the Internet. As an example, OCR<sup>19</sup> scanning of VAT returns could be mentioned. In other cases, the electronic tax return is delivered not over the Internet but on a diskette. Nevertheless, the normal way of submitting VAT returns is and will be over the Internet. Most Member States have implemented this functionality and the others are gradually moving in that direction.

Clear progress has therefore been observed in all Member States. The level still varies and a few Member States have brought the use of information technologies to the pinnacle of present refinement. Other Member States still have to give substantially more emphasis to the development and use of information technology and computers. The best way forward is as always to learn by observing those that have made the most progress.

It would naturally be pointless to claim that developments in computerisation were inspired by previous Article 12 reports. All these improvements reflected developments in telematics and the information society that both provided the potential for more efficient and effective administration and created a demand among taxpayers for facilities made possible by the new technologies. Nonetheless, the Commission has a responsibility to point out continuously to Member States' administrations how they may reconcile their own objectives with those of taxpayers and of the European Union, particularly by judicious use of information technology.

#### **5.4. Intelligence gathering and follow-up**

The availability of several sources of intelligence, internally and externally, is highly important. In the past, some national administrations acquired and developed technical equipment and the necessary computer programmes to exploit all the accessible data in order to determine the trends in specific sectors and to identify fraud risk indicators. Some Member States have set up tax intelligence units to collect all information from any available sources.

It was noticed that a number of Member States did not have filing systems designed to facilitate control activities and that sometimes files were kept at local level and were therefore not accessible to all controllers whose work might benefit from the information held in them.

For these reasons, the following recommendations were made:

- Rapid access to all sources of relevant information from tax and non-tax sources;
- A specialised department for collecting, analysing and refining the gathered information;
- Ensuring systematic intelligence-gathering on operations of specific economic sectors and certain risks; and

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<sup>19</sup> Optical Character Recognition

- Better records from audits, stored in a way that makes it possible to evaluate the fraud situation.

The intelligence function exists in nearly all Member States. However, this has not always been translated into a centralised intelligence department. Only five Member States have a central unit for this work. The others have decentralised data collection as part of the control of individual taxpayers. What is clearly centralised in more Member States is the function of fraud investigation. It seems therefore that the large-scale computer applications already used by several Member States permit them to operate directly at local level and do not necessarily require central co-ordination other than the development of the computer tools. Provided the intelligence is available where it is most useful, this is a satisfactory development, as the collection of data by those who need it for their controls will enhance the quality and integrity of the collected data.

Two Member States still do not use computer-based tools for risk assessment. The other Member States have maintained and further developed their risk assessment applications. It can be concluded that risk assessment is by now an acquired feature of the operations of VAT administrations that, moreover, is usually computerised.

Although risk analysis has been widely discussed in other frameworks at European Union level, this report has looked at the way in which control activities have been and could be further improved. This has highlighted that fact that the structured recording of control results as a contribution to risk analysis is still not systematic; there is room for significant improvement in at least five Member States.

Structured collection of information from the above activities (intelligence, risk assessment and controls) is a necessary condition for a continuous feedback and follow-up of control activities and effective action against fraud. The enquiry showed that ten Member States still need to make this control cycle work fully: some or all of the three components exist but they are not integrated. So it seems necessary that these Member States make a special effort to ensure a satisfactory follow-up to their controls.

## **5.5. Control orientations**

### *5.5.1. Special control programmes*

Control programmes concentrating, for example, on particular economic sectors and/or groups of traders enable controllers to acquire a thorough knowledge of the sector and the group. With this knowledge, the control procedures can be refined and it also simplifies the collection of specific data, e.g. for risk analysis and prevention purposes.

Therefore it was proposed by the Commission to set up special programmes to tackle the most relevant risks, for example risks that require prompt control action such as unjustified VAT refunds, imminent bankruptcies, risks requiring specific techniques such as those relating to particular trade sectors, etc.

In general, Member States have indeed attempted to orient their controls to the most relevant risks. In this respect, they have organised their activities in such a way that large firms and firms that pursue activities with high risk have received special attention. Some administrations have engaged specialist contract staff with a detailed knowledge of particular business sectors to identify potential targets. However, a certain random element has usually

been preserved in the selection procedure, as recommended by the Commission in its previous report. Even though control orientation has taken place, the Commission has, as already pointed out, concluded from the Member States' replies in respect of their control programmes that not enough attention has been paid to the control of groups of firms (which some Member States treat as a single taxpayer) and mixed taxable persons (i.e. with taxed and untaxed activities).

#### *5.5.2. Integrate control of VAT with other taxes*

We have seen how the tradition of a separate department for each tax has widely given way to what is sometimes called a customer-based organisation of the tax administration, i.e. a single tax administration for all the taxpayers' obligations or at least a substantial part of them.

Such an integrated approach has two important advantages. First, it permits an overall approach to all tax audits and can accordingly allocate control resources in an optimal and cost-effective way. Furthermore, controls, computer systems and files are also integrated, which gives a better overview of taxpayers' activities. Taking into account these benefits, the Commission has argued that the integration of VAT control with other taxes should be recommended.

As has been noted in sections 4.2.2. and 4.2.3., this trend has continued since these earlier recommendations were made and it appears justified to conclude that, even though controls are not fully integrated in all Member States, all Member States have given serious attention to integration and to the coordination of their control activities.

#### *5.5.3. Preference given to on-site observations*

Concealment of taxable activity cannot be detected simply by examining accounts and returns at a desk. On-the-spot controls have proved to be the most effective procedure for observing and verifying the genuineness of the taxable person and for comparing this with accounting documents.

Therefore the Commission has recommended that preference should be given to on-site observation. From the replies of the Member States, it can be concluded that this is well understood in all of them. All Member States carry out control visits on the premises of taxpayers.

It is more difficult to say whether the control coverage has increased or not. For some Member States, the statistical data do not allow appraisal of this question. For most Member States, fluctuations have been noted from year to year. In one case, the trend in control coverage was clearly declining during the years under examination.

Some Member States made the reasonable point that the control methods should form a totality that provides the control officials with an appropriate tool for each control situation. For some situations, this tool may be a desk audit and for other situations it could be a control visit. The Commission acknowledges that this is so but continues to recommend a high level of on-the-spot controls.

#### 5.5.4. *Flexible enough procedures to adapt to variable control environments*

In order to deal immediately with specific VAT problems, the character of which is constantly evolving, the control procedures should be flexible. Consequently, Member States were advised in earlier reports to build in the flexibility to change procedures if necessary.

Most Member States claim that there is enough flexibility in their control system. There appears to be no evidence that the rigidity of the system might have damaged the quality of control in any Member State. A good example is the new, special measures taken by several Member States in the reference period to detect and combat carousel fraud in mobile telephones and computers and their components. Therefore it may be concluded that sufficient flexibility has been achieved.

### **5.6. Debt management**

Systematic monitoring of return defaults and quick enforcement of debts is crucial to prevent debts from snowballing and taxpayers from becoming untraceable. Swift and efficient action has, in addition, a deterrent effect on other potential defaulters.

In order to avoid VAT arrears, most Member States have promoted voluntary prompt payment by reducing compliance costs and by closely monitoring traders to analyse their risk of default, in order to prevent arrears from continuing, and, where necessary, by applying preventive measures.

The most important recommendations were:

- coordinate control and recovery responsibilities (interdepartmental cooperation);
- obtain better information on taxpayers' financial position;
- reduce the costs of recovery of low-value debts (using simplified procedures);
- organise recovery action through computerisation of procedures so that the period that elapses between assessment of the debt and enforced recovery can be reduced; and
- prevent defaults on payment more effectively by applying precautionary measures (e.g. guarantees/securities).

Member States can be seen to have implemented or at least started to implement most of the recommendations. Nearly all have computerised recovery procedures in order to improve efficiency and have tried to extend access to taxpayers' information.

Attention was also paid to the recovery of VAT after detection of fraud, e.g. by close cooperation between collection offices and auditors and police services. Other measures included specific programmes for particular types of default, measures against organised insolvencies and bankruptcies and, as already mentioned, the security system in risk sectors. Thus real progress has been made. Nonetheless, the European Court of Auditors, in its Annual Report for 2002<sup>20</sup>, pointed out that "not all Member States' accounting systems for VAT

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<sup>20</sup> See paragraph 3.44 of that report

receipts show, for a specific fiscal year, the amount of VAT due to be paid by taxpayers, the amount collected, the amount outstanding, the amount subject to enforcement procedures and the amount of VAT collected after enforcement.” The implication appears to be that some Member States have still to refine their procedures for monitoring VAT debts.

## **5.7. VAT policy**

Taking into account the ever-changing environment, tax administrations must have a clear focus on their goals and constantly review their procedures to ensure that they are making the most effective and efficient use of the available resources. In the absence of such a strategy, resources might not be allocated according to real needs.

It was noticed that several Member States did not have a real plan with clearly defined objectives or targets. Therefore, a reappraisal of VAT policy was recommended, which should include an examination of the overall policy, the development and implementation of a strategy with clear control objectives and an appropriate organisational structure without any internal barriers.

In most Member States a certain re-appraisal of policy has been undertaken since the last report (twelve Member States out of fifteen), mainly concerning overall tax policy. Encouragement of voluntary compliance has been accepted by most of them as one of the main objectives, translated into more simple and “user-friendly” administrative systems and procedures.

The development and implementation of a strategy with precise control objectives, e.g. a clear national control plan making a link between the overall objective and the strategies to achieve it and also converted into regional or local objectives have been pursued in about half of the Member States.

Two-thirds of the Member States have made modifications to the organisational structure of the tax administration in order to remove internal barriers and improve efficiency. There are signs that these developments will continue. The Commission encourages all Member States to pursue this reflection on VAT policy and its implications for organisation and strategy.

## **5.8. Performance indicators**

Evaluation or performance measurement has become more important because of decentralisation of management and because more emphasis has been put on efficiency, effectiveness and quality of service. Earlier reports recommended first to develop a broad range of performance indicators which measure not only aspects of administrative cost-effectiveness but also taxpayers’ costs, overall compliance levels, the quality of the services provided, equal treatment of all taxpayers, etc. and second to establish standardised evaluation and reporting tools in order to provide a consistent and accurate information base for the review of performance.

A number of Member States have accordingly identified a range of performance indicators that can be used at central and local level to monitor the success of their plans for control and debt management. Most of the preferred performance indicators compare the number of controls undertaken, the volume of debts resolved or outstanding, and the resources applied in achieving these results, i.e. by analysing the administration’s performance in relation to its own costs and to the actual results achieved. There are, however, only a few indicators in use

that either measure the costs to traders of meeting their tax obligations or allow a clear assessment of the improvements in voluntary compliance across the total population of taxpayers. The Commission foresees increasing pressures to adapt procedures in ways that minimise the administrative and financial burden on compliant taxpayers.

Thus, notwithstanding the recommendation, it seems that Member States still attach more importance to quantity, i.e. to the number of audits, additional assessments, etc., rather than to qualitative performance indicators. Only a few Member States have made a survey to obtain a representative view of the quality of the tax service as a whole or have performed quality controls.

## **5.9. Follow-up and evaluation of penalty schemes**

Most Member States have a penalty system that provides for differentiated penalties according to the seriousness of the offence, the nature of the infringed obligation and its financial consequences.

However, most tax administrations were not able to give figures with regard to the imposed penalties and did not evaluate the application of the system of penalties, i.e. whether they are effective, deterrent and proportionate to the offence. The main objective of penalties was to raise additional revenue, rather than acting as an incentive for voluntary compliance.

The Commission has argued in the past that an analysis of the penalty system could give a better idea of the degree of dissuasion offered by the system. Very few Member States have in fact evaluated their penalty system. Some Member States have changed their system because they considered the burden of VAT penalties too heavy, thus having a negative effect on taxpayers' behaviour. By imposing realistic penalties or by showing a certain flexibility, voluntary compliance may be encouraged.

One Member State evaluated the penalty system and concluded that to a large extent the legislation is not applied and that differences in implementation at regional level can be observed. Comprehensive education of personnel about the penalty system and a better follow-up were proposed as remedies.

## 6. CONCLUSIONS

### 6.1. Main findings and assessment

#### 6.1.1. Administration

For the foreseeable future, Member States will maintain a variety of administrative and organisational differences in the management of VAT. Thus any attempt to promote the most effective working practices and to ensure comparable efficiency in applying VAT law at European Union level must take account of these differences. Although Member States' administrations are free to organise their VAT services according to their own requirements and perceptions, it can be observed that most recent reorganisations concerned essentially a move towards closer integration of different taxes and similar charges. Even Member States that reported little or no change regularly assess the performance of their structures and are willing to make modifications where it seems appropriate.

Whether or not they are responsible for other taxes, VAT administrations are still responsible for the registration of taxpayers, for controls and for recovery. The responsibility for the closely related activities of uncovering and investigating major fraud cases, while sometimes also entrusted to the VAT administration, is, in some Member States, performed by other bodies.

Unlike the trend towards integration of various taxes in a single administration, it is difficult or even impossible to identify a uniform tendency in the choice between geographical centralisation and decentralisation in this new integrated structure. This open question merits further discussion at European Union level.

The varying structure of VAT and other tax services in the different Member States makes it difficult to determine the number of officials dealing with VAT. There have been minor increases or decreases in individual administrations during this time but these hardly provide evidence of a significant trend. There appears to be no obvious correlation between the development and extent of computerisation and increases or reductions in staff numbers.

As regards training, it can be observed that the numbers of staff following courses and the numbers of days devoted to training fluctuate from year to year in most Member States, with no discernable tendency in any particular direction. The Commission naturally encourages Member States to maintain a high level of training to equip staff for the rapidly changing environment in which they must work.

Given the obvious variations in the organisation of national tax administrations, the Commission will take care that any recommendations made in this report are formulated in such a way that they do not depend on the existence of similar structures for their execution.

#### 6.1.2. Registration

Most, but not all, Member States acknowledge the importance and benefits of voluntary registration. The extensive use of information technology, and the Internet in particular, is but one example of efforts to pursue this objective. It should be noted that increased voluntary compliance is not only obtained by making the taxpayers' lives easier, but also by stepping up the presence and visibility of controls. The Commission believes that such efforts are

beneficial to the functioning of the VAT system in the European Union. Member States show great inventiveness when designing measures to improve voluntary compliance, which is very positive. It is nevertheless surprising to note that Member States do not record how and to what extent these measures contribute to the functioning of the VAT system. Although the situation and circumstances for the tax administration and taxpayers alike vary from one Member State to another, as they do between regions within a Member State, the Commission invites Member States to make better use of experience gained in other Member States and to evaluate better the measures adopted.

It has also been seen that registration procedures differ greatly from one Member State to another, as illustrated particularly by the varying time needed to issue a valid VAT number. An aspiring trader has legitimate expectations to receive a valid VAT number within a reasonable time. It is therefore important to strike a sensible balance between the controls undertaken and the time necessary to carry them out. It would be instructive to see whether administrations that spend longer processing applications to register actually derive benefits in terms of better compliance.

This last point highlights the most striking circumstance that has emerged from the answers to the questionnaire: this relates to evaluation. Almost three quarters of Member States claim that no evaluation has taken or is planned to take place concerning the measures adopted to improve voluntary compliance. This is a tendency that the reader of this report will see repeatedly under other headings.

#### *6.1.3. The control framework*

Member States are aware that there should be an optimum balance between the tax administrations' control powers and the taxpayers' rights in order to perform an efficient and effective audit. Despite increased recognition of such rights, some administrations have also tried to extend their powers or enhance their anti-fraud legislation by introducing new schemes in order to fight fraud.

As already mentioned for other headings, it has been observed in this section that Member States were not always able to give detailed statistics concerning certain procedures. For example, most Member States could give only rough estimations of the time consumption pattern of the different elements of a VAT audit (selection, preparation, audit, and closure) and only a few tax administrations were able to give exact figures for the VAT collected by the special procedures used for non-filers. This lack of follow-up and data could clearly be improved.

Although Member States have recognised the advantages of electronic submission of VAT returns, it is in most cases still an option complementing the paper-based submission method. However, Member States are willing to increase the proportion of electronic submissions. The Commission believes that this development should be pursued urgently.

A control plan with clear objectives and strategies is a necessary tool for a tax administration. However, for several reasons, a few Member States still do not have a specific VAT control programme. Therefore, it is recommended that these Member States reconsider the introduction of a VAT control programme.

With regard to the evaluation of the control programme, the Commission welcomes the new feedback techniques, introducing quality indicators, applied by some Member States and

recommends that similar initiatives should be taken by those Member States whose evaluation criteria still stress quantity more than quality.

As already noticed in previous reports, the statistics on VAT penalties and interest payments are mostly limited to global figures without any breakdown into different categories. Furthermore, the majority of the Member States have not yet evaluated their penalty system; the Commission believes that this might be an interesting exercise (as confirmed by national surveys).

#### *6.1.4. Before the on-the-spot control*

As far as co-ordination of controls of VAT and other taxes is concerned, at present the Member States, even if their controls are not fully integrated in all cases, pay serious attention to closer integration and coordination in their control activities. In this sense, they have sufficiently followed one of the recommendations given in previous reports.

It has been noted that Member States that possess control programmes were often unable to reply when asked what share of firms is selected for control according to the control programme and what share according to other criteria. The Commission is entirely favourable to a flexible approach that enables local tax offices to deviate from the programme when circumstances justify it, but it is important that the central level of the tax administration should know which criteria the regions have used when selecting firms for control. Member States should develop tools for improving their reporting channels in this respect. Knowledge of the cases in which alternative criteria have been used for selection could help to improve the programmes.

Moreover, when selecting control targets, the Commission has, as already explained, concluded that insufficient attention is given in some Member States to groups of firms and mixed taxable persons. Here the Commission reiterates the recommendation from the past reports that more attention should be paid to these types of firms, considering the increased risk relating to their operations.

Evaluation of the performance of individual control officials is one of the important management tools that the modern administrations have to use for achieving their results. As already noted, two Member States admitted that they do not have any formal evaluation at the moment. The Commission recommends that these countries introduce such an evaluation.

To carry out a control of good quality the controllers need sufficient technical support for their work. It was discovered that two Member States do not provide their auditors with the tools for computerised audit. For these two countries, a specialised IT audit function was also missing. The benefits obtainable from computerisation, have been made clear in the previous reports and are now reiterated as a recommendation.

#### *6.1.5. Control visits*

It was noted that Member States have generally introduced guidelines for auditors in respect of procedures to be followed in controls.

When preparing this report, the Commission asked the Member States for a number of statistics concerning their control activities. Almost all replies to this request were characterised by lack of data. The Commission notes that Member States do not pay sufficient

attention to the production of statistics. The central tax authorities in Member States should be interested to know how many control visits the administration made, how much the control visits produced as additional assessments and which part of these assessments were actually collected. This monitoring cannot be done without adequate statistics.

#### *6.1.6. After the control*

Most Member States have a formal procedure to archive their data, documents and information. It was, however, noticed that some of them still archive documents only in paper format and consequently limit the availability of the information to the tax office holding the file. In order to optimise the exchange of information and to be able to include an assessment of certain risks in the overall system, the Commission recommends using an electronic archiving system.

Member States reported new procedures to combat VAT fraud. One of them is the introduction of a special register listing taxable persons who are suspected to be or have been engaged in tax evasion. This information is used to prevent fraudsters continuing their fraudulent behaviour. The Commission welcomes this new initiative but is aware that in some Member States data protection law prevents the administration from keeping such a database.

Another procedure, applied by some Member States, is to seek agreements with economic operators or trade organisations in order to exchange information, to improve legislation in the specific sector and to identify ways of combating the shadow economy. Experience shows that these agreements really can contribute to combating or preventing VAT fraud.

Only in a few cases do Member States seem to treat on an equal basis the quantitative and qualitative criteria for evaluation of their control procedures. However, some tax administrations have noticed this lack of evaluation and therefore started to introduce new management techniques in an attempt to ensure a better follow-up that is not limited to quantitative measures.

#### *6.1.7. Recovery and enforcement*

The adequacy of present recovery and enforcement procedures in Member States should first of all be assessed by their contribution to the realisation of quantifiable recovery and enforcement percentages. As a second step it should then be examined where present procedures could be reinforced to improve the recovery and enforcement results.

Key data for recovery could be, for instance, the percentage of VAT assessments (made both by taxpayers and by the tax administration) older than one month, three months, six months and one year. The percentage of debts older than, for instance, three months could be subdivided into debts for which payment in instalments was agreed, those for which enforcement proceedings were initiated, those under administrative examination and those for which action is pending.

Although performance indicators of this kind were requested in the enquiry, they were only very partially supplied by the Member States. This therefore seems to be an area that could be improved by national administrations. Examination of these data by the Member States themselves should lead to the proposal and introduction of measures to improve the figures and procedures. This exercise could become more meaningful if common performance

indicators for the Member States existed in order to use benchmarking to make improvements where they are most needed.

In conclusion, the enquiry gave a good overview of the various recovery and enforcement instruments available to the national authorities but, for lack of performance indicators, it cannot be assessed, either by the Commission or by most Member States, whether they are adequate.

## **7. RECOMMENDATIONS**

The principal conclusions and recommendations of this report largely mirror those of earlier Article 12 reports, while perhaps placing a new emphasis on the importance of proper evaluation by Member States of the functioning of their VAT collection activities, ranging from voluntary compliance, through the control plan and control to recovery of the tax. Such evaluation also requires the measurement of the impact of specific actions by the tax authorities. A proper impact evaluation should have 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 is left to the Member States to choose among appropriate indicators those that best take the specific national situation into account. Each category of recommendations below is preceded by a reminder of the corresponding recommendations in previous reports insofar as they have not yet been sufficiently implemented by the national authorities.

### **7.1. Voluntary compliance**

#### *7.1.1. Background*

In previous reports the Commission drew attention to the importance of improving voluntary compliance. In the present enquiry it was observed that Member States continue their efforts to enhance such compliance. However, systematic evaluation of the effects of various actions on the level of voluntary compliance is in general lacking. It is thus the Commission's opinion that, apart from the usual evaluations of tax policy, tax policy should also be evaluated from the perspective of its effects on such compliance.

#### *7.1.2. Recommendation*

- (1) It is recommended that the tax authorities assess the impact on voluntary compliance of the various elements of tax policy (e.g. communication with taxpayers, administrative obligations of taxpayers, controls).

### **7.2. Control plan**

#### *7.2.1. Background*

It was previously recommended that the risk analysis used to target controls should be refined. In the Commission's opinion, some elements require further attention. Moreover, in earlier reports the Commission recommended Member States to go beyond a quantitative analysis of controls and to use qualitative performance indicators to analyse the functioning of the tax administration. This observation is still valid. Naturally, the few Member States that still do not have a control plan are encouraged to work on this.

### *7.2.2. Recommendations*

- (2) Those Member States that do not yet have a VAT control plan should develop such a plan.
- (3) Member States should increase the quality of the information on taxpayers and economic sectors for a better targeting of controls:
  - (a) Generate better information about the quality and status of taxpayers (for instance a register of taxpayers involved in tax evasion where this is authorised, special attention to taxpayers with taxable and non-taxable activities, special attention to several firms operating as a group);
  - (b) Conclude agreements with economic operators or trade organisations on the exchange of information.
- (4) The Commission believes that the control programme should be improved by means of feedback on the implementation of the control plan that also takes qualitative criteria into account and not only the more commonly used quantitative criteria.
- (5) Awareness at central level of the criteria used by the regions when selecting firms for control should be increased.

## **7.3. Control means**

### *7.3.1. Background*

Although previous reports stressed the importance of computerisation in assisting tax administrations in their tasks and the process continues in all Member States, not all administrations have equipped their auditors with computer-assisted audit tools. Furthermore, the related past recommendation on easy access by electronic means to all relevant information from tax and non-tax sources has not yet found sufficient resonance in the Member States.

### *7.3.2. Recommendations*

- (6) Those Member States that have still not equipped their auditors with the necessary IT tools and that do not have a specialised IT audit function are recommended to pursue this objective.
- (7) Electronic archiving of the control process should be adopted unconditionally by the Member States.

## **7.4. Control**

### *7.4.1. Background*

The creation of better records of controls was recommended in the past by the Commission. This recommendation is still valid.

#### 7.4.2. *Recommendations*

- (8) The structured recording of conducted controls and control results as a contribution to risk analysis should be improved (number of visits, additional tax assessments, tax collected due to controls, etc.).
- (9) Member States that do not evaluate the performance of individual control officials should introduce such evaluation.

### **7.5 Recovery and enforcement**

#### 7.5.1. *Background*

Past reports made various recommendations for recovery and enforcement. These included coordinated control and recovery responsibilities, reduction of recovery costs and the introduction of precautionary measures. However, the present enquiry shows that improvements are still possible and that in order to improve the procedures better information is necessary.

#### 7.5.2. *Recommendations*

- (10) To monitor recovery and enforcement more effectively, Member States should develop performance indicators to assess their procedures so that they can be improved where necessary.
- (11) Information on collected and outstanding debts, penalties and interest is of great value and Member States should work to improve the quality of this information and its use in the evaluation of administrative processes.

### **7.6. Follow-up**

It is the Commission's intention to monitor the Member States' responses to the recommendations set out in this report. There will consequently be a discussion at a meeting of the Advisory Committee on Own Resources, to be held roughly midway between the publication of the report and the expected publication date of the next report in the series. At this meeting, not only the 15 Member States whose procedures are analysed in the present report but also the 10 Member States that joined the European Union on 1<sup>st</sup> May 2004 will be invited to present an account of any measures undertaken in furtherance of these recommendations and to report on their results. For this purpose, the Commission and the Member States will need to make every effort to identify action points and intermediate targets that may be used to evaluate any such measures.