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## **The Evolution of the Process of the Harmonization of Value Added Tax (VAT) Within the European Union**

### **Abstract**

The aim of the article is to analyse the process of harmonizing the value added tax (VAT) in the European Union, and in particular the factors behind the decision to build a common VAT system based on the country of destination principle instead of, as initially assumed, the country of origin principle. Characterizing the conditions in which this change in approach took place, the specific features of public finances of these countries were presented, in particular the relation of public expenditure as well as the general level of taxation to GDP. Large differences between EU Member States in this area are one of the main factors making these countries not agree to resign from their sovereignty in shaping taxes. This, in turn, affects the direction and possibilities of the tax harmonization process in the Union, including in the field of VAT. The transitional VAT system operating in the EU since 1993 has been pragmatically adapted to the needs arising from the development of intra-EU trade. Its transformation planned in 2022 to become a new definitive system based on the country of destination principle requires the support of Member States for major legislative changes necessary for its implementation.

**Keywords:** European Union, Single Market, Tax, Tax Harmonization, VAT, Public Expenditure

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## **Introduction**

Taxes are a specific area of cooperation within the European Union. In the Treaty on the Functioning of the European Union (TFEU), this area is not listed as an area of exclusive Union competence (Article 3), nor as an area where the Union shares its competence with Member States (Article 4). It is also not mentioned among the areas where the Union has competence to take steps aimed at supporting, coordinating or supplementing the activities of the Member States (Article 6). This is due to the fact that the power to shape taxes belongs to the Member States, which means that tax measures taken at the EU level must make allowances for the tax sovereignty of these countries, and thus require their unanimous consent.

In general, tax issues were regulated in the Treaty in a relatively prudent and limited manner so as not to infringe the competences of Member States and, at the same time, to guarantee the implementation of common goals. The key factor here was to ensure the principle of tax neutrality with regard to intra-Community trade, which meant equal treatment of domestic products and products from other Member States. For this reason, the regulations contained in the Treaty provide for practically only those such joint actions in the legislative sphere that are necessary to ensure the achievement of this goal. Inevitably, they refer to a much greater extent to indirect taxes than to direct taxes.<sup>1</sup>

Article 113 TFEU states that the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopts provisions for the harmonization of laws. The extent of this harmonization relating to turnover taxes, excise duties and other indirect taxes is to ensure the establishment and functioning of the internal market and to avoid distortions of competition. This provision stipulates that the consequence of EU legislative actions may be only the harmonization of national systems of indirect taxation, and not their unification. The minimum objective of harmonization is therefore to ensure a certain necessary coherence between these systems along with coherence with the objectives of integration within the Union as specified in the Treaties.

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<sup>1</sup> L. Oreziak, *Konkurencja podatkowa i harmonizacja podatków w ramach Unii Europejskiej. Implikacje dla Polski (Tax competition and tax harmonization within the European Union. Implications for Poland)*, Oficyna Wydawnicza Wyższej Szkoły Handlu i Prawa im. Ryszarda Łazarskiego, Warszawa 2007, pp. 133–134.

## **VAT Harmonization and Its Importance for Trade Between EU Member States**

The process of creating a common EU VAT system was initiated at the end of the 1960s, but the so-called Sixth Council Directive, adopted on 17th May, 1977 (77/388 / EEC), was fundamental to the establishing of this system. It became the basis for the creation of a set of common rules necessary to determine the subject of taxation and the method of determining the tax base, as well as some other issues relevant to the application of this tax. In the process of creating this system, it was essential to choose the rule pertinent to the taxation of transactions conducted in trade between Member States, namely the choice between the country of origin principle and the country of destination principle of the goods. It was clear that, if the first rule were to be adopted, there would be a risk that differences in the level of taxation would affect trade flows between Member States. As a result, in the single market it could be more profitable to buy goods in countries with lower VAT, although other factors would not necessarily support such a solution. This situation would put pressure on the countries implementing higher taxes to lower them which, for many of them, might be difficult or even unacceptable. Adopting the country of origin principle to determine VAT taxation in intra-Community trade would make the situation in this trade analogous to that in individual countries. They apply a single turnover taxation system throughout their territory and so, from the tax point of view, it does not matter in which region of the country the purchase is made. The same rules apply to all of them, and they result in the same tax burden. As a consequence, choosing the taxation principle in the country of destination could lead to the need to maintain border controls so that the country of destination could collect tax on goods purchased in other Member States.

The determination of the question whether the principle of taxation according to the rules of the country of destination or the country of origin is to be applied in trade between Member States proved to be necessary. This was due to the completion of the single internal market planned for the end of 1992 and the abolition of border controls in intra-Community trade at the beginning of 1993. Until then, goods exported to other Member States had been subject to VAT according to the rules in force in the country of destination, while in the country of origin, exported goods were not subject to this tax (in practice, a tax with a 0% rate<sup>2</sup>). This

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<sup>2</sup> The application of the 0% rate in this case allows for the treating of export sales as taxable sales, not tax-exempt sales. This solution allows exporters to obtain a refund of input tax when purchasing goods and services used for export production.

solution required the use of border controls to avoid a situation in which the goods would not be taxed at all. These controls were therefore still necessary despite the fact that customs duties in mutual trade between the countries of the Community had been abolished several decades earlier.

As early as in 1987, the European Commission proposed that the planned single market should be governed by the principle that goods in intra-Community trade should be taxed according to the rules and rates used in the country of origin. The Commission's ambition was to create a system similar to that applied within a single country, bringing the Community closer to a single economic area. The solution proposed by the Commission was not accepted by Member States, mainly because its implementation would have meant the need to significantly reduce the existing differences in national VAT rates. Due to the lack of agreement on the new common VAT system in due time, it was decided to continue the option of taxation according to the country of destination principle. However, it was assumed that it was a transitional VAT system and it would remain in force until the definitive VAT system was introduced, based on the application of the principle of taxation according to the rules of the country of origin.

As a result, for the abolition of border controls, the only pragmatic solution was to continue with the existing VAT system. However, the system had to be adjusted so that it could operate within the new conditions, following the abolition of border controls within the Community. Directive 91/680/EEC, adopted by the Council in December 1991, which amended the Sixth Directive, as well as Council Directive 92/77/EEC on the approximation of VAT rates applied by Member States, adopted by the Council in October 1992, were of significant importance here. According to the latter, these countries should apply the basic VAT rate not lower than 15%. In relation to some goods and services of a social or cultural nature (e.g. food, medicines, books, newspapers and magazines, passenger transport services), the possibility of implementing one or two reduced rates, but not lower than 5% was established (as a temporary measure, the application of rates lower than 5% was in exceptional cases).

The common VAT system in force in the European Union since 1993, referred to as the transitional one, has been operating for over a quarter of a century, so it proved to be a permanent solution. Various modifications of the detailed solutions concerning the principles of determining the tax base and the list of goods and services subject to taxation with individual rates introduced since then have not changed the essence of this system which stipulates that in business-to-business trade (B2B) from different Member States, there have been two different transactions so far. The first

of these constitutes an intra-Community tax rate of zero per cent in the Member State of departure, while the second is the intra-Community acquisition of goods taxed in the Member State of destination at the rates in force there. This situation mainly stems from the different treatment of domestic sales and sales to another Member State. Despite the abolition of border controls several dozen years ago, national markets are still treated as separate entities and are subject to different rules in this respect. The fact that, in this transitional system, sales to another Member State generally do not generate a VAT liability for the seller's company has become a factor facilitating intra-EU fraud, and the complexity of the system has so far been a factor hindering the development of trade between EU countries.

The main regulations currently in force regarding the EU VAT system are contained in Directive 2006/112 EC of the Council of 28th November, 2006. In Art. 402 of the directive it is stated that "The rules on the taxation of trade between Member States provided for in this Directive are of a transitional nature and will be replaced by definitive rules based in principle on the taxation of supplies of goods and services in the Member State of origin".

### **Change of Approach to the Definitive VAT System**

The idea of establishing a definitive VAT system in the EU based on the country of origin principle, which has been promoted for over several decades, was clearly called into question for the first time in May 2012, when, at the ECOFIN Council meeting, Member States recognized that, for political reasons, the implementation of this idea was unlikely.<sup>3</sup> This contributed to a change in the approach to this issue on the part of the European Commission. In April 2016, it presented an action plan whose aim was to create a definitive VAT system, but this time it was to be based on the country of destination principle.<sup>4</sup>

The main steps taken by the Commission to establish a new definitive VAT system include its proposal for a directive amending Directive 2006/112/EC on value added tax rates (COM (2018) 20 final) presented on

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<sup>3</sup> Council conclusions on the future of VAT, 3167th Economic and Financial Affairs Council meeting Brussels, 15th May 2012, [https://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/130257.pdf](https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130257.pdf) (access 14.11.2019).

<sup>4</sup> European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT Towards a single EU VAT area – Time to decide, Brussels, 7.4.2016, COM(2016) 148 final.

January 8th, 2018. The changes suggested in this proposal are intended to give Member States more flexibility to apply reduced rates, provided that the weighted average of all VAT rates is always above 12%. So far, there have been large differences in the rates of this tax between Member States. Thus, in 2020, the countries implementing the highest standard VAT rates are Hungary (27%), Denmark (25%), Sweden (25%) and Croatia (25%), while the lowest are in Luxembourg (17%), Malta (18%), Germany (19%) and Romania (19%). It should be emphasized that Denmark is the only EU country that applies only the basic rate and this is one of the highest, i.e. 25%.<sup>5</sup> S. Godar and A. Truger point out that the average standard VAT rate in the EU countries increased from 17.6% in 1980 to 21.6% in 2015. Its sharp increase was recorded after 2008 when, in the aftermath of the crisis, it turned out that it was necessary to obtain additional budget revenues.<sup>6</sup> M. Keen emphasizes that, in this situation, in as many as 13 EU countries an increase in the standard VAT rate was one of the main ways to strengthen public finances.<sup>7</sup>

The proposal for a directive amending Directive 2006/112/EC on the introduction of detailed technical measures for the functioning of the definitive VAT system on the taxation of trade between Member States, submitted by the European Commission on 25th May, 2018, is of key importance for establishing a definitive VAT system (COM(2018) 329 final). The measures specified in this proposal, although called technical, are in fact of fundamental importance. Acceptance of the proposed changes would mean replacing, as of 1st July, 2022, the transitional provisions applicable since 1993 with a new definitive VAT system for intra-EU trade between enterprises. As a result, the separation of a business-to-business cross-border supply of goods into two different transactions for VAT purposes under the current VAT system would cease to exist and result in a 0% taxed supply in the Member State of departure and an intra-Community acquisition taxed in the Member State of destination. The Commission proposed that the supply of goods between businesses from different EU countries should amount to a single transaction for VAT purposes, which would be defined as an intra-EU supply of goods. From 1st July

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<sup>5</sup> VAT rates applied in the EU member states, [https://europa.eu/youreurope/business/taxation/vat/vat-rules-rates/index\\_pl.htm#shortcut-6](https://europa.eu/youreurope/business/taxation/vat/vat-rules-rates/index_pl.htm#shortcut-6) (access 6.05.2020).

<sup>6</sup> S. Godar, A. Truger, *Shifting priorities in EU tax policies: A stock-taking exercise over three decades*, IMK Study, No. 55, Hans-Böckler-Stiftung, Düsseldorf, pp. 28–30, <https://www.econstor.eu/bitstream/10419/191726/1/8869> (access 12.07.2020).

<sup>7</sup> M. Keen, *The anatomy of the VAT*, “National Tax Journal”, June 2013, no. 66 (2), s. 423, DOI: <https://doi.org/10.17310/ntj.2013.2.06>.

2022, business-to-business sales of goods shipped from one Member State to another will result in an “intra-EU supply”, subject to VAT at the rate of the Member State of destination. The seller will, in principle, be liable to pay VAT due in the Member State of destination, unless the buyer has the status of a so-called “certified taxpayer”. In the case of sales of goods between companies from different EU countries, the rules on the application of VAT would therefore be analogous to those already in force in distance sales to natural persons, which are taxed in the Member State of destination. In general, under the new system, traders should register for VAT in all Member States of destination and remit the VAT due to their tax authorities if their customers are not certified taxable persons. However, it will be possible to avoid this in practice by using the new online one-stop shop (“VAT-OSS”) in their home Member State. This would be an extension of the mini-one-stop-shop for electronic services in force since January 2015. A new one-stop shop would allow businesses to complete VAT declaration and payment formalities in one Member State without having to identify for VAT in all Member States where they are liable to pay VAT on their intra-EU supplies of goods. VAT amounts due to a particular country that have been collected via a one-stop shop located outside its territory will then be transferred to this country. In the planned definitive VAT system, a new solution will be essential. It is to allow a buyer from another Member State, who will obtain the status of a “certified taxpayer”, to independently calculate VAT on intra-EU purchases of goods, thus exempting the seller from the obligation to collect the tax.

This new, definitive VAT system would differ from the current system of taxation of intra-Community supplies of goods in which sellers, after fulfilling certain documentary obligations, have the right to apply a 0% VAT rate in their country, because the tax is paid by buyers according to the applicable VAT rate in the country of their registered office. This temporary solution introduced after 1993, which has been used for over a quarter of a century as indicated by N. Hangacova and T. Strema, proved to be highly susceptible to various abuses, in particular to the so-called carousel fraud.<sup>8</sup> In essence, such fraud stems from declaring an intra-Community supply transaction (taxed at 0%), but the goods are actually sold to the final consumer in the country where there is no tax, which obviously makes them cheaper. As a result, the state budget does not obtain

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<sup>8</sup> N. Hangacova, T. Strema, *Value Added Tax and Carousel Fraud Schemes in the European Union and the Slovak Republic*, “European Journal of Crime, Criminal Law and Criminal Justice” no. 26, 2018, DOI: <https://doi.org/10.1163/15718174-02602005>.

its due tax revenues. As indicated by M. Lamensch and E. Ceci,<sup>9</sup> new solutions related to VAT-OSS settlement should prevent such fraudulent actions, because the customer will not be able to disappear without doing the VAT transfer.

K. Krzikallová and F. Tošenovský statistically analysed the degree of positive impact of selected legislative measures in the fight against tax evasion and then discussed the sustainability of the current VAT system in a European context. The analysis was conducted for the Czech and Slovak Republics, two traditionally strong trading partners, and for an important commodity in the form of copper. The analysis showed that there is strong evidence that legislative measures can be effective in reducing the possibility of carousel fraud. The research results confirmed the positive impact of the actions taken.<sup>10</sup>

In the report from 5th June 2020 on taxation in the EU, the ECOFIN Council, referring to the definitive VAT system proposed by the European Commission in 2016 and the legislative proposals it has submitted since then, indicated that Member States generally agreed on the idea of one cross-border B2B transaction instead of the two existing ones. However, most Member States are against the introduction of the certified taxable person concept and are also opposed to the application of different VAT accounting rules depending on whether or not the customer is a certified taxable person. Some Member States also expressed concerns about the possible complexity of the new system and its negative effects on businesses and tax authorities.

The ECOFIN Council report also highlights that most Member States are concerned about any potentially negative effects of making the seller liable for VAT collection, including additional costs and administrative burdens for businesses as well as for tax authorities. Referring to the reform of VAT rates proposed by the European Commission on 18th January 2018, the ECOFIN Council indicated that the majority of Member States believe that this reform should be part of a new, coherent VAT system. The proposed changes to the rates could therefore only become effective after the final arrangements for this system.<sup>11</sup>

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<sup>9</sup> M. Lamensch, E. Ceci, *VAT fraud. Economic impact, challenges and policy issues*, October 2018, <https://www.europarl.europa.eu/cmsdata/156408/VAT%20Fraud%20Study%20publication.pdf> (access 13.11.2019).

<sup>10</sup> K. Krzikallová, F. Tošenovský, *Is the Value Added Tax System Sustainable? The Case of the Czech and Slovak Republics*, "Sustainability" Basel, t. 12, nr 12/2020.

<sup>11</sup> Council of the European Union, Report to the European Council on tax issues, Brussels, 5th June 2020.



## Prospects for Establishing a New Definitive VAT System in the EU

Since 2016, work has been under way in the European Union on a new, definitive VAT system, and at the same time various legislative solutions have been introduced to modernize the transitional system that has been used up to now. Taking this into account, B. Terra emphasises that the European Commission has so far been able to effectively act to advance the process of VAT harmonization, thus paving the way to a more robust EU VAT system. After many years of unsuccessful attempts, the Commission has abandoned the objective of establishing a definitive common VAT system for intra-EU trade based on the country of origin principle.<sup>12</sup> R. Asquith also welcomed the Commission's VAT Action Plan, which included a series of reforms to make the EU VAT system "simpler, more fraud-proof and business-friendly", a plan which was implemented in 2016. At the same time, this author indicates that much more needs to be done for the flagship reform of the definitive VAT system to be implemented in 2022.<sup>13</sup>

As emphasized by E. Wilson, a new form of the definitive VAT system proposed by the Commission is primarily linked to expectations that it will be less vulnerable to cross-border fraud than the current system is.<sup>14</sup> However, it is also emphasised that this planned new system is not free from significant weaknesses. Among others, the reservations are linked to problems that may be encountered by small and medium-sized enterprises. Issues might be related to e.g. the costs of operating this system. Therefore, final decisions on the technical details of new solutions will be of key importance.<sup>15</sup> A. Jones emphasises that the planned changes to the EU VAT system may contribute to reducing the administrative burden for multinational companies operating in multiple jurisdictions. However,

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<sup>12</sup> B. Terra, *Levying VAT in the EU Customs Union: Towards a Single Indirect Tax Area? The Ordeal of Indirect Tax Harmonisation*, "Erasmus Law Review", vol. 12, issue 3/2019, pp. 269–298, DOI: <https://doi.org/10.5553/ELR.000124>.

<sup>13</sup> R. Asquith, *EU VAT reforms: trouble ahead?*, 21st February, 2020, <https://www.taxjournal.com/articles/eu-vat-reforms-trouble-ahead-> (access 17.06.2020).

<sup>14</sup> E. Wilson, *EC urged to roll out a common definitive VAT system for services and goods*, 23<sup>rd</sup> May, 2019, [http://www.rbcvat.com/news/eesc-opinion-definitive-vat-system/?utm\\_source=Mondaq&utm\\_medium=syndication&utm\\_campaign=View-Original](http://www.rbcvat.com/news/eesc-opinion-definitive-vat-system/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original) (access 13.11.2019).

<sup>15</sup> L. Puccio, *Detailed technical measures for the definitive VAT system*, BRIEFING EU Legislation in Progress EPRS, European Parliamentary Research Service PE 625.184–February 2019, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625184/EPRS\\_BRI\(2018\)625184\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625184/EPRS_BRI(2018)625184_EN.pdf) (access 13.11.2019).

these changes can be very complicated initially, especially in the case of large enterprises. For example, these companies will have to think about adapting their supply chains.<sup>16</sup>

It is worth pointing out that a year or two ago there was quite a lot of optimism regarding the definitive VAT system in which the authorities of one Member State transfer the collected VAT to another. Now, however, it seems that some countries, especially Germany, are against it which has a negative impact on the feasibility of this system.<sup>17</sup> It is currently difficult to predict whether the target EU VAT system proposed by the European Commission will start operating on 1st July 2022, and if so, in what form. As the principles of this system are constantly discussed between Member States, it will probably take some time before they are finally defined.

A. Milcev emphasised the importance of the jurisprudence of the Court of Justice of the European Union (CJEU) on intra-Community transactions and the practical application of VAT regulations in the decisions of national courts.<sup>18</sup>

P. Bedri and M. Fitore state that the results of tax harmonization were significantly applied to indirect taxes, while in direct taxes there are still significant gaps and resistance from Member States along with the countries aspiring to make full harmonization because an exclusive competence of a state is to determine the structure of a tax system within its jurisdiction whereby extends its sovereignty, so through direct tax forms will determine the attractiveness of their economy and ensure competitiveness in the foreign investment market.<sup>19</sup>

The difficulties that have arisen so far in establishing a definitive VAT system in the EU based on the country of origin principle, defined back in the early 1990s, stem primarily from large differences between Member States concerning the role of public expenditure in the implementation of social and economic goals specific to each of them, which is reflected in a lower or higher ratio of these expenditures to GDP. This, in turn, affects the overall level of taxation they apply necessary to finance these expenses, and the role of individual taxes in national tax systems.

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<sup>16</sup> A. Jones, *EU moves one step closer to DAC7 with anti-fraud tax package*, “International Tax Review”, London, July 16th, 2020.

<sup>17</sup> Z. Gabrizova, *Tax policy expert: Closing the tax gap can drive political change*, 16.10.2019, <https://www.euractiv.com/section/economy-jobs/interview/tax-policy-expert-closing-the-tax-gap-can-drive-political-change/> (access 20.06.2020).

<sup>18</sup> A. Milcev, *Casting a glimpse to the future of the VAT system in the EU and Romania*, “Romania, E Y. International Tax Review”, London, February 10th, 2020.

<sup>19</sup> P. Bedri, M. Fitore, *The legal framework for harmonization of Value Added Tax (VAT) in European Union*, “Acta Universitatis Danubius. Juridica”, no 13/1/2017.

The level of public expenditure, both in absolute terms and in relation to GDP, has a key impact on the possibility of financing public services, including public health care, education, transport, as well as public goods such as national security and defence or environmental protection. Therefore, these expenditures are an important factor influencing the quality of life, labour productivity, and the pace of economic development. In addition, public spending on social services that provide a socially acceptable minimum income level is important in reducing poverty in society.<sup>20</sup> It is worth noting here that this situation was influenced not only by specific preferences in the field of economic and social policy, but also by regulations affecting the level of public expenditure, and aimed at limiting the excessive growth of public debt.<sup>21</sup>

The ratio of public expenditure to GDP in individual EU countries has so far been very diverse. In 2019, it ranged from 24.8% in Ireland to 55.6% in France. Apart from France, among the EU countries, a high ratio of public expenditure to GDP (2019) occurs in Finland (53.3%), Belgium (52.2%), Denmark (49.6%) and Sweden (49.3%). On the other hand, a relatively low level of public expenditure, apart from Ireland, can be observed in Lithuania (34.9%), Bulgaria (36.3%) and Romania (36.0%). In the case of Poland, this rate (42.0% in 2019) is lower than the average rate for the EU (27), amounting to 46.7%.<sup>22</sup> This results in under-financing of many areas important for society, including public health and education.

What derives from significant differences between EU countries in terms of the ratio of public expenditure to GDP are significant differences between them in terms of the ratio of taxes and compulsory social security contributions to GDP. The highest level of this ratio in 2018 was recorded in France (46.5%), Belgium (44.8%), Denmark (44.5%), Sweden (43.8%), Finland (42.2%). In turn, its lowest level in the EU was recorded in Ireland (23.0%), Romania (26.3%) and Bulgaria (29.9%). In the case of Poland, this ratio was 35.2% and was significantly lower than the average ratio for the EU-27, amounting to 40.2%.<sup>23</sup> In general, the higher the former is, the higher the latter is. The need to finance relatively higher

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<sup>20</sup> L. Oreziak, *Finanse Unii Europejskiej i strefy euro (Finances of the European Union and the Euro Area)*, Oficyna Wydawnicza SGH, Warszawa 2020, pp. 13–14.

<sup>21</sup> A. Madariaga, *Neoliberal Resilience: Lessons in Democracy and Development from Latin America and Eastern Europe*, Princeton University Press, Princeton 2020, pp. 241–242.

<sup>22</sup> Total general government expenditure, <https://ec.europa.eu/eurostat/data-browser/view/tec00023/default/table?lang=en> (access 12.07.2020).

<sup>23</sup> Main national accounts tax aggregates, <https://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do> (access 12.07.2020).

public spending results in a higher level of general taxation in relation to GDP. Compulsory public levies in the form of taxes and social security contributions must be high enough to finance the state economic and social expenses. These goals are an element of the policy implemented by the state and the resulting priorities. Public expenses have an impact on the extent to which the state performs its basic functions, in particular the redistributive function. This, in turn, is a derivative of the philosophy of social policy adopted in practice which determines the extent of market mechanisms correlations and the importance attached to reducing social inequalities through taxes.<sup>24</sup>

It is also worth emphasizing that EU countries characterised by a high level of public expenditure in relation to GDP which, in practice, also means a high tax-to-GDP ratio, generally rank highest in various international rankings when it comes to the international competitiveness of their economies. An example is the positions of the Netherlands, Germany, Sweden, Denmark, Finland and France in the top fifteen of 141 countries in the world included in the World Economic Forum's competitiveness ranking – Global Competitiveness Index (GCI) for 2019.<sup>25</sup> This means that a high level of taxation, necessary to ensure sufficiently large public spending, not only is not a barrier to achieving a high competitive position in the world, but actually supports this goal, e.g. through state-funded education or research. It should also be emphasised that an important feature of the above-mentioned countries is a transparently functioning democratic system of power, without which it would be difficult to gain public support for a high level of taxation.

The maintenance of the single internal market within the EU means the necessity to reconcile the different interests of Member States. In tax matters, as noted by J. Jaakkola, it is particularly difficult because taxation is one of the main instruments of redistribution in society.<sup>26</sup> Characterising the prospects of tax harmonization in the EU, M. Tofan indicates that EU Member States still retain and value their traditional right to decide on tax policy. It is a tool that they do not want to transfer to other

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<sup>24</sup> L.G. Steele, N. Breznau, *Attitudes toward Redistributive Policy: An Introduction*, 28 June 2019, "Societies", no. 9, vol. 50/2019, pp. 1–12, [www.mdpi.com/journal/societies](http://www.mdpi.com/journal/societies) (access 24.06.2020).

<sup>25</sup> K. Schwab, *Global Competitiveness Report 2019*, World Economic Forum, 9th October 2019, Geneva 2019, p. xiii, [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport2019.pdf) (access 2.11.2020).

<sup>26</sup> J. Jaakkola, *A Democratic Dilemma of European Power to Tax: Reconstructing the Symbiosis Between Taxation and Democracy Beyond the State?*, "German Law Journal", no. 20/2019, pp. 660–678.

countries.<sup>27</sup> O. Issing states that there is no chance of implementing in practice any postulates that within the European Union decisions in tax matters should be taken by a qualified majority instead of unanimously. Such a change would not be accepted, first of all, by the Member States from the northern part of the Union, as this change would in fact mean a loss of fiscal sovereignty for them.<sup>28</sup> This means that tax harmonization in the future will also depend on the reconciliation of specific national interests with the general interest of the Union.

The pandemic crisis has demonstrated the need for closer cooperation at the EU level. Many supporters of limiting the role of the European Union realized that the nation-state could not cope with serious economic and social problems alone.<sup>29</sup>

## Conclusions

The analysis of the process of VAT harmonization in the European Union shows that the creation of a common system of this tax, based on the country of origin principle, proved to be an impossible task to implement in practice. Member States of the Union, exercising their fiscal sovereignty, did not agree to such an advancement of this process that would undermine their ability to achieve their specific goals through public finances. These goals result from the adopted solutions assuming a greater or lesser role of the state and the functions it performs, in particular the redistributive function. As a consequence, there are significant differences between EU countries in terms of the level of public expenditure and the overall level of taxation in relation to GDP.

Established almost 30 years ago, the EU VAT system based on the country of destination principle, deemed transitional, has proved to be a permanent solution. It has been pragmatically adjusted depending on the needs resulting from the development of trade between Member States. Despite these adjustments, the system has proved vulnerable to cross-border fraud. The European Commission has proposed to

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<sup>27</sup> M. Tofan, *A Taxation Point of View: Towards a New Level of Integration in the European Union*, June 3rd, 2020, <https://www.europenowjournal.org/2020/06/02/a-taxation-point-of-view-towards-a-new-level-of-integration-in-the-european-union/> (access 24.06.2020).

<sup>28</sup> O. Issing, *The European Commission's Taxing New Idea*, Feb 4, 2019, <https://www.project-syndicate.org/commentary/european-commission-taxes-qualified-majority-by-otmar-issing-2019-02> (access 3.11.2020).

<sup>29</sup> M. Leonard, *Europe's Self-Help Moment*, June 29th, 2020, <https://www.project-syndicate.org/commentary/covid19-could-boost-european-cooperation-and-national-sovereignty-by-mark-leonard-2020-06> (access 2.11.2020).

transform it in 2022 into a new target system, still based on the country of destination principle, but in a different way than before. The implementation of this system requires the support of Member States for major legislative changes. These countries also raise a number of objections to this new system, which calls into question the possibility of its implementation within the assumed time frame, given that any changes in the tax area require a unanimous decision of the EU's Member States.

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