

The value added tax system law european essay

Law



Value Added Tax was invented by German businessman Wilhelm Von Siemens after World War 1 in order to eliminate the burden of having many taxes which infringe on other taxes therefore creating double taxation on manufacturers and distributors. In fact, the Value Added Tax system works in a way that from the manufacturer of the raw material to the distributor of the end product, value added tax is paid at each stage but for each and every transaction made tax paid previously is subtracted from the amount of taxation on the transacted goods therefore creating a system of credit for taxes previously paid. This system incentivizes the payment of taxation as manufacturers and distributors get credit on taxes paid on purchases from other businesses and the system is simplified by the use of invoices which are an indicative trail of all payments of transactions made to and fro. As Europe began a process of integration; both politically and economically, during the 1960s, a major problem occurred in finding a common denominator in taxation processes. In order to facilitate free trade the VAT system was chosen therefore creating a system whereby the invoice trail could work and be rebated at the border of the European Union's members on export. This meant that goods would bear only the tax imposed in the member state of final sale. Today the European Union has a Value Added Tax implemented for all member states which is backed by directive 2006/112/EC, which is a recast of the sixth VAT directive of 1977 as amended over the years. The VAT system in the EU is a consumption based taxation which is linked to goods and services and applies to the majority of goods and services purchased or sold for use or consumption in the EU. Both goods and services being produced in the Community and exported outside of it are normally not subject to VAT whilst on the other hand all imports are

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taxed in order to retain a fair trade system whereby European producers may compete on the same level with those outside of the EU. The main characteristics of the Value Added Tax system in the EU are that it applies in principle to all commercial activities which are directly tied to production and distribution of goods and the provision of services, it is a consumption tax which is paid by the consumer and not the businesses, calculated as a percentage of the total price of the goods and services, collected gradually through transactions of partial payments where the businesses deduct the VAT collected from sales of products and services from that incurred through taxation on purchasing for their business activity and VAT is paid to the relevant authorities by the seller or provider who is actually transferring the tax paid by the consumer thus making it an indirect tax. The Value Added Tax system holds responsible the taxable person who, as already explained is the individual or company providing goods or services. The taxable person is only liable to payment of the tax if the gross income obtained through the business is more than a particular threshold which differs from one member state to the other. Therefore, the taxable person who is responsible to pay the final Value Added Tax is an instrument which takes lead of the whole system making it an automatic period. The system is facilitated through invoices which clearly indicate the registered VAT trader referred through a VAT number. The invoice therefore is the tool which enables a registered VAT trader to recoup VAT already paid on prior business transactions and the indicates the VAT paid by the consumer when purchasing the final product. In this way the total amount of VAT is paid in stages and on the final sale of the finished product. The system is to a good degree self policing. When goods are traded from one Member State to the other VAT is not collected at <https://assignbuster.com/the-value-added-tax-system-law-european-essay/>

the frontier between the two tax jurisdictions, this is due to the fact that the EU being a free trade area; no frontier controls exist. Goods supplied by VAT registered entities (taxable persons) to another person who may produce a valid VAT number in another member state are exempted of VAT but retain the right to deduct from the VAT already paid in order to produce the goods. This type of process on inter-state trade is called "intra-Community supply". Although VAT is exempt for the supplier, the customer receiving the goods must pay VAT at the rate of the Member State where the goods arrive. The customer accounts for any VAT due on purchases from other Member States in the normal VAT return at the rate of his country. A database including all VAT registered entities assists all traders around the Union, this is called the VAT Information Exchange System better known as VIES. Exporting outwards from the European Union is facilitated through the VAT system as no Value Added Tax is charged when trade is made towards non-EU member countries. Moreover, the VAT which had already been paid by the manufacturer of goods throughout the course of production is deducted, this exemption, which allows taxable persons to deduct the input VAT is called 'zero-rating'. Through this arrangement, there is no lingering VAT in the export price giving EU producers and manufacturers a level playing field. On the other hand, imported goods are dealt with in the opposite way, whereby importers must pay VAT at the moment products are imported, this is done in order to place exports on the same footing as equivalent goods manufactured in the EU. Taxable persons, registered for VAT shall be allowed to deduct the VAT paid on import in the following VAT return. Value Added Tax rates differ throughout the 27 members of the European Union, but the VAT Directive 2006/112/EC outlines the standard VAT rates which apply for <https://assignbuster.com/the-value-added-tax-system-law-european-essay/>

each and every member. The rates are 15% as a minimum and a special reduced rate of 5% which is tied to the supply of goods and services referred to in an annexed list. Although the directive produces such rates as a standard more simplified ruler for Value Added Tax regulatory bodies, these are complicated by a number of derogations which apply differently for certain Member States, in a number of instances the greater part of the Member States. These derogations are the outcome of the discussions which led to the VAT rates directive of 1992 and negotiations of Member States pertaining to their accession to the EU. The result of these derogations is that a system of identical VAT rates in all EU States is not permitted. As already outlined the rates of the Member States are different, in fact the standard rate varies between 15%, implemented by the VAT authority in Luxembourg and the 25% VAT rate of Sweden. Other example of the standard VAT rates are 18% in Malta and Cyprus, 20% in Austria, Bulgaria, Estonia, Slovenia, Slovakia and the United Kingdom and 23% in Greece, Ireland, Poland and Portugal. Reduced rates vary between the minimum of 5% to the staggering rate of 18% found on certain goods and services in Hungary. Reduced rates also include a zero rating on services and goods in a number of member states which are the result of derogations obtained through negotiations, these include a zero rating on foodstuff and pharmaceutical products in Malta, Ireland and the United Kingdom, Malta also has a zero rating on water supplies and inland public transportation (scheduled-bus service). A number of services are also exempt of VAT, in the majority of the Member States, services such as dental / health care and social services are exempt. Other examples of exemptions include services rendered by writers and composers in Denmark, Finland, Italy and Latvia and <https://assignbuster.com/the-value-added-tax-system-law-european-essay/>

the admission to cultural activities such as the cinema, theatre and shows in Member States such as Belgium, Germany, Spain, Ireland, Cyprus, Latvia, Lithuania, Austria and Portugal. Another important rate is the Parking Rate, which is actually a derogated rate under the standard 15% rate which is applied to certain products in a number of Member States which is intended to increase to the standard rate in an undefined period, always taking into consideration the relevance of the particularity of the different cases where such rate is used. This rate starts from 12% and examples of the parking rates are 12% VAT on energy products in Belgium, 13% on wine and agricultural tools in Portugal to a rate of 13. 5% applicable to services tied to immovable and movable property in Ireland. Although all member states within the European Union must apply VAT to goods and services, a number of countries contain particular geographical areas within their confines which are either duty free areas, therefore no VAT is paid or they have special reduced VAT rates. The island of Heligoland and the territory of Büsingen in Germany, Mount Athos in Greece, the Canary Islands, Ceuta and Mellila in Spain, Livigno, Campione d'Italia and Lake Lugano in Italy and the Åland Islands in Finland are all VAT free. After analyzing the different rates within the EU, we shall now look into the way VAT is applied to services. Services rendered by a taxable person to another taxable person shall be tied to the place where the customer has established his business or else to the place where the taxable person receiving such services has his permanent address, therefore his own residence. On the other hand the supply of services to a non-taxable person shall be deemed to take place where the supplier has set up his business therefore the address of his establishment or private residence. Services such as immovable property, transport of goods,

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passenger transport, hiring of vehicles for transportation, services related to catering and restaurants and activities which are of a cultural, artistic, sportive, scientific, educational and entertainment nature are a number of services which are a number of exceptions to the general rule as they are taxed at the place where service is rendered. When services are rendered to non-EU countries, in order to avoid a number of complications such as double taxation, no taxation at all and unfair competition, EU countries have taxation options such as; choosing to applying taxation on services situated within the EU territory as being situated outside the EU, this may take place on if effective use and enjoyment takes place in non-EU countries, another option is that taxation of services may take place outside the EU and still services are effectively used and enjoyed within an EU Member State's territory. On importing goods into the EU from non-member countries, VAT shall be paid on goods at the point of entry, this means that if a shipment of goods arrive in Valletta port, the relevant rate of VAT as per Maltese jurisdiction shall be applied to the goods, if goods are put under a suspensive customs procedure or any similar arrangement in a particular EU port meaning that they are in transit to another EU Member State, VAT shall be paid on the goods at the rates pertaining to the final destination, this means that if goods arrive in France but are meant for Belgium, the rate of VAT paid on the goods shall be those of Belgium being the final destination of the imported goods. The Value Added Tax system implemented in the EU has evolved throughout the years, mainly due to the harmonization of the European Union's taxation systems and the relevance to the EU budget. When the European Community was formed, the original six Member States had different forms of indirect taxation. These were cascade taxes, which

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mean that levies are paid on each stage of the production of a good. This tax system makes it practically impossible to establish the exact amount of tax which is actually added onto the price of the final good or product. Therefore, these taxation systems always posed a risk that Member States could subsidize their exports through overestimating taxes refundable on exportation. In light of these taxation difficulties, it was clear that the Community had to embark in the construction of a taxation system which would not only render towards its budget but also ensure tax neutrality meaning that the exact amount of tax could be rebated on export. As already explained the VAT system allows that exports are completely tax free. Furthermore the VAT system was a catalyst in solidifying the path towards an efficient single market in Europe. The process which led to VAT in the EU as we know it today started through the first two VAT Directives which were adopted on 11th April 1967. These primary VAT directives established a general outline of a replacement tax and only laid down general structures for a taxation system but left it to the Member States to decide and the rates and coverage in their countries. It was not until 17th May 1977 that a uniform VAT coverage in all Member States was established through the 6th VAT Directive. Another important milestone was reached with the realization of the single market in 1993, as the Commission abolished controls at fiscal frontiers; it proposed that the new VAT system change from charging VAT at destination to charging it at the origin of where the supplier was established. This proposal was not accepted by the members as VAT rates were different throughout the Union and there was no adequate methods which could mirror actual VAT on consumption.

Therefore, the Union adopted a Transitional VAT System which maintains

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diverse fiscal systems but obtains a free market. This system allows non-taxable persons to buy goods and pay VAT at origin and take them home without paying VAT again and on the other hand transactions between taxable persons are tied to VAT being paid at the destination of goods. January 1st 2007 saw the birth of the VAT Directive (2006/112/EC) which replaced the Sixth Directive and other various provisions into one legislative body and standardized a number of fiscal issues throughout the EU such as a minimum VAT rate of 15%, 1 or 2 reduced rates of at least 5% and temporary derogations such as zero rates in a number of EU countries. The VAT directive also guarantees that the VAT contributed by the 27 Member States to the EU can be calculated. A percentage of VAT collected by the Member States is one of the three main income systems which compose the revenue of the EU. In fact own resources which are mainly: customs duties on imports from outside the EU and sugar levies, a standard percentage of the VAT base of each Member State and a standard percentage of the Gross National income of each EU Member account for 99% of the Union's budget. Therefore the relevance of VAT to the EU's budget is very important and accounts for around €14 billion every year. Each Member State contributes a standard percentage of the VAT collected which is capped at 50% of the Gross National Income for each country. The scope of this mechanism is meant to create fairness between the Member States; as a result less wealthy Member States will not end up forking out a disproportionate amount compared to the stronger EU nations. In the future the EU shall continue to strive to craft an even more standardized VAT system for all Member States alike and will seek to remove certain derogations but it is of utter importance that one realizes that throughout the last 40 years, the EU

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has made strides forward which are clearly reaping the fruit when it comes to collection of taxes and the direct relation to the budget. Reference: http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/index_en.htm
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VAT : European law on VAT rates

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