

Alliance Importance and Security Continuity of Funding European Budget

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Abstract

One of the three major pillars of funding the European Union's budget is the Value Added Tax. Within the European Community, under the terms of the legislation, trade in goods and services operates under the so-called reverse charge system (Section 108 Act No 235/2004 Coll., Council Directive 2006/112/EC). Correct implementation of the budgetary prediction should be in the interest of everyone, because the budget supports the important infrastructure areas of the concerned countries. The aim of the paper is to identify the significant sectoral section in terms of the collection of Value Added Tax in the Czech Republic after joining the EU and to present a possible security threat to the Value Added Tax collection. The result was the awareness of the importance of a major industry from the perspective of collecting Value Added Tax. The paper presents a simple example that could compromise tax collection.

Keywords

Security of funding, Value Added Tax, European reverse charge, Dynamic Vector Logistics of Processes

JEL Classification

H 26L

Introduction

Financial flows are not a static matter, we can say that these are dynamic flows that are highly related to other factors in this area, including information flows. Information flows are closely linked to national differences in customs and habits within the European Union. The European Union must be seen as a single entity, not as a single territorial unit. Value Added Tax plays a crucial role in terms of EU funding. In the case of Value Added Tax, its neutrality should be ensured in every economic activity (Council Directive 2006/112/EC). The aim of the paper is

to identify the significant sectoral section in terms of the collection of Value Added Tax in the Czech Republic after joining the EU and to present a possible security threat to the Value Added Tax collection on a simple example in this sectoral section from the EU perspective.

1 Research and Data

The basis for determining the methodology to meet the objectives set out in this article is to link qualitative and quantitative research. For the purposes of this paper, the method DYVELOP © /dynamic vector logistics will be used, in a static image and live in PowerPoint with structured real time, environments and entities. This way, it will be possible to clearly see selected financial flows from the tax agenda, which contribute mainly to complex financing in the Czech Republic, in individual process logistic systems with the capture of sources and financing objectives. The advantage of this method is the fact that it is possible to express not only the ties between individual entities in different environments, but also their relationships.

The DYVELOP © method can process a “case ” entity that will be used in further scientific research when financial flows and their relationships will be analyzed and critical or crisis areas that negatively affect financial flows will be identified. The DYVELOP method uses the following special terminology for the purposes of this article: The Entity is all that exists or what can only be imagined in human consciousness on any scene. Dominance is the dominant aspect of the scene. Domains = real time - t and environment - ENV are dominant entities that are absolutely independent of the controlling of human consciousness.

Environment (ENV) is the first entity species that has the role of the main domain of any scene that defines the implementation framework (field) of the abstract superclass [UML] without a defined controlling actor. The processor (PrS), the second entity species, fulfilling the role of transformation of inputs into emerging new things (products), is the object in the role of the structural thing, the regulation of which is performed by an external controlling actor from a defined environment. We model five types of PrS. The case (the CASE) is the third entity species that performs the role of a complex situational arrangement of procedural entities, performing under certain circumstances and conditions. Urbanek (2013).

Value Added Tax is one of the three pillars of financing the European budget. Table no.1 shows the sum of the total Value Added Tax allocated for the years 2005 to 2017 in the Czech Republic. Financial Administration (2019). This sum of the total Value Added Tax is divided in sectors according to section CZ-NACE. Czech Statistical Office (2019).

**Table no. 1 Total Value Added Tax Sum for the Years 2005-2017 (Since EU Accession),
in CZK Thousand and Number of Tax Returns**

Sectors according to CZ-NACE	Granted Tax (Value Added Tax) (in thousand CZK)	Number of tax returns (in pcs)
Section 0 - Not Specified	269 309 868	1 506 772
Section A - Agriculture, Forestry and Fisheries	-28 874 770	1 730 430
Section B - Mining and Quarrying	39 224 864	47 549
Section C - Manufacturing	246 938 128	5 309 129
Section D - Electricity, Gas, Heat and Air Conditioning	238 492 490	228 765
Section E - Water Supply; Activities Related to Waste Water, Waste and Remediation	22 243 989	265 090
Section F - Construction	75 509 196	6 030 657
Section G - Wholesale and Retail; Repair and Maintenance of Motor Vehicles	1 829 604 702	12 153 367
Sector H - Transport and Storage	132 373 437	1 988 004
Section I - Accommodation, Catering and Hospitality	56 685 459	1 564 914
Section J - Information and Communication Activities	274 640 841	1 330 132
Section K - Finance and Insurance, (65,66)	44 428 877	199 271
Section L - Real Estate Activities (68)	149 027 757	1 918 713
Section M - Professional, Scientific and Technical Activities (69,70,71,72,73,74,75)	278 851 207	3 999 688
Section N - Administrative and Support Activities (77,78,79,80,81,82)	102 632 487	1 024 609
Section O - Public Administration and Defense; Compulsory Social Security (84)	27 712 363	194 387
Section P - Education (85)	11 739 186	217 064
Section Q - Health and Welfare (86,87,88)	20 644 066	186 931
section R - Cultural, Entertainment and Leisure Activities	20 482 273	511 302
Section S - Other Activities (94,95,96)	45 888 817	1 175 785
Section T - Household Activities as Employers; Activities of Households Producing Unidentified Products and Services for their Own Use (97,98)	51 783	3 980
Section U - Activities of Extraterritorial Organizations and Bodies (99)	80 553	1 863

Source: Financial Administration (2019), own elaboration

The table no. 1 above shows that the Section G - Wholesale and Retail; Repair and Maintenance of Motor Vehicles plays a significant role in tax revenue. The Pearson coefficient r , its theoretical value is p , the correlation coefficient rises between the numbers -1 to 1 and indicates the direction of the dependence, if $r = 0$ (or gets near zero), the variables are independent. Hendl and Remr (2017).

We can plot this situation graphically, for example using a correlation and regression analysis graph and the Pearson coefficient r (1), pairs of measured values $(x_1 y_1), (x_2 y_2), \dots, (x_n y_n)$ for variables X and Y:

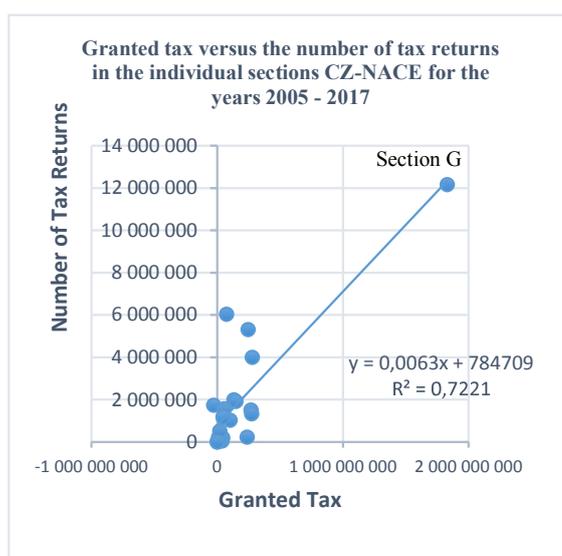
Y – number of tax returns in individual branches of industry (section CZ-NACE)

X – Value Added Tax granted in the various branches of industry

$$r = \frac{\sum_{i=1}^n (x_i - \bar{x})(y_i - \bar{y})}{\sqrt{\sum_{i=1}^n (x_i - \bar{x})^2 \sum_{i=1}^n (y_i - \bar{y})^2}} \quad (1)$$

Regression and correlation analysis of the number of tax returns, Value Added Tax attributable to industry branch 2005 to 2017 for variables Y = number of tax returns and X = Value Added Tax. Sum of all the data on the number of tax returns and the granted tax for the years 2005–2017 according to individual branch industries, see Table no. 1 – Value Added Tax for the years 2005–2017 (data from the accession to the European Union) and according to Fig. No. 1 of the correlation regression analysis, a correlation coefficient of 0.849739907 is reported. According to the graph of the correlation regression analysis it means that the branch G – wholesale and retail; repairs and maintenance of motor vehicles determines the direction of correlation and goes beyond the industry.

Figure no. 1 Regressive correlation analysis of the tax and the number of tax returns in individual branches (CZ - NACE sections) for 2005 to 2017



Source: Financial Administration (2019), own elaboration

The controlling of individual sections of the branch industry, respectively “economic activities” should be identified according to the Value Added Tax Act, both from the past and forecasted outlooks. The Figure no. 1 and the Table no. 1 show that Section G – Wholesale and Retail; Repair and Maintenance of Motor Vehicles is very important for the economy of the Czech Republic, as it has a large share in the revenues of the Czech state budget. And this despite the fact that this section includes already mentioned reverse charge as part of Value Added Tax. The principle of intra-community trade within the European Union lies in the trade in goods and services between registered Value Added Tax payers in the course of their economic activity, where the seller of the goods or service does not pay Value Added Tax, but records only the basis of the tax in his tax return and the mandatory statement – report, and the buyer or the person who accepts the service is liable for the tax and also states it in his tax return and at the same time he is entitled to deduction of tax in case that he fulfils the conditions stipulated by the law. This means, that in the basic reverse principle when conditions are fulfilled, the tax is not paid to the state budget, but tax frauds are also eliminated. However, the question is whether all transactions are actually carried out. It should be recalled that Value Added Tax is linked to income tax. Within the European Union, information flows are compiled, comparing data from mandatory statements – summary reports from the supplier of goods and service providers, and data from the tax return on the recipient of services and goods. The means of control are information flows obtained through the Value Added Tax Information Exchange System, which serves to the electronic exchange of information in the area of Value Added Tax, namely the fulfilment of the obligations of Value Added Tax payers between European Union member states. Reverse charge diversifies risks, but still in the presence of tax frauds and “carousel frauds”. OECD (2019) The European Union’s Commission Staff Working Document Impact Assessment, Generalized reverse charge mechanism, dates 21. 12. 2016 states: The common system of Value Added Tax (VAT) is a major and growing source of revenue in the European Union (EU), raising almost EUR 1 trillion in 2014, which corresponds to 7 % of EU GDP or 17.5 % of national tax revenues, including social contributions. One of the EU’s own resources is also based on VAT (13 % of EU budget in 2014). As a broad-based consumption tax, it is considered as one of the most growth-friendly forms of taxation. However, huge sums of VAT are being lost each year due to tax fraud and evasion. Research shows that the overall difference between the expected VAT revenue and the amount actually collected (the so-called 'VAT Gap') amounted to nearly EUR 160 billion in the EU in 2014. About EUR 50 billion out of this would be due to carrousel fraud. This illegally

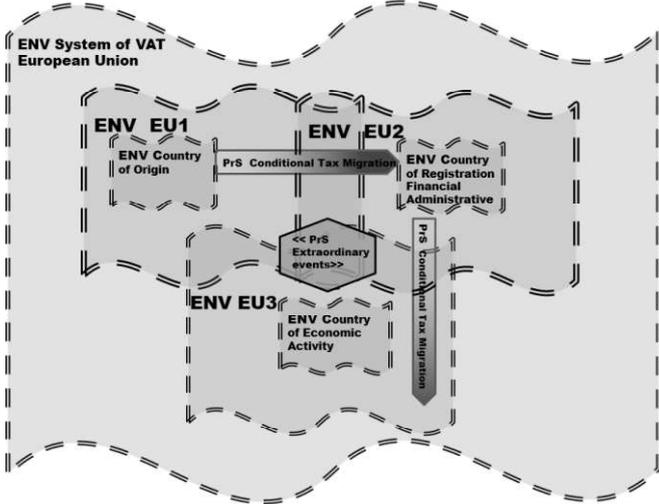
deprives Member States' public budgets of money but also creates unfair competition between compliant and non-compliant businesses. EUR-Lex (2019).

But we will not even deal with these cases in this article. We take the simple and real case that holds the Czech proverb “it does not have to flow; it is enough if it drips”. In the framework of the VIES (VAT Information Exchange System) benchmarking controls, which are undoubtedly numerous due to the number of taxable transactions carried out, a certain financial limit is probable that is determined and investigated under the imbalance. But let's take a case where monthly data on the imbalance between the supplier and the purchaser of the goods or the provider and the recipient of the services gets below the specified threshold for further investigation.

2 Case Study

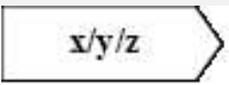
As a case, we will choose three countries from the European Union. The entrepreneur will come from the EU1 (for our case listed by the EU Member State, but it can also be a case from 3rd countries - outside the EU) and decides to register with the intention of economic activity in the EU2. In the EU2, he establishes a business corporation, signs up as a VAT payer, and receives a tax identification number (VAT). In this Member State, it will also find its seat – a virtual seat, as it is physically, existentially and entrepreneurially (family = background) moving in the EU3. In the EU3, he uses all that a reverse charge system can offer to the taxpayer. All of his purchases are tax free, as he submits a tax identification number issued in EU2.

Figure no. 2 Conditional Tax Migration



Source: own

Table no. 2 Entities Table

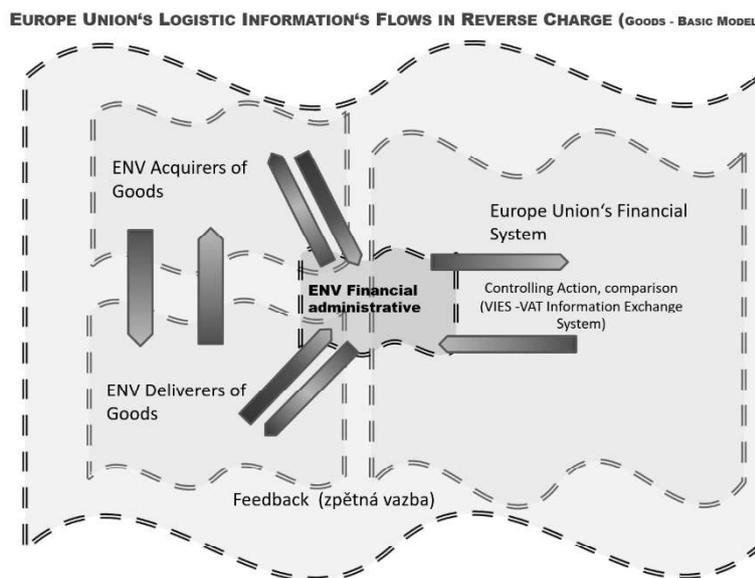
Classifier Name of the entity	Semantics Entities role	Remarks and Decorations
		Characteristics, properties, symptoms, system features, quantity, quality, measurement units, specifications, ornaments ...
ENV System of VAT European Union	European Union	28 Member State of the European Union
ENV EU 1	Member State of the European Union 1	for our purposes marked with 1
ENV Country of Origin	Environment in the Member State 1 of departure	the original country where the background was
ENV EU 2	Member State of the European Union 2	country, there is the fictitious seat of a business corporation
ENV Country of Registration	Environment in the Member State 2	Financial Administration there is the Value Added Tax registered and the establishment of a business corporation
ENV EU 3	Member State of the European Union 3	country backgrounds
ENV Country of Economic Activity	Environment in the Member State 3	the environment in which it is actually living and the economic activity is carried out
	Symbol of the Logistics Process System	from source to target, acting on a defined ENV; the symbol has the shape of a pentagon with sharp corners, the controlling actor is the interface line dividing the logistic flow into two qualitatively different doses from the source to the target, the doses may have the nature of the flow of material, information, money,
PrS Conditional Tax Migration	Movement of business activities across the EU	Conditional Tax Migration

Source: own

That's the beginning of the information flow time. In an EU2 country where an entrepreneur is registered as a taxpayer of Value Added Tax, he has to fulfill the corresponding obligations, at least in the submission of tax claims. As an expert in his duties, he can serve negative tax returns there (without all data). So the tax administrator will not have any doubts, because other information is unavailable. The game of time will be more interesting if it is a VAT payer who submits his tax returns **quarterly rather than monthly**. His possible business activities, given the physical distance, cannot be fully monitored from the EU2, **the EU2 tax administrator does not have local knowledge and the payer does not**

have a corporate social responsibility. The flow of information on possible purchases of goods and services in an EU3 country comes to the country that issued VAT, i.e. EU2 with a time lag and in relation to the amount of paid entrepreneurs in the country EU3. The information may not be verified due to the amount of tax fraud in a unit of time. In the case, that information on the transactions completed without tax from the service providers and the suppliers of goods listed in the summary report and compiled in the VIES system comes to the EU2 tax administrator, apparently by the **cumulating of time units**, it will ask whether the payer actually carries out his activities and where output tax is paid. The EU2 Tax Administrator will initiation of proceeding. (Section 91 Tax Regulations) The challenge should be addressed with clear specific doubts, so only with the information available to the tax administrator.

Figure no. 3 Logistic Information's Flows in Reverse Charge (Goods – Basic Model)



Source: own

Here, we need to point out the intersection where the administrator cannot work with the information at his disposal because it is not possible to define it negatively: for example, “prove that you have not acted”, i.e. the tax administrator is unconstrained in this respect. However, it has information about the purchases of goods without tax, or the receipt of the services, they list in a call to remove their doubts and sends them electronically to the virtual office. The call is sent to our payer's mailbox, which will not be accepted, and is automatically delivered on the 10th day after the expiration of the deadline. The deadline for removing these doubts is set at 15 days from the date of delivery of the call. Of course, the payer

does not respond to that call. But in the next quarter, he will return the tax return, which is filled in as negative. And the whole cycle is repeated over and over again. At the same time, the tax administrator is limited to information where the acquirers of goods and the deliverers of goods are known. Within the legislative environment, for the time being, the tax administrator is unable to prevent the taxpayer from doing his business, for example by canceling registration for non-compliance, because the payer fulfills his obligation by filing negative tax returns. Payers can also not cancel the registration because the information that they are purchasing goods or accepting services in the European Union is not appropriate for canceling the VAT registration. The whole process of addressing tax administrator EU3 depends on the type, amount and speed of information flow over time.

Conclusion

The aim of the paper was to identify the significant sectoral section in terms of the collection of Value Added Tax in the Czech Republic after joining the EU and to present a possible security threat to the Value Added Tax collection on a simple example in this sectoral section from the EU perspective. It was found that a significant sector in terms of the collection of Value Added Tax in the Czech Republic after joining the EU is the sector section Wholesale and Retail; Repair and Maintenance of Motor Vehicles. From 2005 to 2017, a total of CZK 1,829,604,702.00 was collected on Value Added Tax, with 12,153,367 tax returns. Given the extraordinary representation of this economic activity, a higher risk of possible tax losses can be assumed. The risk of proper tax security continuity has been diversified by Member States through the reverse charge regime. However, there may also be inconsistencies on the side of the purchasers and suppliers of goods, or the acceptance and provision of services (carousel fraud). The paper did not follow the complete issue of the carousel fraud, but from the EU point of view, it presented a security threat to the collection of Value Added Tax. This problem was introduced on a simple case where a VAT payer uses the possibility of VAT registration in a Member State other than where his actual economic activity is operated. Of course, it can be assumed that the case can be involved in a carousel fraud. One of the principles of VAT neutrality is *“a VAT system achieves the highest degree of simplicity and of neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution, as well as the supply of services. It is therefore in the interests of the internal market and of Member States to adopt a common system which also applies to the retail trade.”* (Council Directive 2006/112/EC). The contribution of this

paper was to identify an important sector in the Czech Republic from the point of view of VAT collection after joining the EU and to point out a case that could disrupt the continuity of financial flows. Finally, it can be pointed out that even the simplest and neutral system cannot function without timely and correct information flows if the legal principles laid down fail. For this reason, it is important to give them priority.

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