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VAT Control Statement as a Solution to Tax Evasion in the Czech Republic

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Abstract

The paper discusses the issue of the value added tax control statement. The aim is to assess, based on an analysis of available information, this tax fraud control instrument and predict possible impact on tax entities belonging to the category of small and medium enterprises (SME), as well as effects on the revenue part of the national budget. Our results show that while this measure brings benefits to the tax authority, fairly-dealing entities experience burden, particularly because of sanctions. In relation to fraudsters the instrument is not likely to improve tax collection.

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Keywords: Czech Republic; Tax Evasion; Tax Payer; VAT Control Statement

1. Introduction

Of global importance, value added tax (VAT) has spread to more than 140 countries worldwide since its implementation into the French tax system in 1954. Its popularity gradually increased mainly due to it becoming a convenient tool for the taxation of international trade (Nerudová & David, 2008; Terra & Kajus, 2007). Neutrality is this tax' main pillar; it is achieved when claiming input VAT. The payer is entitled to deduct at the moment when the transaction has been done and after the issuance of the invoice. The capability to generate significant amounts for the national budget is another positive aspect of VAT with about one fifth of all tax revenues being collected as part

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of this tax globally (Borseli, 2011). This makes it possible to predict annual revenues in each country for the benefit of the Treasury (Ministry of Finance, 2013). If one restricts the selection of states to the European Union only, then it is possible to state that VAT is one of the best-harmonised taxes at all. Currently, value added tax is harmonised by Council Directive 2006/112/EC, which unifies the rules for applying the tax within the Member States of the European Union.

The resistance against tax evasion is considered to be a strong characteristic of value added tax. European Commission itself estimates, however, that all EU Member States lose about EUR 190 billion annually (European Commission, 2013). Because this VAT gap cannot be ignored, every Member State seeks to find its own solutions to the issue although limitations apply for the proposals, resulting from Council Directive 2006/112/EC. In the event that the draft measure significantly deviates from the Directive, it can be made null and void by the European Court of Justice.

Approval of the Quick Reaction Mechanism (Council Directive 2013/42/EU) can be regarded a ground-breaking milestone in this area. The scheme makes it possible to introduce a local reverse charge mechanism for problematic goods and services in terms of the tax. The mechanism is based on the same principles which work for intra-Community transactions (trading between at least two EU Member States). The provider of the taxable supply issues an invoice without VAT. There is exemption and zero tax rate. The recipient of the taxable supply is required to pay tax on the same supply, i.e., paying output VAT. Because the principle of neutrality applies, the payer can simultaneously claim input VAT at the same moment (Pfeiffer & Semerád, 2013).

The Quick Reaction Mechanism can however only be applied for the maximum of nine months; a list of accepted supplies is limited (Council Directive 2013/42 / EU). Any change must be approved throughout the European Union, because there is a risk of fraud moving to another state. While this can be seen as a victory for one state, it does not resolve the problem of Member States as a whole.

VAT Control Statement (MF CR, 2015c) is the most recent solution to the VAT tax fraud in the Czech Republic (MF CR, 2015c). The instrument focuses on the very essence of the functioning of the tax since VAT is based on the principle of tax payer claims. The tax return indicates the payer's aggregate amount of individual items and the resulting tax liability. This may involve either tax liability as such or excess VAT. Excess VAT occurs when the level of input VAT exceeds that of output VAT. If the tax authority has no doubts about the legitimacy of the excess, then it returns the difference thus generated to the taxpayer within 30 days of filing the tax return (Semerád, 2014). Now the possibility to verify the tax payer claim can be denoted a weakness of VAT. In order to verify the facts stated in the tax return, the tax authority needs to check the tax payer physically. This makes a problem for cross checks. If there is a received VAT invoice, then another entity must exist by which the invoice was issued (output VAT). If the supplier (provider) was from a different region, then it needs locally competent staff of the tax authority to become involved in the check (Article 13, Tax Code). This is a demanding process in terms of administration and finances since under the Czech law a recipient of a taxable transaction can claim the deduction even after three years from the date of the taxable supply (Article 73, Section 3, Act on VAT).

For the Czech tax authority to be able to check taxpayers in real time (i.e. on the date of filing a tax return), it can make use of the information made available to it as part of the VAT Control Statement. A specialised software application was developed that compares submitted data that all the taxpayers provide for the benefit of the tax authority (Financial Administration, 2015b). The program employs the above mentioned principle to evaluate the compliance and, if necessary, non-compliance of individual taxable supplies. It is a ground-breaking tool, the real impact of which can be evaluated only with some time delay. However, since space can occur for tax fraud or a problem may exist in the actual use of the software, we focused on this instrument from this point of view as well.

2. Methodology and Data

The aim of this paper is to assess, based on an analysis of available information, this tax fraud control instrument and predict possible impact on tax entities belonging to the category of small and medium enterprises (SME) as well as on the revenue part of the national budget. The authors also focused on technical parameters and selected elements of the tax administration.

Methods and procedures used in the process of production of the paper are outlined below. Available information on control statements was studied by analysing; this particularly involved the legislation and implementing