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Questions and Answers:

1. VAT Gap in the EU – report 2024

What is VAT?

Value Added Tax (VAT) is a consumption tax charged on most goods and services consumed in the EU. The tax is levied on the 'value added' to the product at each stage of production and distribution. This means that VAT is charged when VAT-registered businesses sell to other businesses (B2B) or to the final consumer (B2C). Businesses are able to reclaim any VAT that they pay on goods or services. Businesses are given a VAT identification number and have to show the VAT charged to customers on their invoices.

The VAT system in the EU is governed by a common legal framework: the VAT Directive. Each Member State is responsible for the transposition of these provisions into national legislation and their correct application within its territory. The Commission is responsible for ensuring the correct application of the VAT Directive.

Furthermore, VAT contributes significantly to national budgets that pay for schools, hospitals and other public services in EU Member States. It is also a source of revenue for the EU budget. It is therefore fundamental to work towards improving VAT collection and reducing the VAT compliance gap.

What is the VAT compliance gap?

The VAT compliance gap estimates the impact of non-compliance with VAT obligations, in absolute or in percentage terms. To estimate this gap, we first approximate the VAT Total Tax Liability (VTTL), which represents the theoretical VAT revenues that could be achieved if all taxpayers complied with their obligations, taking into account current reduced VAT rates and exemptions in place. We then compare this with actual VAT receipts. The difference between these two values is the VAT compliance gap. Therefore, the results on the VAT compliance gap are estimates and should not be considered actual measurement of VAT revenues not collected.

In the context of the estimates for the EU in 2022, the amount of €89 billion represents revenues lost to:

- VAT fraud and evasion
- VAT avoidance and optimisation practices
- bankruptcies and financial insolvencies

- miscalculations and administrative errors.

While some revenue losses are impossible to avoid, decisive action and targeted policy responses could make a real difference, particularly when it comes to non-compliance.

What are the main findings of this year's report?

- The VAT compliance gap in 2022 increased compared to 2021. This increase can be seen as a levelling out of the VAT compliance gap, given the sharp decline in the years before (i.e. a decline of almost EUR 50 billion between 2019 and 2021).
- However, over a 5-year period , there is a clear decreasing trend. The **VAT compliance gap** decreased by approximately EUR 30 billion between 2018 and 2022, to EUR 89 billion in 2022.
- Estimates for the COVID-19 years 2020 and 2021 remain less robust than the rest of the time series. Therefore, the report compares data over a longer period, between more robust estimates (until 2019, and as of 2022).
- **Several factors have contributed** to the reduction in the VAT compliance gap, including:
    - Electronic declarations, compulsory e-invoicing, online cash registers, and real-time reporting requirements
    - Streamlining of the tax administration
    - The rise of digital payments.
- The report includes a more than-usual upward revision of the 2021 VAT compliance gap figure, due to updates to national account figures and VAT revenues for 2020 and 2021. The revisions were driven mainly by benchmark revisions of national accounts (which as main data source inform the estimates), but also due to updated information on substantial deferrals of tax payments during the COVID-19 pandemic.
- This latest edition of the VAT gap report puts a greater emphasis on the **actionable VAT policy gap**. Different from the overall VAT policy gap, the actionable VAT policy gap focuses on the part of not collected VAT revenues that are due to reduced rates and exemptions that could potentially be lifted (i.e., where Member States can act upon).
  For 2022, the actionable VAT policy gap was estimated at almost 20% of the notional, theoretically possible VAT revenue. In addition to not collected revenue, the report provides for a hypothetical scenario, where all actionable exemptions and reduced VAT rates are repealed. In such a scenario, the single statutory VAT rate that would remain VTTL-neutral could be almost 5 percentage points lower and would amount, on average in the EU27, to 16.6%.

What is being done at EU level to improve the VAT compliance gap?

The EU has recently taken a number of actions to reduce VAT losses, in particular targeting VAT fraud. Member States have already agreed and begun to implement ambitious rules to increase cooperation and information sharing among Member States and with law enforcement agencies. The EU has supported Member States in working better together in the 'Eurofisc' network that was launched in 2010 for that purpose – a network where national anti-fraud officials from the EU and Norway can exchange information resulting from national risk analysis. This exchange leads to early, EU coordinated follow-up actions to stop the detected chains of fraud involving several Member States.

Since 2019, Eurofisc can also carry out central risk-analysis and actively use the Transaction Network Analysis (TNA) tool financed by the Union for rapidly exchanging and jointly processing VAT data so that they can automatically detect cross-border VAT fraud at a much earlier stage. Since January 2024, another electronic analytic tool has been available to Eurofisc, allowing the network to track e-commerce VAT fraud by following data on international payments. New VAT rules for online shopping also entered into force in 2021, which lifted the VAT exemption for parcels worth less than €22 from entering the EU – a measure that had been extremely susceptible to fraud worth €7 billion a year.

In December 2024, the Council endorsed the Commission's 2022 proposal for new measures that will bring the EU's VAT rules into the digital age (ViDA). With new rules on electronic invoices and real-time data reporting, as well as business carried out through digital platforms, this package of legislation will fight tax fraud, support businesses and promote digitalisation.

What methodology was used to calculate the VAT compliance gap?

The study derives the expected VAT revenues (VTTL) for each country from national accounts by mapping information on different VAT rates (standard, reduced and exemptions) onto data available on final and intermediate consumption, along with other information provided by Member States. This means that the quality of the estimates of the VAT compliance gap depends on the availability, accuracy and completeness of national accounts data.

When national accounts figures are reliable, the methodology is precise enough to estimate the VAT compliance gap. Member States use different methodologies to estimate the informal economy and to reflect it in their national accounts, thus indirectly affecting the VAT compliance gap figures.

Information on VAT rates and other model parameters was obtained from Member State tax administrations through a detailed survey.

What causes such differences in the VAT compliance gap between the Member States?

Variations in the VAT compliance gap reflect the differences in Member States in terms of the scale of fraud, tax compliance, avoidance, bankruptcies, insolvencies and the performance of the tax administration, among others. The estimates also reflect structural differences in national economies and other variables. Indirect circumstances such as the

organisation of national statistics could also have an impact on the estimated size of the VAT compliance gap.

This year's report notes that the number of tax administrations monitoring the gap in the EU has grown rapidly in recent years, with 15 Member States now regularly monitoring their VAT compliance gap.

What is the VAT policy gap?

The VAT policy gap is an indicator of the additional VAT revenue that a Member State could theoretically collect if it applied a uniform VAT rate on all consumption of goods and services supplied for consideration, which would lead to so-called notional ideal VAT revenues. The VAT policy gap compares these notional ideal VAT revenues with the expected revenues in the actual current system which allows for reduced rates and exemptions (the VTTL). In 2022, the total VAT policy gap level in the EU was 49.6% of the notional ideal VAT revenue.

The VAT policy gap as defined above can in turn be broken down into the VAT rate gap and the VAT exemption gap. As the terminology suggests, the VAT rate gap represents the potential revenue loss due to the existence of reduced rates, whereas the VAT exemptions gap represents the potential revenue loss due to the existence of exempted supplies of goods and services. The breakdown of the VAT policy gap shows that in 2022, approximately 12.2 % can be attributed to the application of various reduced and super reduced rates (i.e., the VAT rate gap). The VAT exemption gap was 37.5% in 2022, with the largest part of the exemption gap consisting of exemptions on services that cannot be taxed in principle.

What is the actionable VAT policy gap?

The actionable VAT policy gap is a proxy for the potential of VAT revenue that could be raised by removing reduced rates and exemptions. The actionable policy gap was estimated at 19.3% of the notional, theoretically possible VAT revenue in 2022. The highest actionable VAT policy gaps were estimated for Ireland (29.8%), Spain (27%) and Greece (26.5%). The lowest actionable policy gaps were recorded for Malta (0.7%), Denmark (3.1%) and Bulgaria (4.6%).

In addition, the report considered a hypothetical scenario, where all actionable exemptions and reduced VAT rates were repealed. In such a scenario, a completely 'flat' system would be envisioned, where a single statutory VAT rate would apply on the broadest tax base possible. This flat VAT rate would then generate the same VAT Total Tax Liability as the current system, with all reduced VAT rates and exemptions in place. The study estimates that, in this flat system scenario, the average statutory VAT rate would be on average 16.6% in EU27, i.e. 4.9 percentage points lower than the current EU27 average rate.

2. MTIC gap: VAT compliance gap due to Missing Trader Intra-Community fraud (MTIC fraud)

What is MTIC fraud?

Missing trader intra-Community fraud (MTIC fraud) is a prominent form of VAT non-compliance. This type of fraud exploits VAT-free trade of goods and services between EU Member States. Fraudsters acquire goods and services VAT-free from another Member State, supplying them to other businesses and charge VAT, before disappearing without remitting the VAT to the tax authorities (hence the term 'missing trader'). We refer to VAT revenues lost due to this type of fraud as 'MTIC gap'.

What are the main findings of the report?

The Missing Trader Intra-Community fraud (MTIC fraud) is estimated to have resulted in annual VAT revenue losses of between EUR 12.5 billion (conservative estimate) to EUR 32.8 billion (more comprehensive estimate) between 2010 and 2023, equivalent to 1-3% of actual VAT revenue. The relatively stable range and level of MTIC fraud over time suggests that other factors contribute to the fluctuations in the VAT compliance gap.

Between 2010 and 2022, the MTIC gap contributed 9-24% to the overall VAT compliance gap (lower and upper estimate, respectively). This confirms the significance of MTIC fraud in the VAT compliance gap, even if the estimates are more conservative than some existing estimates.

The structure of contributions to the MTIC gap mimicked that of the overall structure of EU trade, with fraud schemes involving goods acquired from Germany (15.9%), the Netherlands (12.4%), Belgium (9.3%), Italy (7.1%), France (7.1%), and Poland (6.2%).

What methodology was used to calculate the MTIC gap?

This report follows on an assessment published in March 2024, which provided an overview of methodologies to estimate the MTIC gap. The methodological approach based on Intrastat data focuses on irregularities in value and discrepancies in mirror statistics to estimate the value of VAT revenue lost. The random forest estimation algorithm is used to circumvent the limitations of Intrastat data by filtering for irregularities caused by various factors.

The analysis spans across a 14-year period (2010-2023) and covers all Member State (with the exception of Croatia for 2010-2012). Two estimates of MTIC gap were produced, the lower and upper estimates. The lower estimate is based on a more conservative, restrictive approach, including only product categories for which at least once during the 14-year period MTIC fraud had been discovered in one of the EU Member States. The upper estimate is more inclusive, covering a wider range of product categories that could potentially be targeted by MTIC fraud.

For more information

Press release

Factsheet

VAT gap in the EU

VAT in the Digital Age