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VALUE ADDED TAX IN BULGARIA ON THE THRESHOLD OF THE EU ACCESSION: A COMPARATIVE SURVEY

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Abstract: This paper is intended to outline the basic features of the VAT system applied across the European Union. The value added tax is presented as a general, indirect, broadly based consumption tax, which is widely employed in EU, because of its advantages, namely neutrality, transparency, invisibility, and rationality. Besides, VAT is a multi-stage net tax, which avoids cascading, due to the apportioned tax accounting and collection. As far as VAT accounting system is self-policing to a high degree, VAT application is precondition for strong financial discipline. It is noteworthy, that these undoubted advantages of VAT can be only enjoyed in a developed country with mature fiscal system, stable legal framework, traditionally strong system for financial audit, and perfectly working tax administration.

Basically, VAT has regressive effect as the tax charge relies on personal end-consumers, burdening the low income population. To a high degree this effect is neutralized by the old EU Member States, while most of them have retained the privilege to levy zero rates, super reduced rates and reduced rates on essentials. Although to a limited extent, most of the new Member States have managed to negotiate such a privilege for themselves. Unfortunately, Bulgaria has not succeeded to protect its low income population. Because the EU VAT system applies an origin based accounting mechanism when end-consumers are taxed, consumption of essentials in our country bears the charges of the highest tax burden.

Moreover, Bulgarian tax system is extremely based on consumption, meaning that the revenues from indirect taxes on consumption exceed more than three times the revenues from direct taxes on income and property. As a main tax, VAT has ensured almost one third of the total budget revenues during the last few years. Because of the immature financial system and inefficient tax administration, VAT accounting and collection during the pre-accession period has been more successful on the borders than inside the country. Consequently, a fiscal shock is expected after the EU accession due to the frontier control abolishment.

Key words: value added tax, EU VAT system, intra-Community supply and acquisition, VAT burden

INTRODUCTION

The value added tax (or VAT) is a general, indirect, broadly based consumption tax assessed on the estimated market value added to goods and services at every stage in the manufacture (from raw materials to finished product) and distribution process, ultimately passed on to the end-consumer. Usually this "value added" is determined to be the difference between the value of sales or outputs compared to purchases or inputs of a product or service. Because the consumer ultimately pays a higher price for the taxed commodity, a VAT is essentially a hidden sales tax. Originally introduced in France (1954), it is now a major part of the tax system in most European countries.

Basically, value added tax is a **general tax** that applies, in principle, to all the commercial activities involving production and distribution of goods and provision of services. VAT is a **consumption tax** because it is borne ultimately by the final consumer. Although VAT is accounted to the tax authorities by the seller of the goods or services, who is the "taxable person", it is actually borne by the buyer as part of the price. VAT is thus an **indirect tax**, which is collected and administered by a person different from the actual tax burden bearer, (namely the seller rather than the consumer), so it is not a charge on the business sector. Because VAT is charged as **a percentage of prices**, the actual tax burden is visible at each stage in the production and distribution chain. At the same time, it has the advantage for governments of raising revenue "**invisibly**," that is (in most cases), without appearing separately on the bill paid by the end-consumer. Ordinarily, VAT is collected **fractionally**, via a system of partial payments whereby every taxable person deducts from the VAT he has collected the amount of tax he has paid to other taxable persons on purchases needed for his economic activity. This accounting mechanism ensures that the tax is **neutral** regardless of how many transactions are involved. Because of the above mentioned possibility for VAT recovery, the total tax levied at each stage of the economic chain of supply is a constant fraction of the value added by a taxable person to its products, and **most of the cost of tax accounting, administration and collection is borne by the taxable persons**, rather than by the State.

In general, the total VAT accrued during the production and distribution process, is reflected in the price of goods and services sold to end-consumers, because each re-seller along the economic chain usually passes along its VAT costs. In this way, VAT is quite similar to a national sales tax, and the two forms of taxation are often compared by the experts. Basically, VAT differs from a conventional sales tax in that VAT is levied on **every member of the production and distribution chain** - retail, wholesale, and intermediate - as a fraction of the price of each taxable supply they make, but they are in turn reimbursed VAT on their purchases, so the tax is applied to the value added to the goods and services at each stage of production and distribution process. On the contrary, sales taxes are normally only charged on final sales to consumers. Obviously, VAT has the merit of so-called "**apportioned tax collection**" as far as the State collects a cumulative portion of the tax at each stage in the economic chain, and therefore need not wait until the sale to the end-consumer.

Because of reimbursement, **VAT avoids cascading**, so it has the same overall economic effect on final prices. The main disadvantage is the **extra accounting** required by those in the middle of the supply chain, but it is balanced by application of the same tax to each chain-member regardless of its position and the position of its customers, reducing the efforts to check and certify their status. As far as VAT has few, if any exemptions, VAT accounting is even simpler. Moreover, experts claim that in spite the fact, that VAT entails higher administrative costs, it is **easier to enforce** than a national sales tax. It is indicatory, that although **VAT generates a lot of burdensome accounting** and paperwork, it remains a major source of tax revenues across the European Union.

Generally, sales taxes are considered by some as regressive, because low income population tend to pay a greater percentage of its income in sales tax than higher income population, as far as the poor tend to spend a higher percentage of their income on taxed items. Others consider indirect taxes as one of the best taxes since they only tax consumption. However, in many countries items such as food and prescription drugs are exempt from sales taxes to alleviate the burden on the poor and resultant loss of budget revenue is compensated by other tax sources. As an indirect tax, the value added tax has also been criticized as the burden of it relies on personal end-consumers. Therefore, as any sales tax based on the consumption of essentials VAT is **a regressive tax**.

Obviously, VAT applies more or less to all goods and services that are object of domestic trade. Because VAT is intended as a tax on consumption, **exports** which are, by definition, consumed abroad are normally zero rated and VAT is refunded. Conversely **imports** are taxed by standard rate to keep the system fair for domestic producers so that they can compete on equal basis on the domestic market with suppliers situated outside the country. In countries with immature financial system, unstable legal farmework and inefficient tax administration revenues from value added tax on domestic sale-purchase transactions are frequently lower than expected, because they are difficult and costly to administer and collect. If this is the case, VAT collection is actually more successful on the borders than inside the country. Moreover, VAT has become more important in many jurisdictions as tariff levels have fallen worldwide due to trade liberalization. In this way, **VAT has essentially replaced lost tariff revenues.** Whether the costs and distortions of value added tax are lower than the economic inefficiencies and enforcement issues from high import tariffs is debated, but theory suggests value added tax is far more efficient. Due to the fact, that exports are generally zero rated and VAT is refunded, this is often the sphere where **VAT abuses** occur. In sectors or countries where VAT abuses are prevalent, attempts by tax authorities to control it often have unintended consequences, and raise costs for honest taxpayers.

THE HISTORY OF EU VAT CONVERGENCE IN BRIEF

At the time when the European Community was created, the original six Member States were using different forms of indirect taxation, most of which were **cascade taxes**. These **multi-stage taxes** were each levied on the actual value of output at each stage of the production process, making it impossible to determine the real amount of tax actually included in the final price of a particular product. As a consequence, there was always a risk that Member States would deliberately or accidentally subsidize their exports by overestimating the taxes refundable on exportation. It was evident that **if there was ever going to be an efficient, single market in Europe, a neutral and transparent turnover tax system was required**. Obviously, VAT system allows for the certainty that exports are completely and transparently tax-free.

On 11 April 1967 **the first two VAT Directives** were adopted, establishing a general, multi-stage but non-cumulative turnover tax to replace all other turnover taxes in the Member States. However, these Directives laid down only the general framework of the system and left it to the Member States to determine the coverage of VAT, rate structure and VAT accounting mechanism. In 1977 **the Sixth VAT Directive** was adopted, which established a uniform VAT coverage. This guarantees that the VAT contributed by each of the Member States to the Community's own resources can be calculated. It still however, allowed Member States many possible privileges and exceptions from the standard VAT coverage. Moreover, it did not set out the rates of VAT to be applied in Member States with the result that these differ widely even today.

The realization of the single market in 1993 resulted in the abolition of fiscal control at the frontiers. To achieve this, the European Commission proposed moving from the pre-1993 **"destination based" accounting system**, where VAT is effectively charged and collected at the rate applicable where the buyer is established, to an **"origin based" accounting system**, with VAT being charged at the rate in force where the supplier is established. This would have effectively abolished fiscal frontiers within the EU. This was, however, not acceptable to Member States as rates of VAT were too different and there was no adequate accounting mechanism for VAT receipts redistribution, in order to mirror actual consumption.

Therefore, until the conditions were right the Community adopted a **transitional VAT system** which maintains different fiscal systems but without frontier controls. Because the intention is still eventually to have a common origin based VAT system, the transitional system is an origin based system for sales to end-consumers, who can buy taxed items anywhere in the Union, and take them home without having to account for VAT. There are some exceptions to this general rule however, e.g. the purchase of new means of transport and distance selling. In regard to sale-purchase transactions between taxable persons a destination based VAT accounting system is still applicable.

EFFECTIVE VAT TAXATION IN THE EU: SOME BASIC PRINCIPLES

Now, a common VAT system is compulsory **for Member States of the European Union. The EU VAT system is imposed by a series of European Union Directives, the most important of which is the Sixth VAT Directive (Directive 77/388/EC). Nevertheless, some Member States have negotiated VAT exemption or variable rates for regions or territories. The Canary Islands, Ceuta and Melilla (Spain), Gibraltar (UK), Aaland Islands (Finland), Livigno, Campione d'Italia and the territorial waters of Lake Lugano (Italy), the Island of Heligoland and the territory of Büsingen (Germany), The Faeroe Islands and Greenland (Denmark) are outside the scope of the EU system of VAT, while Azores and Madeira (Portugal), Jungholz and Mittelberg (Austria), Corsica and the overseas departments (France), Lesbos, Chios, Samos, the Dodecanese and the Cyclades, the Aegean Islands of Thassos, the Northern Sporades, Samothrace and Skiros (Greece) are allowed to levy variable preferential rates.**

According to the EU system of VAT, for the purposes of taxation, **a person under a tax obligation** is any natural person and legal entity which supplies taxable goods and services in the course of economic activity. However, in order to be VAT registered, the annual turnover of this person must exceed certain limit (the VAT registration threshold), which differs according to the Member State. Actually **VAT registered person** means registered for **VAT accounting purposes**, i.e. entered into an official VAT-payers register of a country. Countries that use VAT have established different thresholds for compulsory VAT registration. All the registered persons are obliged to **keep accounts of any sale-purchase transaction,** in order to be able to demonstrate the total VAT calculated on taxable goods and services that they supply and the total VAT paid as part of the purchase prices.

Basically, the VAT accounting system operates in a very simple way. Value added tax, that is charged by a registered person and paid by its customers is known as **output VAT** (or VAT on the output supplies), while VAT that is paid by this registered person to other registered persons on the purchases is known as **input VAT** (or VAT on the input supplies). Generally, VAT registered persons are **entitled to recover input VAT** to the extent that it is attributable to the taxable outputs. Input VAT is recovered by deducting it from the output VAT for which the registered person is required to account to the tax authority and remiting the difference to the particular State budget, or, if there is an excess, by claiming a repayment from the budget. Therefore, double taxation is avoided and tax is paid fractionally, only on the value added at each stage of production and distribution process. In this way, as the final price of any taxable product is equal to the sum of the values added at each stage, the final VAT paid is consisted of the sum of the tax charged at each stage. Moreover, in order to apply for VAT recovery any registered person must demonstrate the total sum of input VAT by **special tax invoices**, so this accounting system is **self-policing** to a high degree. Because the system rouses direct financial interest in mutual control between the different traders intended to ensure correct drawing up of every sale-purchase transaction, it is often pointed out as a basic precondition for **correct VAT accounting** and strong financial discipline.

For the purpose of **exports** between the EU and non-member countries, no VAT is charged on the transaction and the input VAT already paid on the purchases is refunded. This is so-called "zero-rating", which ensures that there is no residual VAT contained in the export prices. As far as **imports** are concerned, VAT is generally charged at the border, at the same time as customs duty, so they are immediately placed on the same footing as equivalent goods produced in the Community. No frontier control exists between EU Member States and therefore VAT on goods traded between these tax jurisdictions is not collected at the internal frontiers. Instead, goods supplied by a VAT registered person in one EU Member State to a registered person in another EU Member State are levied zero rate with a right to deduct the input VAT on this supply, if the customer can demonstrate a valid VAT number. Legislatively, this is defined as an "**intra-Community supply**". Actually, the VAT due on this transaction is payable on acquisition of the goods by the tax registered customer in the Member State of destination, which is defined as "**intra-Community acquisition**". The customer accounts for any VAT due in his normal VAT form at the rate in force in the country of destination. The detailed application of VAT accounting mechanism varies according to the administrative customs and practices of each Member State within the framework set out by Community legislation.

Some legal entities can be required to register for VAT accounting purposes in EU Member States, other than the one in which they are based, if they supply goods **via mail order** to those States, over a certain threshold. Following the changes introduced in 2003 (under Directive 2002/38/EC), non-EU legal entities providing **digital electronic commerce** or **entertainment products and services** to EU countries are also required to register for VAT accounting purposes with the tax authorities in the relevant Member State, and collect VAT on their sales at the appropriate rate, according to the location of the purchaser. Alternatively, under a special scheme, non-EU legal entities may register and account for VAT in only one EU Member State. Because this practice produces distortions as the VAT is effectively charged by the rate in the Member State of registration, an alternative approach is under negotiation, whereby VAT is levied at the rate of the Member State where the purchaser is located.

Actually, the VAT due on any sale-purchase transaction is calculated as a percentage of the price. In this way the price may be **inclusive** of VAT, so it is included as part of the agreed price, or **exclusive** of VAT, so it is payable in addition to the agreed price. It is noteworthy, that **different rates of VAT apply in different EU Member States.** The minimum standard rate of VAT throughout the EU is 15%, although reduced rates of VAT, not lower than 5%, are applied in various States on various sorts of supply referred to in an exhaustive list. The maximum VAT rate in the EU is 25%, but it is based only on political commitment. Because EU legislation only requires the minimum standard rate and the minimum reduced rate, actually applied VAT rates vary between Member States, and differ even widely between certain types of products. In addition, most of the Member States have retained separate privileged rules in specific areas.

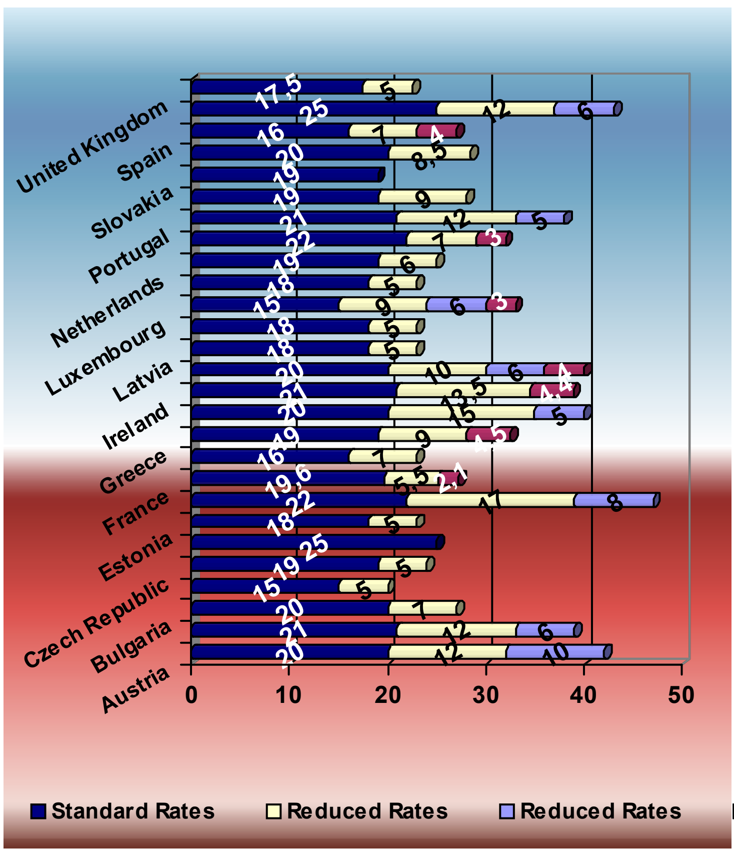
First of all, the Sixth VAT Directive requires certain goods and services to be **exempt** from VAT (for example, postal services, medical care, lending, insurance, betting), while other supplies can be exempt optionally under legislative regulations of any particular Member State (such as land and certain financial services). Input VAT that is attributable to exempt supplies is not recoverable, although any registered person can increase the prices so the customer effectively bears the cost of the "sticking" VAT. In this case, the effective rate is lower than the standard rate depending on the balance between previously taxed input, profit and labour at the exempt stage.

In addition, some goods and services are "zero rated". The **zero rate** is a positive rate of tax calculated at 0%. Supplies subject to the zero rate are still taxable supplies, so they allow VAT recovery. Although the zero rate is not featured in the EU Sixth Directive it remains in some Member States, most notably the UK and

Ireland, as a legacy of pre-EU legislation. These Member States have been granted a privilege to continue applying zero rate but they are not allowed to add new goods and services in the list of zero rated supplies. Finally, such a legacy are the **super reduced rates.** In spite of the explicit rules, some of the Member States have retained the privilege to apply super reduced rates, meaning lower than 5%. Obviously, at the moment the uniform VAT rate throughout Europe seems a unacheivable task.

The difference between VAT rates was originally justified by defining certain products as "**luxuries**" and thus bearing higher rates, whereas other items were considered to be "**essentials**" and thus bearing lower rates. However, often high rates persisted long after this argument was not valid, creating contradiction in terms. For instance, France levied 33% VAT on cars as luxury products until 1980s, when most of the French households owned one or more cars. Similarly, in the UK clothing and footwear for children are zero rated whereas clothing and footwear for adults are subject to VAT at the standard rate of 17.5%.

Chart 1 VAT Rates: Comparisons across the European Union



(%)

Notes: 1/Exemptions with a refund of tax paid at preceding stages (zero rates) are not included
2/Rates in Greece are reduced by 30% to 13%, 6% and 3% on the islands
3/The standard rate in Germany is increasing up to 19% since the beginning of 2007
Source: VAT Rates Applied in the Member States of the European Community, **European Commission, Taxation and Customs Union, DOC/1829 /2006 (Situation at 1st September 2006)**

Although some of the old EU Member States (and especially Scandinavian countries) have some of **the world's highest VAT rates**, namely 25% in Denmark and Sweden, 22% in Finland, 21% in Belgium, Portugal and Ireland, 20% in Austria and Italy, most of them have retained the privilege to apply **zero rates, super reduced rates and reduced rates for essentials**. For example **food products** are zero rated in Ireland and the UK, super reduced rates are applied in Spain, Italy, and Luxembourg, and reduced rates - in Belgium, Denmark, Greece, France, Netherlands, Austria, Portugal, Finland and Sweden. **Water supplies** are exempt in Ireland, zero rated in the UK, super reduced rated in Luxembourg, and reduced rated in Belgium, Germany, Greece, Spain, France, Italy, Netherlands, Austria, and Portugal. **Pharmaceutical products** are levied zero rate in Ireland, Cyprus, Sweden, and the UK, super reduced rates in Spain, France, Italy, and Luxembourg, whereas reduced rates are applicable in Belgium, Germany, Greece, Netherlands, Portugal and Finland. **Newspapers, books, specialist periodicals, and printing services** are zero rated in Ireland, Finland, and the UK, super reduced rates apply in Greece, Spain, France, Italy, and Luxembourg, and reduced rates - in Belgium, Germany, Netherlands, Austria, Portugal, and Sweden. Most of the old Member States also apply reduced rates on **hotel accommodation**, **agricultural inputs**, and **scheduled passenger transport**. Spain, Italy, and Luxembourg levy super reduced rates on **property sector services** as supply of new buildings, renovation, repairs, and construction work on new buildings.

Table 1 Application of Reduced VAT Rates by Old Member States to Some Categories of Goods and Services

Country \ Category	Foodstuffs	Water supply	Pharmaceutical products	Medical equipment for disabled persons	Transport of passengers	Books	Newspapers	Periodicals	Social housing	Agricultural inputs	Hotel accommodation
Austria	RE	RE			RE	RE	RE	RE		RE	RE
Belgium	RE	RE	RE	RE	RE	RE	Z	Z	RE	RE	RE
Denmark							Z				
Finland	RE		RE		RE	RE	Z	Z		RE	RE
France	RE	RE	SRE	RE	RE	RE	SRE	SRE	RE	RE	RE
Germany	RE	RE		RE	RE	RE	RE	RE		RE	
Greece	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE
Ireland	Z		Z	Z		Z	RE	RE	RE	RE	RE
Italy	SRE	RE	RE	SRE	RE	SRE	SRE	SRE	SRE	SRE	RE
Luxembourg	SRE	SRE	SRE	SRE	SRE	SRE	SRE	SRE	SRE	SRE	SRE
Netherlands	RE	RE	RE	RE	RE	RE	RE	RE		RE	RE
Portugal	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE
Spain	SRE	RE	SRE	RE	RE	SRE	SRE	SRE	SRE	RE	RE
Sweden	RE		Z		RE	RE	RE	RE			RE
UK	Z	Z	Z	Z	Z	Z	Z	Z	RE		

Legend: **Z** – zero rate; **SRE** – super reduced rates; **RE** – reduced rates

Source: Directive 77/388/EEC, Annex H

Although the standard VAT rate in the UK is not one of the highest in the EU (17.5%), the list of zero rated supplies in this country is the most comprehensive and also includes children's clothing and footwear, sewage services, construction of buildings for residential purposes, live animals, seeds, plants, and trees etc.

Besides the UK, some of **the lowest standard VAT rates** among the old Member States are levied in Luxembourg (15%), Spain and Germany (16%), Greece and Netherlands (19%). In spite of this fact, super reduced VAT rate (3%) is levied on all the essentials in Luxembourg, 4% super reduced rate and 7% reduced rate are applied in Spain, 4.5% super reduced and 9% reduced rates are levied in Greece, 6% and 7% are the respective reduced rates in Netherlands and Germany.

Table 2 Application of Reduced VAT Rates by the New Member States to Some Categories of Goods and Services

Category / Country	Foodstuffs	Water supply	Pharmaceutical products	Medical equipment for disabled persons	Transport of passengers	Books	Newspapers	Periodicals	Social housing	Agricultural inputs	Hotel accommodation
Cyprus	Z	RE	Z	RE	RE	RE	RE	RE		RE	RE
Czech Republic	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE
Estonia			RE	RE		RE	RE	RE			RE
Hungary			RE	RE		RE					
Latvia			RE	RE		RE	RE	RE			RE
Lithuania	RE		RE	RE		RE	RE	RE	RE		RE
Malta	Z	Z	Z		Z	RE	RE	RE			RE
Poland	SRE	RE	RE	RE	RE	RE	RE	RE	RE	SRE	RE
Slovakia											
Slovenia	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE	RE

Legend: Z – zero rate; SRE – super reduced rate; RE – reduced rate

Source: Directive 77/388/EEC, Annex H

It is noticeable, that zero rates, super reduced rates and reduced rates applicable in the **old Member States** covers almost entirely all the goods and services of paramount importance. Although most of the **new Member States** apply comparatively low standard VAT rates, namely 15% in Cyprus, 18% in Estonia, Latvia, Lithuania and Malta, 19% in the Czech Republic and Slovakia, only Cyprus and Malta has been granted the privilege to apply zero rates on a few essentials. Poland is the only one country allowed to apply super reduced rate (3%) on foodstuffs and agricultural inputs. The reduced rates applicable in Cyprus, Malta, Czech Republic, Hungary, Latvia, Lithuania and Estonia (5%) are the lowest among the new members in comparison with these in Poland (7%) and Slovenia (8.5%), while Slovakia has not negotiated any reduced rates at all. In this way, the old Member States are in privileged position regarding VAT burden on essentials, than the new Member States. The situation is even worse having in mind the wide difference between income levels in the new and old Member States.

VALUE ADDED TAX IN BULGARIA

Value Added Tax is the general sales tax in Bulgarian tax system. It is the most important source of state finance, accounting for **almost one third of the total budget revenues**. For the first time VAT was practically introduced in our country in 1994, according to the efforts for Bulgarian tax system convergence with the EU tax legislation. The positive and negative experience acquired between now and then emphatically shows that VAT is appropriate and most effective in a developed country with mature financial system, stable legal framework, traditionally strong system for financial audit, and perfectly working tax administration.

Otherwise, VAT is an occasion and instrument for numerous abuses, as far as its application is connected with a series of financial machinations and legal offenses, which have often been observed in Bulgaria during the transition period.

Bulgaria has a single VAT levied at the national level and no proportion of VAT revenues is shared with the local governments. Special new law on value added tax has been adopted in our country in order to reflect the basic accounting rules on imports, exports, intra-Community acquisitions and supplies**, outlined in the European VAT Directives. The new** Value Added Tax Act[1] **is in force from the date of Bulgaria's accession to the EU, replacing the old Value Added Tax Act in force since 1st April 1994.**

Value added tax in Bulgaria is comparatively broadly based consumption tax, as far as the threshold limit for **mandatorily VAT registration** is a taxable turnover of over 50 000 BGN[2] in a tax period of 12 consecutive months. Natural persons and legal entities, performing independent economic activity with a taxable turnover under the threshold can also register on a **voluntarily base**. In addition, if a natural person or a legal entity performs intra-Community acquisitions, totaling up to at least 20 000 BGN during the current calendar year, it is a subject to mandatory VAT registration as well.

Since the EU accession every VAT registered person in our country, willing to trade across the Community, must fill up a **special VIES form** in order to receive an identification VAT number. VIES is the abbreviation of VAT Information Exchange System, established in 1993 along with the Common market with the purpose of binding Member States accounting databases and expediting tax information exchange. VIES allows every registered person to verify the validity of his EU contractors' VAT number and ensures the necessary conditions for **correct accounting and mutual financial control.**

In practice, all the VAT registered persons are obliged to **furnish documentary evidence** for any taxable supply by issuing special **VAT invoice**. In order to be eligible for VAT accounting purposes, and especially for the input tax refund, this invioce must **specify the calculated VAT on a separate row.** The **standard VAT rate** in Bulgaria is 20%. There is **one and only reduced rate** of 7%, which is applicable for a night's lodging in hotels, but only as a part of an organized trip. By presumption, all the prices in Bulgaria are **VAT inclusive**. Of course, VAT can be payable in addition to the agreed price, but only if it is exclusively negotiated for a particular sale-purchase transaction.

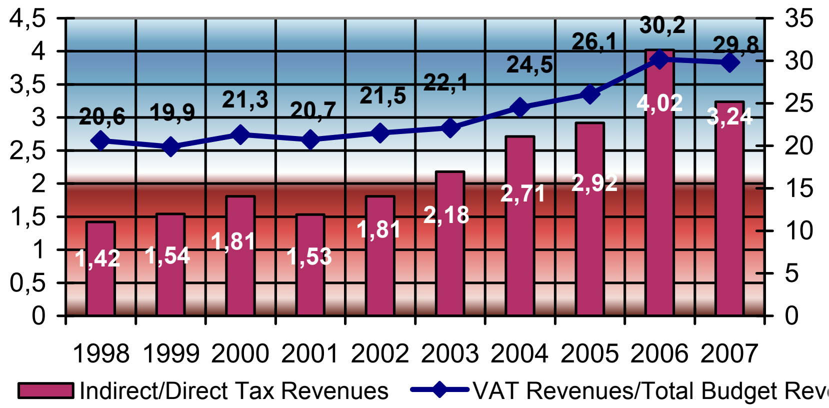
Basically, the tax period **for VAT accounting is a month, so any VAT registered person must account to the local tax authorities on a monthly base by keeping certain obligatory records, namely a register of supplies, a register of purchases, and VAT form. The necessary documentary information for each supply or purchase consists of invoice number and date, contractor's name and identification number, quantity and type of goods or services supplied, date of supply, tax base, tax rate, and tax liability. Registered persons submit the standard** VAT form**, which is intended to provide both a general and detailed picture of all the types of purchases and supplies, accountable for VAT, apportioning the total taxable turnover between the zero-rated, reduced-rated and standard-rated supplies.**

In accordance to certain prognoses, Bulgaria can experience a serious **fiscal shock** after the EU accession, mainly due to the special features of the native tax system. According to the data at our disposal, during the last few years tax burden in our country has been gradually transferred from the direct to the indirect

[1] Value Added Tax Act **has been published by the Official State Journal in Issue 63/04.08.2006**
[2] **BGN is the abbreviation of Bulgarian currency. According to the Currency Board provisions the exchange rate is fixed in proportion 1,95583 BGN per EURO**

taxpayers. In a nutshell, the tax strategy applied during the pre-accession period can be summarized as follows: reduce direct taxes (namely personal income tax and corporate profit tax), keep the VAT rate fixed, and increase gradually the excise duty in order to meet its minimal European rate.

Chart 2 Development of the Indirect/Direct Tax Revenues Ratio and VAT evenues/Total Budget Revenues (%) in Bulgaria 1998-2007



Sources: 1/ Nikolov, Ch., **Justice and Injustice in the Tax Sphere**, Le Monde Diplomatique, September, 2006
(Data about Indirect/Direct Tax Revenues in 2003-2006)
2/Own calculations **based on the** State Budget Acts **for Fiscal Years 1998-2007**
Note: **Calculations for FY 1998-2005 are based on the fiscal reports, while data for FY 2006 and 2007 are based on the budgetary prognosis.**

As a result, current tax system is **extremely based on consumption**, meaning that the revenues from indirect taxes on consumption exceed more than three times the revenues from direct taxes on income and property. As a main tax VAT has ensured almost one third of the total budget revenues during the last few years. Having in mind that no more than 10% of VAT has been collected by the territorial tax offices and the rest has come from the Customs offices it is easy to reach a conclusion for the efficiency of the different tax units. Obviously, tax administration in our country is not fully prepared to effectively **control VAT accounting and collection** after the frontier control abolishment. Consequently, at least 8% reduction of budgetary revenues can be expected after the EU accession.[3]

It is noteworthy that VAT avoidance is a problem not only in our country. In the first fiscal year after the EU accession, the new Member States have accounted for approximately 30% reduction of real VAT revenue collection. However, their budgets have been affected to comparatively slight extent thanks to the hybrid tax systems. For example, the indirect/direct tax revenues ratio in the Czech Republic was 1.21, in Poland – 1.26, in Hungary – 1.41, and in Slovakia - up to 1.85 in the pre-accession years, whereas the average indirect/direct tax revenues ratio is equal to 0.9 in the old Member States.[4] By comparison with the respective calculations for Bulgaria, it is easy to draw certain conclusions.

CONCLUSION

The value added tax is a general, indirect, broadly based consumption tax. It is widely employed in European Union, because of its advantages, namely

[3] **See Nikolov, Ch.,** European Integration: Shocks and Therapies**, In Finance Scientific Magazine, 2/2005**

[4] **See Nikolov, Ch.,** International Public Finance, **Southwest University Press, Blagoevgrad, 2006, p.19-22**

neutrality, transparency, invisibility, rationality and fractional collection. Moreover, VAT is a multi-stage net tax, which avoids cascading. Due to the apportioned tax accounting and collection VAT is comparatively difficult of avoidance and easy of enforcement. Because system is self-policing to a high degree, VAT application is precondition for correct accounting and strong financial discipline. It is noteworthy, that these undoubted advantages of VAT can be only enjoyed in a developed country with mature financial system, stable legal framework, traditionally strong system for financial audit, and perfectly working tax administration.

The one and only disadvantage of VAT is its regressive effect as the tax charge relies on personal end-consumers, burdening the low income population. To a high degree this disadvantage is neutralized by the old EU Member States, while most of them have retained the privilege to levy zero rates, super reduced rates and reduced rates on essentials. Although to a limited extent, most of the new Member States have managed to negotiate such a privilege for themselves. Unfortunately, Bulgaria has not succeeded to protect its low income population. Because the EU VAT system is an origin based accounting mechanism when end-consumers are taxed, consumption of essentials in our country bears the charges of the highest tax burden.

Moreover, Bulgarian tax system is extremely based on consumption, meaning that the revenues from indirect taxes on consumption exceed more than three times the revenues from direct taxes on income and property. As a main tax, VAT has ensured almost one third of the total budget revenues during the last few years. Because of the immature financial system and inefficient tax administration, VAT accounting and collection during the pre-accession period has been more successful on the borders than inside the country. Consequently, a fiscal shock is expected after the EU accession due to the frontier control abolishment.

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