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VAT

## Reassessing the Structural Foundations of the EU VAT System

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**There is a fundamental flaw at the heart of the European VAT system—one that is sustained not by sound logic, but by widespread belief. The belief that it works. It does not. At least not as a VAT system should.**

Undeniably, VAT generates substantial revenue for Member States, consistently ranking as their single largest source of tax income. Consumers, meanwhile, rarely see it. Embedded quietly in the price of goods and services, VAT escapes scrutiny and, with it, public resistance. Businesses are legally compelled to serve as unpaid tax collectors for national treasuries, operating under strict compliance regimes backed by the threat of severe penalties and even criminal prosecution. Tax authorities, for their part, need only ensure that this collection mechanism functions as intended.

From a governmental perspective, the appeal is obvious. VAT is simple to impose, inexpensive to administer, and remarkably flexible. A modest one-percentage-point increase can yield hundreds of millions of euros almost overnight.

It is little wonder, then, that more than 170 countries worldwide have adopted VAT systems. Within the European Union, this takes the form of the so-called “common VAT system,” derived from a European VAT Directive and presented as a harmonized framework.

Only it is not.

When countries acceded to the European Union, many did so on negotiated terms, securing derogations from the VAT Directive. Others went further, exercising Directive “options” to tax supplies that would ordinarily be exempt—or to exempt supplies that would otherwise be taxed. These options, embedded throughout the VAT Directive, are not merely numerous; they are destabilizing.

Member States retain wide discretion over the administrative formalities they deem necessary to ensure the correct assessment and collection of VAT. The result is a fragmented landscape. A VAT return in Cyprus contains just 13 data fields. In Italy, it exceeds 100. Across the Union, additional declarations are routinely required in the name of “safeguarding the public purse.”

Reform offers little relief. Any change to EU VAT legislation requires unanimous approval from all 27 Member States in the European Council. In matters of taxation, the European Parliament is largely sidelined.

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This is not harmonization. It is fragmentation, entrenched by design and frozen by unanimity.

In 1993, the European Commission introduced a new construct into VAT law: the *intra-Community acquisition*. Maurice Lauré—the architect of the EU VAT system—was 76 at the time. He warned, unequivocally, that this change would expose the system to fraud. He was right.

According to the European Commission’s 2025 report on the EU VAT Gap—the difference between expected and collected VAT revenue driven by fraud, evasion, and administrative failure—the gap reached €128 billion in 2023, representing 9.5% of potential revenue and an increase on the previous year.

The response has been relentless legislative intervention. Measures have been layered on at both national and EU levels—sometimes overlapping, sometimes contradictory—all in the name of combating fraud. The cost of this complexity has not been borne evenly. Small and medium-sized enterprises, the backbone of the Cypriot economy, have absorbed the heaviest administrative burden.

Yet the imbalance is striking. Just five Member States—Germany, Italy, France, Poland, and Romania—account for 69% of the total EU VAT Gap.

Before rolling out EU-wide experimental policies that erode the margins of smaller businesses, perhaps the priority should be obvious: address the fraud where it actually occurs. EU-wide solutions will fail as long as the real VAT problem remains geographically concentrated and politically untouched. Fix the fraud where it lives—before asking Europe’s smallest businesses to pay the price.

There is more.

France has imposed a multi-million-euro VAT assessment on a Cypriot business, asserting that VAT on the services supplied is due in France. The VAT has already been paid—in Cyprus—based on a sound interpretation of the law derived from the supposedly single, harmonized EU VAT Directive.

The result is contradiction, not clarity. The same provision of EU law is interpreted differently by the tax authorities of different Member States. The two governments will not engage with one another. The European Commission does not intervene in disputes between Member States, and no binding mechanism exists to compel a resolution.

The case now sits before the French courts, with the faint hope that national judges will recognize that the question is European, not domestic. The only definitive answer lies with the Court of Justice of the European Union—yet only national courts may seek its guidance.

Until then, the door remains wide open: more conflicts, more paralysis, and double taxation becoming not the exception, but the cost of doing business in Europe. One law, 27 interpretations—and the bill lands on business. In a system built to be uniform, certainty is the first casualty.

In another case, I became aware of a U.S.-based company providing virtual entertainment services to customers across the European Union. EU-based providers of identical services are required to charge VAT according to the Member State in which the customer is located. The U.S. company’s position, stated plainly in writing, is that it does not charge VAT because it is “a U.S.-based company.” The law is unambiguous. VAT should be charged.



When I raised the issue with the European Commission, the response was equally clear—and equally revealing. Such matters are not addressed at EU level. Each Member State is expected to initiate its own enforcement procedures to recover VAT it believes is due.

The result is a fragmented system that places compliant businesses at a disadvantage and highlights the need for coordinated EU-level enforcement to ensure fair competition and consistent application of the VAT rules. Without EU-wide coordination, the burden of compliance falls on those who follow the rules, while non-compliance thrives unchecked. Fragmented enforcement leaves compliant businesses vulnerable and undermines the uniformity VAT was meant to ensure.

Donato Raponi, a former senior official at the European Commission’s Directorate-General for Taxation and Customs Union (DG TAXUD), spent years navigating the labyrinth of EU VAT policy—balancing political rivalries, bureaucratic egos, national interests, and complex tax strategy.

In 2021, after leaving public office and working in the private sector, he was asked at a conference in Sweden about the future of the EU VAT system. His response was both startling and profoundly clear:

“Abolish the entire system, and move to a simpler sales-tax type system.”

A lifetime of experience distilled into a single, uncompromising insight.

At the EU VAT Expert Group—a body tasked with shaping the future of Europe’s tax system, of which I’m a member—plans are being laid for amendments stretching over the next decade and beyond. Among them: the proposed abolition of the *intra-community acquisition* transaction, a mechanism introduced in 1993 that has since left the VAT system vulnerable to fraud.

A reform long overdue—33 years in the making.

And yet, as the debates unfold, one question looms over the entire process: in a system this complex, what could possibly go wrong next?