

# TAX RATIONALISATION PROGRESSES

## TRENDS IN INSPECTION AND EXECUTION

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**Since 2004 the Tax Administration of the Slovak Republic (TA) has been implementing the TA Strategic Plan for 2004 - 2008. This plan has seven main aims, where the second aim is focused on the field of tax inspection and tax arrears, entitled "To Reduce Tax Evasion and Tax Arrears".**

The field of taxes in Slovakia has seen three important events since 2004:

- the tax reform takes effect on 1 January 2004, simplifying the system and reducing taxes,
- Slovakia entered the EU on 1 May 2004 and tax harmonisation with the EU continued,
- rationalisation within the tax administration system, with emphasis on the application of performance management.

### Positive features in tax inspection

If we focus our attention on the table describing long-term trends in tax inspection and tax execution, it is clear that results over the five-year period have been improving, particularly in 2004, when performance management was introduced in tax inspection and tax execution.

The overall efficiency of tax inspections has risen, where fewer inspections have brought more financial back tax duty than was the case in the past with more inspections. At the same time the element of ex-ante inspection has been strengthened, rather than relying solely on ex-post inspection. The strongest effect of the portfolio of indicators in the summary evaluation table is clearly the increase in total back duty following inspection and a radical growth in the work productivity per tax inspector.

It should be emphasised that this has been achieved without increasing salaries, something which in this segment of central government is already long overdue, and which is counter-productive. It is still clear, and not only to the experts in finance, that an underpaid tax official is a barrier on the road to increasing the effectiveness of public finance control.

### Register of tax arrears

From the aspect of recovering tax arrears it is necessary to draw attention to the fact that the accumulated "sins" of 1990 – 2004 have for long time been left unsolved and only the current government and manage-

ment of the Ministry of Finance and TA have plucked up the courage and formula for gradually bringing them into an economically more realistic light and for terming things by their true name. One specific step in this procedure was the transfer of more than SKK 22 billion in unenforceable tax arrears from the TA to the Slovak Consolidation Bank at the end of 2004.

The enforceability of the law in the SR is viewed poorly also by international experts as a large shortcoming of the state in the field of public finances, which can be seen from the table of trends in tax execution, as well as the discordance between, on the one hand, the growing number of execution operations over the past years and, on the other hand, the fall in work productivity per executor.

Here, emphasis does though need to be drawn to the fact that compared to the situation in the past, tax execution in the SR has lost two strong instruments in its "weaponry":

- the position of first creditor among debtors (which is logical and justified, since it is standard in the EU),
- the possibility of holding a database of necessary information to counter defences in the execution of tax debtors' assets, following the decision of the Constitutional Court cancelling the obligation to submit an asset return (which is now less logical and non-standard among modern taxation practices in the EU and around the world).

### Dominant effects in the past years

If we compare the majority groups of indicators from both tables for the years 2000 – 2004, it is clear that the rationalisation of tax administration and internal re-engineering brought radical changes, in particular in 2003 and 2004, which compared to the years 2000 – 2002 are marked by an increased overall efficiency.

### Weak points in inspection and execution

An experienced economist or financial professional



can see the clear predominance of positive development in the indicators for 2000 – 2004 tracking a progressive trend. There is then little reason to examine the strong points, instead we shall look at the long-term failures in tax inspection and tax execution.

The greatest shortcoming in inspection I see as being the low redemption of taxes from inspection (as of 1 January 2004 there was also introduced for the first time in 14 years, in the framework of humanising tax proceedings, a dilatory effect in paying taxes in the case of a dispute, something which many tax subjects have automatically abused for lodging appeals – even in the case of a clear error from the side of the taxpayer, though many simply exploit the effect of the time they can temporarily borrow from the side of tax offices).

The low redemption of taxes following a back duty assessment from a tax inspection, is nevertheless not a new feature, rather one long-term, that has now persisted for many years and where no more radical solution has as yet been found, due to the very delay in improving the enforceability of law, to reverse this negative trend.

I see the greatest problem in tax execution as being

the low success rate of the fastest and most effective technology for enforcing tax arrears, i.e. execution from the tax debtor's account. This is so in the SR for two reasons in particular:

- the still high share of cash payments (i.e. “briefcase” payments) compared to advanced economies in the EU,
- the absence of a uniform state information system with an interconnection of the databases of registers of selected institutions processing the necessary accompanying counter-information regarding the execution of any assets of a tax debtor.

### New technologies in performance management

In performance management of tax inspection and execution the SR Tax Directorate prepared many new working aids and technologies for increasing effectiveness. For example, in inspection a new software product was implemented – the own product Kontrolsoft 1 and a purchased product for electronic audit – the software IDEA. In the field of execution there was for example the own product EXEKUTORSOFT. A huge barrier still re-

#### Overview of indicators assessing execution activity for 2000-2004

No.	Data	1 2000	2 2001	3 2002	4 2003	5 2004
1	Recovered and paid tax arrears together with re-accounting under Article 63 of Act 511/92 Coll. in SKK bln.	10.20	15.39	13.63	15.04	14.35
2	Performance of the informative value in recovering tax arrears, including re-accounting – Art. 63 in %	neexist.	99.00	84.70	161.80	101.70
3	Number of execution operations in thous.	43 865.00	52 543.00	47 466.00	51 864.00	62 110.00
4	Tax arrears growth index in %	1.21	1.09	1.09	1.08	0.83
5	Recoverable tax arrears in SKK bln.	52.50	29.20	34.20	31.70	32.90
6	Average number of operations per executor	619.00	675.00	753.00	762.00	824.00
7	Number of decisions issued on the commencement of tax execution proceedings in thous.	10 564.00	16 106.00	17 282.00	18 625.00	21 705.00
8	Recovered amount on the basis of executors' operations in SKK bln.	4.80	5.34	4.27	4.17	4.49
9	Tax arrears recoverable / recovered ratio in % in %	24.50	18.20	12.40	13.10	13.60
10	Amount of tax arrears under recovery in SKK bln.	7.26	6.80	6.23	6.85	7.38
11	Number of tax execution challenges issued in thous.	8 102.00	14 417.00	15 617.00	16 283.00	19 818.00
12	Number of tax execution orders issued in thous.	10 048.00	9 292.00	12 159.00	12 684.00	15 764.00
14	Number of issued rights of lien securing tax arrears in thous.	9 227.00	8 642.00	7 485.00	4 523.00	2 944.00
15	Benefit per executor for state budget in mill.	19.70	19.20	18.16	15.17	13.42
16	Development of tax arrears for 2000 – 2004 (on a cumulative basis since 1993) in SKK bln.	62.9	68.6	75	81.3	67.4

Source: Tax Directorate SR – February 2005,

Deputy General Director Unit of SR TA for Tax Inspection and Tax Execution, Section for Securing and Recovery of Tax Arrears

**Overview of main indicators assessing inspection activity for 2000 – 2004**

						index	index
<b>Total Tax Directorate SR</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2004/2003</b>	<b>2004/2000</b>
Findings from tax inspections (SKK thous.)	5 650 000	5 989 000	5 194 000	6 428 342	8 395 706	1.31	1.49
of which: VAT (SKK thous.)	3 718 000	2 849 136	2 796 995	3 888 581	5 237 344	1.35	1.41
Efficiency of tax inspections (%)	18.9	19.0	20.0	29.4	51.7	1.76	2.74
Payment of tax (SKK thous.)	2 573 838	1 320 209	455 268	495 385	971 953	1.96	0.38
Level of findings from MZ (SKK thous.)	5 454	7 219	6 619	15 316	31 980	2.09	5.86
of which: findings from ERP (SKK thous.)	3 818	4 486	4 840	12 256	22 844	1.86	5.98
Number of tax inspections	47 361	52 874	54 430	47 600	33 747	0.71	0.71
Number of tax inspectors	1 778	1 713	1 658	1 718	1 742	1.01	0.98
Average finding per inspector (SKK thous.)	3 178	3 496	3 133	3 742	4 820	1.29	1.52
Average finding per inspection (SKK thous.)	119.23	113.27	95.43	135.04	248.79	1.84	2.09
Number of MZ	13 620	18 480	27 584	30 205	30 253	1.00	2.22
of which number of MZ ERP	6 646	7 214	8 283	10 923	12 221	1.12	1.84

Source: Tax Directorate SR – February 2005,  
 Deputy General Director Unit of the SR TA for Tax Inspection and Tax Execution, Section for Strategy and Planning Tax Inspections

mains the essential transformation of social opinion, i.e. to not accept tax evaders. This phenomenon is not yet conventional in Slovak society. A sign of social tolerance in this field is for example the absence so far of an effective codification of the institute of evidential poverty in the field of proving intent in the reduction or non-payment of taxes.

### Staff retention problems

The TA in 2004 fulfilled very demanding tasks connected with the necessary tax harmonisation with the EU, with implementing the new tax reform, reducing taxes and simplifying the system. It concurrently began with a new quality of performance management. The results for 2004, even in the context of long-term trends, as well as in the field of the front office line (tax inspection and execution) of the tax bodies give good reason for hope. In conclusion, though, it is necessary to mention that the modern tax administration in all comparable countries of the EU with Slovakia, suffers almost no fluctuation in the workforce, because the training of tax experts is expensive, but profitable. In comparison, the turnover of staff in the Slovak Republic, leaving state tax bodies for the private sector continues each year to greatly exceed the desirable trend. This is particularly so because, although tax bodies significantly fulfilled the aims for 2004 (the plan of tax remittances to the state was exceeded by SKK 14 billion), they received neither a pay rise nor any

other system advantages or effects appropriate for a modern third-millennium state official in the European Union.

Tax rationalisation in the a field of the internal re-engineering of the inspection and execution of taxes by the TA in 2004 brought a radical turnaround for the better - work productivity rose. The fluctuation of expensive (from the aspect of the state's investment in their education) human resources and the most productive components of central government in the SR is nevertheless a hazard impoverishing the state and enriching the private sector which receives relatively "free" ready-made experts for financial audit and debt recovery. I suppose that this public's secret has long been ripe for effective change. From the data in the tables it is clear that the direct benefit of one tax inspector annually is on average more than SKK 3 million and more than SKK 13 million per tax executor. These benefits are quantifiable only at the repressive level, the benefits at the preventive level, brought by tax inspection bodies and the recovery of tax arrears, are undoubtedly much higher. Costs to the state for each of them do not exceed on average gross SKK 0.7 million per year. The best tax inspectors have a productivity much higher, but salaries unworthy of financial professionals is certainly an area in need of correction.