

MILESTONES ON THE ROAD TO TAX REFORM 2004 – 2005

EFFICIENT RESOURCES FOR CONSOLIDATING PUBLIC FINANCES IN THE SR

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Since 2004 Slovakia has won increasing regard in the EU for its successes in tax reform and tax policy, which together are creating a more business-investor friendly environment. The past year was one again of demanding reforms and rationalisations in the field of taxes. The current year, 2005, as at 30 June 2005 has recorded positive development in overall tax collection, i.e. government tax revenues for the first half-year of 2005 have been fulfilled. Concurrently the results of the practical implementation of changes to towns' and municipalities' taxation, on the basis of the new Local Taxes Act, are now fully in place.

I think then this is an appropriate juncture to look at some of the milestones the SR has passed on the road to achieving global recognition in its reforms and innovations in the field

I believe that of the steps taken towards achieving an efficient system, the following have been the most important:

The year 2004:

- tax decrease and the introduction of a flat-tax-rate as of 1 January 2004,
- change in the administration of highest risk taxes as at 1 May 2004,
- tax decentralisation (regional in 2004, local from 2005),
- first process-function audit of tax authorities for the years 1990 – 2004 (completed in September 2004),
- tax harmonisation – Slovakia's accession to the EU and benchmarking with foreign top tax administrations in the EU (with a focus on Holland – performance management, risk management),
- submission of a draft amendment to the Tax Authorities Act from the side of the SR Ministry of Finance with the aim of reducing the excessively large structure of 102 tax authorities of varying size – an extravagance for the SR,
- efficient tax collection in 2004 (significantly exceeding the plan, by SKK 14 billion).

The year 2005:

- effect of Act No. 582/2004 Coll. on local taxes and local charges for communal waste and minor building waste (although this was a combined effect as of 1 November 2004 and 1 January 2005 the main effects have begun to appear only in 2005),
- March 2005 – rejection of an amendment to the Tax Authorities Act by the coalition council (this concerned in particular a draft reform of the wide network of tax offices in the SR, which would have meant a transformation of the regional branches of the SR Tax Directorate

into self-managing components and the present 102 tax offices would have been changed into branches of the regional branches –which would have brought large overall savings. The Government passed the law in September 2004, and it then was passed in the Slovak National Council at its first reading, though has not yet reached its second reading),

- July 2005 – compilation and announcement of an Action Plan by the Ministry of Finance on increasing the efficiency of tax administration and customs administration,
- twinning project in the framework of international cooperation with the EU, focusing on improving tax audit (system changes in tax audit – in cooperation with Denmark from September 2005).

Tax decrease and more intensive audit has helped taxes

The simplification of the tax system in the SR, through a series of new acts as of 1 January 2004 and 1 May 2004 and the radical reduction in income tax rates, has helped stimulate tax subjects towards paying taxes and partially reduced tax evasion. Concurrently it has become a good basis for reducing the annual budget deficit, since the annual plan of the state's tax revenues was not only met, but greatly exceeded, even despite the huge risk from the forecast collapse in VAT following the SR's entry to the EU (1 May – 31 December 2004), as had been warned of repeatedly by foreign experts and advisers, according to the model of the previous entries of some older EU member states in the past, as well as the huge risk of how the market would receive the tax reform effective as of 2004. I believe this to have resulted from a favourable conjunction of



various factors, particularly though the reduction in the rates of direct taxes, which has stimulated entrepreneurs to pay taxes and been a positive motivating factor away from tax evasion, and improving efficiency and labour productivity via internal measurement of performance in the SR Tax Administration (internal re-engineering).

Changes in administration of highest risk taxes

I consider a rational and highly productive step to have been also the change in the administration of excise duties and VAT as of 1 May 2004 in favour of strengthening the effectiveness on the basis of a strong state element. What happened? The Government decided, with effect as of 1 May 2004, to change the competence of the administrator for the highest risk excise duties (alcohol, cigarettes...) from the SR Tax Administration to the SR Customs Administration and to transfer a part of the competences – that the SR Customs Administration was to have moved fully, as part of VAT administration, by 30 April 2004 to the SR Tax Administration. This step should help increase the elimination of tax evasion in alcohol, cigarettes and other hot commodities from the field of excise duties, since the SR Customs Administration also has armed units at its disposal – i.e. an arsenal the tax bodies did not have available and do not dispose with on the one hand, but which is on the other hand a necessary working aid in the effective fight against the black market in alcohol and tobacco products.

Tax decentralisation

One of the basic economic rules of pragmatic financial control says that most of the revenues from sources should be allocated (reinvested) most closely to the place of their arising. This axiom applies fully also for taxes. It is therefore welcome that the Ministry of Finance in 2004 began a radical tax decentralisation – i.e. the nationwide tax revenues were redistributed from the level of the state and Government in favour of the regions (higher territorial units) and localities (also Act No. 582/2004 Coll. on local taxes and local charges for communal waste and minor building waste – effective as of 1 November 2004 and 1 January 2005). The necessity for a proportional need for new financing of the country's reformed general government necessitated tax decentralisation, which is the good systemic step. Why? Since an individual, or a firm, – as a taxpayer of this state, knows far better how to check whether tax revenues have been used sensibly and economically in the region rather than at the nationwide level.

First audit of the tax administration

Over the course of 2004 (May – September 2004) a historically first audit in the system of the state's tax

bodies was performed, something which I see as a positive strategic decision of the Tax Directorate, since this is the first verification of the internal processes, organisational structure and performance of this organisation over the 15 years of the Slovak tax bodies' operating in the new era. An audit in a firm or organisation is always a good step by the management, whether its strategy or focus is rational, pragmatic or in a complex, comprehensive way effective. A systemic shortcoming in this direction may be viewed the fact that despite the auditor's recommendation and a year's work by the Tax Directorate at thinning down the network of 102 tax offices to smaller and larger professionally better managed units, members of parliament rejected this draft amendment to the law in 2004, despite the Government's passing it in September 2004. The truth here remains that the partial politicisation of so sensitive a component of central government as the Tax Administration, prevents for the time being any full development of a rationalisation tendency in the SR.

Tax harmonisation

The unification of Slovakia and its social, economic and legal harmonisation with the European Union was finished in the first half of the year and resulted in integration with the advanced EU market following 1 May 2004, i.e. following the SR's entry to the EU. The lion's share of Slovakia's tax harmonisation with the EU environment has already been completed, or work still continues on partial rules. A positive feature in particular is that the SR Tax Administration is comparing the management of performances with leading tax administrations from comparable countries (i.e. comparing it with smaller countries such as the Benelux states, the Scandinavian countries, the Czech Republic, Hungary) and not with the EU giants (e.g. France, Britain, Germany...).

In 2004 notable projects were under way with Netherlands and, since 2005, also with Denmark. This has been a good decision, because through any comparison with the best in the market or in the public sector, a firm or organisation can raise the quality of its performance. Accent was placed in particular on three twinning projects aimed at risk management, performance management and system changes in tax audit.

Efficient tax collection

The budgeted tax revenues for Slovakia for 2004 were not only met, but also greatly exceeded. The plan of tax revenues for the past year was, despite the huge risk of a collapse in VAT (the nature of a systemic change) following the SR's entry to the EU (as of 1 May 2004), according to the balance as at 31 December 2004, exceeded by more than SKK 14 billion. This may be assessed as a significant success for the state's tax collection in the 2004 tax year.

Development of local taxes since 2005

A mistake in the framework of local taxes and their development since 2005 may be considered to be the non-regulation of the level of rates, at least for the transitional period, from the side of the state, because some municipalities and towns were clearly unable to make appropriate estimates for rates particularly in the case of real-estate. I do not agree with the claim made by some economists that an all powerful, all seeing market will alone solve everything and I believe some pragmatic interventions by the state into regulating the economy to be the most effective method in pursuing optimal efficiency and prosperity for the country also in a market economy. In this regard I believe that for the mentioned Act 582/2004 Coll. it will not be long before it is amended.

New action plan and tax senates

With the aim of raising precision in the performance of the tax and customs administration the SR Ministry of Finance in July 2005 presented a new action plan for raising the efficiency of tax collection – which requires at minimum 10 considerable legislative changes for eliminating self-destructive tax-legal elements – basic black holes in eliminating tax evasion. Personally, I believe the most important element in this plan to be the effort to strengthen the quality of a court decisions in tax matters. In order to achieve real quality and objectivity in the tax judiciary in the SR, it is essential to establish a special profile of education for judges and to implement, according to the model taken from advanced EU countries, tax courts, or at least tax senates composed not only of judges, but also a broader college of professionals – tax experts (tax advisers, auditors, accounting-court experts).

Certain negative aspects still requiring solution

Despite the demanding aims which the Ministry of Finance and Tax Directorate have transformed in the field of taxes into milestones on the road to consolidating public finances and building an overall more efficient tax administration, particularly in the period from 2004 to the present, there remain steps which have so far failed to be taken and still await systemic solution. I see the remaining barriers to a more effective performance of tax bodies in the SR to be in particular:

- reducing the too extensive network of 102 tax offices and three levels of management, which increases the cost of management and slows down any possible effects,
- to stop and stabilise the fluctuation of experts in the tax administration from the state to the private sector due to inappropriately low salaries. Subsequently the result

- of this situation is also a widespread disrespect and poor estimation of tax bodies' work also from the side of the public and low respect by business subjects towards tax authorities (which in comparison with the EU is absolutely counter-productive and non-standard),
- the absence of any nationwide information system for general government (this would facilitate not only tax administration and control, but also the state's service for individuals, firms and the public, i.e. increasing the convenience of services),
- removing self-destructive legislative elements tolerating non-payment of tax (amendment to the Criminal Code (better demonstrability in finding suspects guilty of tax understatement and evasion, by removing the unnecessary burden of evidence, i.e. the hitherto problem of proving intent) and the amendment to the Trade Licence Law – a firm with several years' consecutive losses loses its business licence (the Austrian model),
- a reassessment of the model used to date, the bicameral operation of tax and customs bodies in the SR, which is not standard in advanced EU economies: the development of practice over the years 1990 – 2005 has shown that the numerous delays and restrictions on the effectiveness of taxation in the SR means also that the SR Tax Directorate and the SR Customs Directorate is not organisationally incorporated as a natural component of the Ministry of Finance in the SR. Many advanced member states in Europe have a better organisational model. In this regard the dominant models of administration are where the tax and customs administrations are a component of the Ministry of Finance (as a separate section), which facilitates and speeds up their practical performance. It is not necessary to look far for examples. This model has worked efficiently for some years now in our closest neighbours – the Czech Republic – and not only there.

Conclusion

The consolidation of public finances in the SR (a necessity on the road to the transition to the Euro from 2009, and on the road to a prosperous economy and functioning democracy in the country) indisputably involves serious limits such as tax reform or social reform. The trends to date in the state clearly confirm, that whereas tax reform proceeds apace, social reform is clearly lagging. There are therefore increasingly heard pragmatic calls by professionals in the field for the collection of taxes and contributions to the social insurance and health insurance funds and the National Labour Office to be brought under one roof and for this collection to be performed by the tax offices themselves.