

Effects of Tax Audit on Tax Evasion and Grey Economy in the Republic of Serbia

Miodrag Todorović

Tax Administration, Branch Office Leskovac, Republic of Serbia

Samir Ljajić

International University of Novi Pazar, Republic of Serbia

Aleksandar R. Ivanović

International University of Novi Pazar, Republic of Serbia

Abstract

The aim of this paper is to point to the systematisation of matter, which relates to the assessment of the efficiency of tax control as the mainstay of the reduction of tax evasion and the grey economy in our country, with a comparative analysis with the developed countries and countries in transition. Financial effects of large-scale tax evasion may contribute to generating the budget deficit. Economic effects of tax evasion can be particularly damaging to economy. It can upset parity of conditions for doing business by lowering production costs in taxpayers and economic sectors that resort to tax evasion. This creates unfair competition between conscientious and unscrupulous tax payers, which on economic plan reflects through the price disparities between goods manufacturers, and especially if the tax evasion has reached a significant threshold. Disturbances in economy may take the form of sectoral imbalances on the market when economic choices of business entities are disrupted under the influence of tax evasion, which further affects rationality and economic efficiency. If all taxpayers settled their tax liabilities, there would be an opportunity for reducing tax incidence. In countries where the rule of law works only "bravest" dare to evade taxes. Most countries have undertaken a series of measures aimed at combating tax evasion and the grey economy, however, the success of the struggle is different.

Keywords: tax control, grey economy, evasion, system, taxes, society, research

JEL classification: M4, H20, H26

Introduction

This paper presents the basic guidelines regarding the assessment of the efficiency of tax audit as the mainstay of the reduction of tax evasion and the grey economy in our country, with a comparative analysis with the developed countries and countries in transition. Extensive research has confirmed the basic hypothesis: poorly organized tax control represents the first indicator of weakness in the work of tax administration and therefore weaker inflow of funds in the budget of Serbia (Brummerhoff, 2000).

The word "evasion" derives from the Latin word "evader", which means running away or avoiding. Tax evasion is present in all countries and all systems. It can be conditioned by various factors and it may have different consequences. Recently we have witnessed the occurrences of frequent financial transactions that primarily aim at evading taxes. These transactions are one of the main features of the grey economy, in other words, one of the most significant forms of its manifestation (Begović et al., 2003).

Tax audit is a control that represents the control of business records of tax payers, as well as the regularity of calculation and payment of all public revenues depending on tax payers' business. In the widest sense, the control represents a specific activity that checks whether a particular phenomenon or behaviour of an entity is in accordance with the law, regulations, norms, standards or some other prescribed forms of behaviour, that is, prescribed features (Managing, 2005).

The previous work of tax authorities was often repressive, marked by different punishment measures. In this paper, we will try to find the reasons and explain the need for control, which will besides repression be directed at combating tax evasion and the grey economy with the aim of establishing a balance between the tax coercion and tax voluntariness (Stiglitz, 2004). The controls which will be discussed in this paper affirm the idea of raising the tax moral of all tax payers in order to approximate the level of tax revenues collection in the budget of Serbia to the optimal level. Modern understanding of the country is increasingly becoming a necessity for tax payers' education (Starašinič, 2007).

This paper presents a theoretical basis of tax evasion and the grey economy and then the phases in the process of control. It analyses the achieved level of the grey economy and tax evasion in developed countries, countries in transition and our country. Based on the comparative analysis of the achieved extent of the grey economy and tax evasion in Serbia and in the developed countries and the countries in transition, the range of measures for improving tax control with the aim of reducing the consequences of the already mentioned negative phenomena is given (Zlatanović, 2008).

Phases in the process of control

The process of control is a complex process. It checks accuracy, correctness and veracity of bookkeeping documents and other records, the regularity of bookkeeping and the regularity in the application of tax regulations. It is performed in several phases. The most important are the following:

- planning and the preparation of the control,
- performing the control,
- making the record and its delivery,
- the procedure after the delivery of the record, including issuing the decision with the requirements for offence or criminal proceedings (Popović, 2006).

Grey economy as a companion of the modern state and the market

Grey economy is a global phenomenon, present in all countries, to a lesser or a higher extent, regardless of the type of society and the level of socio-economic development. There are various definitions of the term "grey economy" and some of its synonyms that are often used are: "informal economy", "hidden economy", "illegal economy", "unofficial economy", "irregular economy" and many other terms. However, since there are certain differences in meaning of these terms, it is important to point to them at the very beginning (Schneider, 2008).

The extent and dynamics of the grey economy in the Republic of Serbia

The grey economy is one of the greatest challenges that the economy of Serbia is facing and its consequences are visible in the areas of tax evasion, market distortion,

unfair competition and inefficient allocation of resources. In many countries in transition, including Serbia, grey economy is a significant obstacle to the development of the strong company sector and of functional market industry. The following table shows comparative data on the extent of the grey economy in Serbia and the chosen countries in transition (in % of GNP).

Table 1

The extent of the grey economy in Serbia and the selected countries in transition (in % of GNP)

Country	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Average
Bulgaria	36,2	35,4	35,2	34,6	34,2	33,5	33,0	32,6	32,9	32,3	33,9
Czech	18,4	18,0	17,6	17,3	17,0	16,4	16,1	15,6	15,9	15,2	16,8
Estonia	32,0	31,6	31,2	31,0	30,6	29,9	29,4	29,2	29,6	29,2	30,4
Hungary	24,3	24,0	23,7	23,4	23,0	22,6	22,4	22,0	22,6	22,1	23,0
Latvia	30,0	29,6	29,3	29,1	28,6	27,8	27,3	26,9	27,2	26,6	28,2
Lithuania	33,0	32,9	32,5	31,7	31,4	30,7	29,8	29,4	29,7	29,3	31,0
Poland	27,5	27,3	27,1	27,0	26,7	26,3	26,1	25,8	25,9	25,6	26,5
Romania	33,4	33,2	32,7	32,3	31,8	30,5	30,2	29,6	29,8	29,5	31,3
Serbia	33,2	32,7	32,1	32,0	31,6	31,2	30,7	30,1	30,6	30,1	31,4
Slovakia	18,8	18,5	18,3	18,0	17,7	17,2	16,6	16,3	16,9	16,2	17,5
Slovenia	26,6	26,2	26,1	26,0	25,7	25,3	24,8	24,3	24,6	24,1	25,4
Average per year	28,5	28,1	27,8	26,8	27,1	26,5	26,0	25,6	26,0	25,5	26,9

Source: Krstić, G., 2015, Grey economy in Serbia: New findings and recommendations for reforms, The Economic Development Fund, Belgrade, page 48.

The results of the estimates of the extent and movement of the grey economy of the eleven countries from Central and Eastern Europe are shown in the Table 2. The Table 2 clearly shows, in general, the negative trend of the grey economy movement in all 11 surveyed countries. Since the Table is self-explanatory, here we will explicitly specify only the values for Serbia.

The scope of the grey economy in Serbia amounted to 33.2 % in 2005. By 2012 it fell to 30.1%, increased to 30.6% in 2013 and then again decreased to 30.1% in 2014. A slight increase in 2013 can be noticed in almost all of these 11 countries. The data show that the scope of the grey economy in Serbia declined during the period of economic growth and then it remained almost unchanged since the beginning of the economic crisis. Moreover, it can also be noticed that the scope of the grey economy in Serbia is higher than the average values of the selected 11 countries during the observed period. When compared to other countries, only in Bulgaria the scope of the grey economy in percentage of GNP is higher than in Serbia (to 2.2% in 2014) (Krstić, 2015).

In Serbia between 2005 and 2014 there was a powerful (statistically very significant) negative relation between the extent and movement of the grey economy and the level and movement of the registered GNP. If the registered GNP falls by one percentage point, the grey economy increases by between 0.60 and 0.70 percentage points, depending on the model used. Therefore, if the formal economy is in severe recession, there will be a significant increase in the grey economy. This is an obvious result that can be observed in many other studies (for instance compare the study of Feld and Schneider from 2010, or Schneider from 2011) (Schneider, 2011). If the formal economy decreases and if the citizens have fewer opportunities to earn money from it, they will make a significant effort to

increase the scope of their activities in the grey economy in order to make up for what they lost in the formal, or in order to earn more (Krstić, 2015).

In times of economic crisis, the need for a deep understanding of the grey economy and finding measures for its reduction through formalization becomes acute. Under such conditions, it is apparent that the grey economy could not only be the consequence, but also simultaneously the cause of the further reduction of GNP and deepening of crisis. Therefore, the main objective of this paper is to give guidelines and recommendations for encouraging formalization of the grey economy in order to improve the competitiveness of Serbian economy and contribute to economic development.

The inevitability of each country is to fight against the grey economy. The skill of this struggle is to build institutions that will be able to stimulate citizens and companies to perform their economic activity in the legal sector. The government should encourage the citizens and companies to do business more in the legal sector of economy, thus using a range of advantages and benefits of the legality of the system (Tomaš, 2010).

The effects of tax control in combating tax evasion and the grey economy

A key feature of the developed countries in the field of tax administration is that it has modern organization and work efficiency of tax controls of these countries is at the highest level, what the following data actually show. The observed three-year period can bring us to the conclusion that the tax evasion share in all tax types, determined by tax control in the total gross national product is the lowest in Finland. The average for the period 2012-2014 is 0,41%. The highest share of tax evasion in total gross national product is in Germany and it is 0,69%.

Table 2

Share of detected evasion in GNP of the selected countries and Serbia, for the period 2012-2014.

Countries	Detected evasion in GNP (%)			Average per country (%)
	2012.	2013.	2014.	
Germany	0,66	0,68	0,73	0,69
Austria	0,73	0,72	0,44	0,63
Portugal	0,6	0,34	0,61	0,52
Finland	0,27	0,55	0,41	0,41
Annual average	0,56	0,57	0,54	0,56
Serbia	1,03	0,88	0,92	0,94
Relation RS/Average	183,9	154,4	170,4	167,7

Source: www.iota-tax.org/ IOTA The Intra-European Organisation of Tax Administrations

A group of developed countries that was observed in the previous table encompasses one big and three small national economies. Within the subgroup of smaller countries there is one country (Portugal) that had significant structural problems in the period of the global economic crisis. Independently of this structural diversity of the countries, the level of evasion in relation to GNP has not fluctuated significantly in them. The highest average relative extent of evasion was achieved in Germany, whereas the lowest was in Finland, socially very organized country. In relation to the achieved 3-year average relative extent of evasion of 0.56% of GNP, Portugal and Finland have lower level of evasion, while Austria and Germany higher.

The data show that the extent or relative stability of economic activities in the observed countries does not affect the extent of evasion in them. This indicates that the extent of evasion is more complementary with the internal organizational capabilities of their tax administrations, which is the basic hypothesis formulated in this paper.

In relation to the Republic of Serbia the relative extent of evasion is by almost 68% (index 167.7) higher than in the observed developed countries. Although these were the years when the growth of trend of efficiency of tax administration work was noticed, it did not have a significant impact on the decrease in the relative scope of evasion; therefore it is still high, when compared to the developed countries. The cause of that may be seen in still poorly developed organizational ability of tax administration in Serbia, the issue which should be further thoroughly addressed.

Conclusion and discussion

The forms of tax evasion are numerous and they largely depend on the type of the tax and the amount of taxation that taxpayers are obliged to pay. Tax evasion is an indicator of rejecting taxation, due to which, taxpayers, in order to avoid paying taxes, do legal or illegal acts or omissions. Modern states are trying to reduce tax evasion by using institutional, legal and socio-economic measures, where a good system of informatics support plays a major role. The rapid modern development of information technology in front of Tax Administration in our country represents the task of a continuous upgrading of information system, particularly within the program infrastructure, by introducing new application programs, as well as the necessity of connecting information systems with the information systems of other statutory authorities.

Well-trained, responsible and efficient tax administration is a precondition for fulfilment of its specific duties. It is reflected in the efficient and legal control, detection and collection of public revenues, work within public interest, impartiality in performing duties, respecting the principle of legality, responsibility for work and material responsibility for the damage done during work.

The tax system of Serbia should be much more transparent. Citizens should be acquainted with the purposefulness of public revenues. They should know what exactly the funds are spent on and which tasks the state finances with their money. Recent research has shown that many people think that most of the money is spent on financing inefficient and expensive tax administrations, on political parties and that funds go to private pockets through different forms of corruption. Efficient tax control, transparency of tax regulations and laws and active role of the state should change such a negative reputation. Simplifying tax procedures, closer relationship in the collection of public revenues and lower tax rates are measures that lead to the reduction of tax evasion. Introducing synthetic personal income tax will also result in the reduction of direct taxes evasion due to including all the revenues in the tax basis, whereas the progressive rates will increase the extent of the collected revenues. Direct reduction of wage tax, as well as the reduction of social security contributions may further result in the reduction of grey economy and tax evasion.

The significance of the research of this paper is to review theoretical and practical aspects of the impact of tax control, tax administration and other statutory authorities on the reduction of tax evasion and grey economy together with simultaneous analysis of internal and external causes. The research refers to the domestic economy, together with comparative analysis and representation of tax evasion and grey economy in developed countries and countries in transition. Special attention is paid to the possible directions for improving work of tax

administration, key determinants and activities in order to reduce tax evasion and grey economy.

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About the authors

Miodrag Todorović was born on 2nd November 1961 in Leskovac, Republic of Serbia. In 1985 he finished Faculty of Economics in Belgrade with average score of 8.97. He has a Master's Degree in Economics at the Faculty of Economics in Niš. He worked as a bookkeeper and accountant in the Textile Industry Grdelica and today he works in the Tax Administration Department in Leskovac as a tax inspector and since October 2014 as a professor of Public Finance and Financial Law at the International University of Novi Pazar. The author can be contacted at miodragtodorovic61@gmail.com.

Samir Lajić was born on 1st September 1979 in Novi Pazar, Republic of Serbia where he finished in 1998, with honours, high school in Novi Pazar. In 2015 he finished Faculty of Economics at the International University of Novi Pazar with an average of 9.09. Currently, he is a student of the second year of doctoral studies at International University of Novi Pazar, Department of Economics. He participated in numerous scientific conferences and published several papers in the field of economics. The author can be contacted at ljajics@gmail.com.

Aleksandar R. Ivanović was born on 23rd September 1984 in Novi Pazar, Republic of Serbia. In 2007, as the best student in class, he was engaged as a teaching assistant at Faculty of Law at the International University of Novi Pazar. Since 2008 he is a member of the University Senate and is actively engaged in the scientific work in the field of crime-related security and criminal legal doctrine. His works are published in highly ranked national and international journals. As of October 2013 he is appointed as a Dean of Faculty of Law at the International University of Novi Pazar. The author can be contacted at d.prava@uninp.edu.rs.